AVERAGIUM

Newsletter of Harvey Ashby Limited, Average Adjusters & Claims Consultants
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IHC - A New Acronym

Two years ago we reported on the failure of an initiative to introduce a London Market claims procedure. One year ago we reported on the postponement of an initiative to revise the Institute Time Clauses – Hulls. The headline to our last edition – *Institute Time Clauses – Hulls 2002?* – was prophetic as, this year, we are pleased to report that the Joint Hull Committee grasped the nettle and undertook a comprehensive review of the Hull clauses, launching the International Hull Clauses in late October.
The revision of the clauses was undertaken by sub-committees appointed by the Joint Hull Committee (Michael Harvey served on the claims sub-committee) and involved substantial consultation with representative bodies of the insurance and shipping industries. Although this revision is not a total re-write, the alterations are substantial and we make no apology for devoting this entire edition to the new clauses. A full copy of the new clauses can be downloaded from the Resources page of our website.

The Institute Time Clauses have been the principal hull clauses used in the London Market for over one hundred years. They have been amended from time to time. Revisions have been necessary due to changes in underwriting philosophy, changes in the law and the perceived need to modernise. Not all of the changes have been popular, in particular those proposed last time around in 1995 which were prepared with virtually no consultation with Shipowners, Brokers or Adjusters.

The Joint Hull Committee, the custodians of the London Market hull clauses, appreciated the need to change the clauses. To modernise the language, to reflect and support international measures aimed at increasing safety, to amend the cover to reflect changes in the law and the need to remain competitive with other markets and to improve claims handling procedures to give a more efficient and prompt service to their clients. In order to achieve these objectives they understood the need to consult with their clients and those who were required to use the clauses on a day-to-day basis.

The revision of the clauses took place over a period of six months during which time proposals were considered by a series of sub-committees, the members of which consisted of not only underwriters but also included lawyers, brokers and a representative average adjuster – I know I was that man! The fruits of their labours were circulated to various representative bodies, including the International Chamber of Shipping, the London Market Insurance Brokers' Committee and the Association of Average Adjusters. Each of their comments, as well as those of all other bodies and organisations consulted, was considered and many taken into account in a revised draft which went through the same consultation process, leading to the final published version – the International Hull Clauses (01/11/02).

The Joint Hull Committee launched the new clauses at a market gathering in the Old Library at Lloyd's on 31st October 2002. The presentations given at the launch could, of course, only provide an overview of the changes. Most people in the market will by now have considered the new clauses in more detail and will have formed their own view on them. We have already seen comments in the press, some of which, I regret to say, appear to be based on old prejudices rather than an open minded review of the clauses.

Our objective is to provide an overview of the new clauses from the perspective of a claims practitioner.

We now see the Perils Clause given the prominence it deserves by appearing on the first page of the Clauses. Some of the changes made to this clause are simply sensible. For example, the shift of the coverage relating to contact with aerial devices or objects falling therefrom, from 2.2 to 2.1 where it is no longer subject to the due diligence proviso. The proviso itself has been changed from its 1995 guise, which included superintendents and any of the onshore management of the assured, owners or managers amongst those to whom the due diligence provision was applicable. The deletion of these parties to the proviso has been welcomed by all. Shipowners considered it an unreasonable restriction whilst practitioners felt that it was difficult to apply.

But the most significant change to the Perils Clause has arisen due to the Court of Appeal decision in *The Nukila* [1997] which concerned the coverage of latent defects and the damage occasioned thereby.

A latent defect has been defined as a defect which would not be discovered on such an examination as a reasonably careful, skilled man would make. The defect must be latent at inception of the policy. Latent defects are a form of inherent vice and, in the absence of positive provision in a policy of marine insurance, are excluded by Statute. Section 55(2)(c) of the Marine Insurance Act 1906 provides: -

> *"Unless the policy otherwise provides, the insurer is not liable for ordinary wear and tear ……inherent vice or nature of the subject-matter insured,…"*

Thus unless the policy *otherwise provides*, an insurer cannot be liable for the cost of rectifying the latent defect itself or any resultant damage.

For decades hull insurers have been willing to cover the damage caused by a latent defect in a vessel's machinery or hull. Both the 1983 and 1995 versions of the Institute Time Clauses have *otherwise provided* by specifically covering (under Clause 6.2.2 in both versions): -

> *"…loss of or damage to the subject-matter insured caused by……any latent defect in the machinery or hull"*

In applying this provision the practice, supported by the decision in *Scindia Steamships v London Assurance [1936]* and others, was to accept claims in respect of damage that resulted from, i.e. was caused by, the latent defect and to exclude the cost of repairing or replacing the latently defective part itself.

However, the advice received from legal advisers to the Joint Hull Committee was that the comparatively recent decision in *The Nukila [1997]* supported the view that, provided that the latent defect has caused damage to the subject-matter insured during the currency of the policy, it might be difficult to resist claims for the cost of making good the damage, even if this included the defective part itself.

It is not the business of insurers to guarantee that the machinery and hull of a vessel are free

Welcome to the seventh edition of AVERAGIUM, Harvey Ashby Limited's Newsletter which we endeavour to publish twice each year.; although this is the only edition published in 2002. It has been a busy year.

We trust that you will find the Newsletter informative and would welcome any comments or contributions.

Those of more mature years may recall that AVERAGIUM was the telegraphic address of Bennett & Co, the average adjusting firm with which Messrs Harvey and Ashby started their average adjusting careers in 1969.

from defects or to undertake to make good such defects where they are discovered during the period of the policy. However, underwriters continue to recognise that coverage in respect of the damage caused by latent defects is the proper subject of insurance coverage.

In revising the hull clauses, the initial view was that the coverage provided should remain the same as that available under the previous clauses as understood and accepted prior to the Nukila decision; i.e. excluding the cost of repairing or replacing the defective part. However, it was felt that to have achieved this objective would have necessitated providing guidance as to what constitutes a part.

In order to avoid disputes on this account, the new clauses provide coverage, as in previous versions, for loss or damage caused by latent defects in the machinery or hull but they have been amended to specifically make it clear that the cost of correcting the latent defect is, in effect, excluded.

This approach preserves the principle that insurers should not be liable for the cost of correcting defects which existed, whether or not known to the assured, prior to the inception of the policy.

The revised wording reads as follows: -

2.2 This insurance covers loss of or damage to the subject-matter insured caused by

2.2.1 ……

2.2.2 any latent defect in the machinery or hull, but only to the extent that the cost of repairing the loss or damage caused thereby exceeds the cost that would have been incurred to correct the latent defect

Thus insurers will be liable for loss or damage caused by a latent defect in the machinery or hull but only to the extent that the cost of repairs exceeds the cost that would have been incurred had the defect been discovered and corrected at the inception of the policy.

An hypothetical example will serve to illustrate the affect of the clause. A rudder stock is found to be badly cracked and to require replacement. Upon close examination the crack is established to have emanated from a small casting defect which might only have been discovered through destructive testing and was therefore latent.

If technical evidence establishes that the casting defect could have been repaired by gouging and welding had it been discovered before it had caused damage, the cost of replacing the rudder stock less the cost that would have been incurred in gouging and welding the original defect, will be recoverable. However, if the cost that would have been incurred in gouging and welding the original defect equals or exceeds the cost of replacing the rudder stock, no claim will arise. The costs would be recovered under the new Additional Perils Clause, if such cover is purchased.

Of course, in either event, the cost of repairing any other damage resultant upon the defective condition of the rudder stock will be recoverable.

An optional Additional Perils Clause, which has been amended to reflect the changes outlined above, appears as Clause 44. This coverage, as with that of Clauses 40-43, only applies where the Underwriters have expressly agreed so in writing at the inception of the insurance or by subsequent endorsement.

The new clauses also now include coverage in respect of Leased Equipment and Parts Taken Off, i.e. removed, although the latter is limited to 60 days.

An important change, and one which brings the IHC into line with competing forms concerns constructive total loss. Under the earlier Clauses, in determining whether or not a vessel was a constructive total loss it was necessary to demonstrate that the cost of recovery and repair of the vessel would exceed the insured value of the vessel. This has changed. Under the new Clauses (Clause 21) it is now only necessary to show that the cost of recovery and repair would exceed 80% of the insured value.

Although claims practitioners may have wished for clarification as to whether or not expenses incurred prior to the tendering of Notice of Abandonment could be taken into account in determining if the vessel is a constructive total loss, this will have to wait for another day.

The coverage with respect to general average also has been changed.

Property insurers have a natural reluctance to assume any liability in relation to pollution exposures which they feel should more properly be the province of P&I insurers. However, it is sometimes difficult, particularly in relation to general average to differentiate between measures undertaken to protect property and those undertaken to protect the environment.

This problem was addressed at the meeting of the CMI (the custodians of the York-Antwerp Rules [YAR]) when revisions were being discussed in 1994. It is reported that, at that time, the provisions agreed in this respect, as discussed below, were regarded as a compromise acceptable to all parties. Thus it came as a surprise to many when the Institute Time Clauses – Hulls 1/11/95 were issued and found to effectively exclude ship's proportion of general average under Rule XI(d).

There is a general rule under the YAR (Rule C) which precludes allowances in general average relating to: "…losses, damages or expenses incurred in respect of damage to the environment or in consequence of the escape or release of pollutant substances from the property involved in the common maritime adventure."

However, this rule is subservient to the express provisions of Rules VI and XI(d) which are the only other rules that contain provisions relating to the prevention or mitigation of damage to the environment.

Rule VI concerns salvage and whilst permitting the inclusion of an allowance of salvage remuneration under Article 13.1(b) of the International Convention on Salvage of 1989 (i.e. an enhanced award in respect of skill and effort to prevent or minimise damage to the environment), expressly excludes any special compensation payable under Article 14 of the same Convention (i.e. where there has been a threat to the environment and the salvage service has been unsuccessful, or only partially successful).

Rule XI(d) details four specific circumstances when the cost of measures undertaken to prevent or minimize damage to the environment are allowable in general average.

The four specific instances covered by Rule XI(d) are as follows: -

1. As part of an operation performed for the common safety;
2. As a condition of entry into any port or place in the circumstances described in Rule X(a) (i.e. when necessary for the common safety);
3. As a condition of remaining at any port or place in the circumstances prescribed in Rule XI(b) (i.e. where detention in the port of refuge is necessary for the common safety or to enable repairs necessary for the safe prosecution of the voyage to be effected) but excluding the cost of additional measures if there is an actual escape or release of pollutants.
4. Where necessary in connection with the discharging, storing or reloading of cargo when the cost of these operations is allowable in general average (i.e. when the discharging is necessary for the common safety or to enable repairs necessary for the safe prosecution of the voyage to be effected).

The limitations under the 1995 Clauses, applicable to the recovery of general average adjusted in accordance with the YAR 1994, have been removed and do not appear in the International Hull Clauses (01/11/02). Thus insurers now accept that, where general average has been incurred in connection with the avoidance of a peril insured against, they will be liable for Ship's proportion of general average in full where the YAR 1994 apply, subject of course to any applicable deductible.

Another clause concerning general average is the optional General Average Absorption Clause (Clause 43). Many hull policies have included this type of coverage under which general average is payable in full (excluding only general average commission and interest) up to a specific pre-determined limit. Such cover avoids the trouble and cost of obtaining general average security from the other parties involved and the complexities, and therefore also cost, of procuring a full general average statement, when the amount involved may not justify such expense.

However, the Absorption clauses utilised have come in a large variety of flavours and it was considered that a standard coverage ought to be available. Some people were disappointed that the recently issued BIMCO clause was not used. However, that clause appears to provide very broad cover and therefore requires further evaluation.

Coverage in relation to Collision Liabilities is still provided on a 3/4ths basis (Clause 6), although optional extensions to 4/4ths and in relation to liability for damage to fixed and floating objects are available under Clauses 40 and 41. However, a new sub-limit of 25% of the insured value of the vessel is introduced in relation to legal costs.

During the process of revision the issue of warranties was closely examined. Warranties are defined in the Marine Insurance Act 1906 as conditions which must be literally complied with and if they are not complied with, the insurer is discharged from liability as from the date of the breach. Thus the breach of a warranty attracts a severe penalty irrespective of whether its breach has any relevance to any subsequent loss or was remedied before the loss occurred.

This draconian penalty has resulted in a reluctance by English Courts to accept that certain conditions are, in fact, express warranties, preferring to view them only as conditions precedent wherever possible. Modernisation of the wording has resulted in a re-evaluation of how certain conditions should be viewed.

The need to differentiate between varieties and the importance of breaches of policy conditions has been recognised. Thus there are those breaches which should go to the root of the contract and entitle underwriters to avoid the policy and those where the breach might reasonably have a more limited affect, such as a suspension of cover during the course of a breach or only where the breach was causative to a loss. A further factor which has been taken into consideration is that competing wordings do not apply the full sanction of the Marine Insurance Act in the event of breaches of certain matters which have been considered as warranties in the Institute Time Clauses.

The conditions which are viewed as being of the utmost importance and will attract the automatic cancellation of the insurance at the time of the breach, are dealt with in Clause 13.

These are that at inception and throughout the period of the insurance:

- the vessel shall be classed,
- there shall be no change, suspension, discontinuance, withdrawal or expiry of class,
- any recommendations, requirements or restrictions imposed by class and which relate to the vessel's seaworthiness shall be complied with by the dates required by class,
- the owners/operators of the vessel shall hold a valid Document of Compliance, and
- the vessel shall have a valid Safety Management Certificate.

Of course, automatic cancellation will not apply if the underwriters have agreed to waive any breach, where the vessel is at sea or where any change etc. in class has arisen from damage to the vessel.

Automatic termination will also arise, under Clause 14.1, where there is any change in the ownership, flag or management of the vessel or when it is bareboat chartered or requisitioned for use. However, this is due to a change in the nature of the risk rather than a breach of any condition.

Under Clause 14.4, the assured, owners and managers are required to comply with all statutory requirements of the vessel's flag state with regard to, inter alia, the operation and manning of the vessel and to comply with the requirements of class with regard to the reporting of accidents and defects in the vessel. However, in the event of a breach of any of these conditions, underwriters will not be liable for any loss, damage or expense attributable to such breach.

A new condition precedent is embodied in Clause 36 (Recommissioning Condition). This requires a survey of the vessel before sailing to re-enter service after a period of lay-up of more than 180 days.

An example of the final variety of condition are the navigational restrictions imposed by Clauses 10 and 34. By reason of Clause 11, underwriters will not be liable for any loss, damage, liability or expense arising from an accident during the period of the breach.

Perhaps the most significant change in the new clauses is the inclusion of provisions relating to the conduct of claims. The objective of these provisions is to streamline and clarify the claims process for the benefit of both insurers and shipowners.

The clauses envisage that Leading Underwriter(s) will play a more active role in the claims process and will be enabled to take decisions on claims, including settlements, which will bind the co-insurers although the Leader(s) will not assume the financial responsibilities of those co-insurers.

The Leading Underwriter(s) Clause (Clause 45) sets out their obligations in relation to claims and also establishes the relationship between them and their co-insurers. With regard to the latter, the co-insurers agree to indemnify the Leader(s) in respect of liabilities, costs or expenses incurred in relation to the Leaders' duties under the Clause. The Clause also incorporates a provision concerning the cost of collecting the underwriters expenses, such as surveyors charges and legal costs.

It is recognised that the inclusion of provisions relating to the relationship between underwriters may present difficulties of enforcement where co-insurers are not subscribers to the same policy document as the Leader(s); particularly where overseas markets are involved. Nevertheless, the intent is clear and should undoubtedly improve the claims' process.

The duties of the Leading Underwriter(s) in relation to claims are set out in Clause 49. These deal with issues concerning the instruction and payment of the fees of surveyors and average adjusters and the period within which the leaders will respond to a claim submission.

Shipowners have traditionally viewed the appointment of the average adjuster as their inalienable right. Nothing in the Clauses indicates that the shipowner may not select the average adjuster. However, unless the adjuster is agreed at the inception of the insurance, the shipowner shall be entitled to propose the average adjuster to be appointed who shall be either a Fellow of the Association of Average Adjusters of the U.K. or any other average adjuster mutually acceptable to the shipowner and the Leading Underwriter(s).

I view this as a positive step which should ensure that both the shipowner and the underwriters have confidence in the adjuster and respect his skills. However, average adjusters should be aware that the perception of some underwriters persists that not all adjusters act as independently and impartially as they might. Recognition, for the first time, of the existence and role of the average adjuster in London Market conditions presents average adjusters with an opportunity to demonstrate their worth to the Market which they serve.

In return for the right to have some say in the appointment of the average adjuster, and a direct right of access for status reports, underwriters accept responsibility for their reasonable charges irrespective of whether a claim ultimately arises under the insurance.

Underwriters consider that these procedures will enable them to be more active in the claims' process and, in particular, that their awareness of and assistance in resolving claims' issues as and when they arise, will enable them to agree claims more promptly when they are presented. Whether this proves to be the case in practice may be dependent upon whether underwriters are prepared to respond to requests for advice or assistance more meaningfully than "seen and noted".

The corollary of including duties for underwriters is, of course, that Duties of the Assured are also included. Clause 48 reinforces generally accepted duties with regard to the provision of documents and information and general assistance reasonably required by Leading Underwriters for the purpose of considering any claim. These include making the vessel available for survey and authorising the inspection of class records.

The Clauses include a provision with regard to the Notice of Claims under Clause 46. This clause was the subject of some debate during the committee stage of drafting. The unpopular 1995 clauses, required notice to be given to underwriters promptly after the date on which the assured either became aware, or should have become aware of loss or damage. The difficulties with this are obvious – what does promptly mean? - isn't any consideration of when the assured should have became aware of loss or damage entirely subjective?

These problems were recognised with the result that the revised wording requires notice to be given within 180 days after the date on which the Assured, Owners or Managers became aware of an accident or occurrence. The penalty for notification outside this timescale is the forfeit of the claim. Underwriters consider that it is entirely reasonable to expect any assured to be able to report potential claims within six months from their discovery and point out the importance to them of being aware of all potential claims.

All of the provisions concerning Recoveries have been grouped together under a single clause – Clause 52. The principal changes here are two-fold. Firstly, there is a requirement that the Assured shall keep underwriters advised with regard to the prospects of a recovery and shall co-operate with the Leading Underwriter(s) in taking steps to pursue any claim against third parties, irrespective of whether underwriters have actually paid or agreed to pay a claim Secondly, there is an express provision that any net recoveries in respect of claims shall be apportioned taking into account the Assureds' interest in the deductible. This is a significant change which brings the Clauses into line with the position under competing wordings. Under the old clauses, and in line with English law, recoveries fell to be dealt with on a 'top down' basis.

For the first time the new Clauses incorporate a Provision of Security Clause (Clause 50) under which Underwriters agree to give consideration to the provision of security to third parties on behalf of the Assured. The provision of security, if agreed to, is subject to a number of conditions. It is recognised that to be fully effective a market scheme with regard to bail is required. I understand that this will be considered in the near future.

Whilst it is hoped that the new Clauses will not give rise to disputes which cannot be resolved during the normal claims process, Clause 53 sets out a Dispute Resolution procedure involving mediation or any other form of alternative dispute resolution. Of course, the use of such a procedure is dependent upon the agreement of the parties.

Although some have already expressed disappointment that the new clauses have not dealt with their pet issues to their satisfaction, the International Hull Clauses are a great step forward and are to be welcomed, especially in view of the Joint Hull Committee's assurance that they will continue to evolve. The London Market now has a set of clauses which, I believe, are superior to the equivalent American conditions.

Myths & Misconceptions

We are aware some mis-guided comments have been made as to the intentions and reality of some aspects of the IHC 01/11/02. For example:

- Underwriters have taken away the centuries-old accepted practice that it is the shipowners who appoint the average adjuster to investigate and state any claim arising.

  Wrong – the new clauses say that underwriters will confirm the appointment of the average adjuster who will assist the assured in the preparation of the claim. The intention is that underwriters will sanction the appointment, by the shipowners, of an average adjuster who is mutually acceptable to both parties. Furthermore, underwriters will pay the reasonable fees of the adjuster, irrespective of whether a claim arises.
- Underwriters have taken steps, post the "Nukila" [1997] law case, to limit the broader interpretation of the Inchmaree Clause given it by the Court of Appeal judgement.

  Wrong – underwriters have supported the "Nukila" decision by excluding only the cost of correcting the latent defect, thereby making it clear that Clause 2.2.2 does not necessarily require consequential damage to have been sustained to another part of the machinery or hull in order for it to apply.
- Underwriters are attempting to remove the entitlement of the shipowners to decide where they will repair their vessel by reason of the Tender Provisions included under Clause 47, which give the right to underwriters to decide the port of repair and a right of veto over a place of repair or repair firm.

  Wrong - Far from being a new provision, we can recall (just!) that similar rights of underwriters, as appear in Clause 47, have been included in the five previous versions of the earlier Institute Time Clauses. In all that time we can recall only two instances when underwriters have invoked their right to require repair tenders to be taken and in those cases, the assured was duly compensated for the time lost at 30% per annum of the insured value, in accordance with the Clause. All that this confirms is that this provision is rarely used in practice but that underwriters feel the need to maintain this entitlement in order to avoid certain ports or repair firms.
- London simply copied the Norwegian Hull Plan with regard to the change from the previous requirement in the Institute Time Clauses to prove accident repairs will exceed 100% of the insured value, in order to demonstrate a vessel is a CTL, to only 80% under the IHC.

  Wrong - Although the percentage is now the same for both sets of hull conditions, the IHC provision requires 80% of the insured value to be exceeded whereas the NHP calls for 80% of the higher of the vessel's insured value or her market value after repairs to be exceeded in order for the assured to prove a CTL. In addition, the NHP positively states that salvage awards cannot be taken into account by the assured in seeking to prove a CTL, whereas the IHC clearly permits such inclusion by allowing the 80% to be based upon the cost of recovery and/or repair of the vessel.

Comings & Goings

Since the last edition we have visited Abu Dhabi, Dubai, Oman, Norway, Sweden, Denmark and Indonesia..

Adjusterindo

A New Venture in Indonesia

We are pleased to announce our association with a new adjusting company in Indonesia. Ajusterindo has been established to provide comprehensive and professional claims handling services within Indonesia. The Company will utilise the expertise and experience of its personnel in Indonesia to provide quality adjusting and claims consultancy services which will be complemented, as and when required, by expertise from this office.

Adjusterindo's vision is to provide value for its clients through independent and professional services aimed at establishing a reputation which stands on the quality, impartiality and speed of its services.

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In view of the above announcement this may be an appropriate time to remind you all of our other associates around the globe. These are:

- Berridge & Co., Average Adjusters, Cardiff, Wales
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