

Offshore Construction Insurance: Damage to Surrounding Property

This article considers recent case law and the appropriate practice for arranging cover in respect of surrounding property risks during an offshore construction project.



Introduction

The WELCAR 2001 Offshore Construction Project Policy is the standard policy form upon which most underwriters will insure offshore oil & gas platform construction risks.

The WELCAR 2001 policy form was introduced by leading Lloyd's underwriters in response to a general hardening within the offshore construction sector of the insurance industry at the end of the 1990's. A less than favourable loss record within the sector, combined with a soft rating cycle, resulted in numerous insurers ceasing to underwrite offshore construction risks.

This strengthened the position of those underwriters prepared to insure this class of business and enabled them to introduce a single standard policy form.

The WELCAR 2001 policy defines both Principal Assureds and Other Assureds. The Principal Assured will be named in the policy. Other Assureds are defined as parties with whom the Principal Assured has entered into written contracts directly in connection with the project. Other Assureds will include sub-contractors.

The expectation of the underwriters responsible for drafting the WELCAR 2001

policy form was that the Principal Assured would be the oil & gas operator on whose behalf the platform is being built plus any joint venture partners with an ownership interest in the new platform. It further being the expectation of such underwriters that the Other Assureds were to be the contractors and sub-contractors carrying out the work.

Primarily, contractors and sub-contractors were granted Other Assured status in relation to Section I, *Physical Damage*, of the WELCAR 2001 policy form. This was in recognition of certain oil & gas industry practices which granted

contractors access to operator controlled "First Party" Physical Damage cover.

The standard WELCAR 2001 policy terminology stipulates that the status of contractors and sub-contractors, as Other Assureds, is dependent upon compliance with Quality Assurance / Quality Control provisions imposed contractually by the Principal Assured. When the policy form was launched there was considerable misunderstanding regarding this policy terminology, with concern amongst operators that they may be deprived of coverage in the event that contractors and sub-contractors did not comply with Quality Assurance / Quality Control provisions. In fact, in the event of non-compliance with Quality Assurance / Quality Control provisions by contractors and sub-contractors, the specific policy terminology does not affect the rights of the Principal Assured under the policy but may enable underwriters to pursue a recovery in subrogation, from contractors, following a claims payment. Nonetheless, in the years following the launch of the WELCAR 2001 policy form, increasingly underwriters were prepared to consider removing the reference to Quality Assurance / Quality Control provisions from within the standard policy wording.

So far as Section II, Liability, of the WELCAR 2001 policy form is concerned, it is clear that the drafters of the policy wording intended contractors and sub-contractors to have very limited access to the coverage provided by the insurance contract. In this respect, the drafters of the WELCAR 2001 policy form incorporated a specific "watercraft exclusion" into the Liability section of the policy which states as follows:

"The insurance... does not apply to actual or alleged liability arising out of the use or operation of watercraft, whether owned, time chartered, bareboat chartered or operated by any Assured, or for which any Assured may be responsible other than as declared hereto."

Accordingly, whilst in principle Liability coverage under the WELCAR 2001 policy form extends to Other Assureds, in practice the policy will not respond to liabilities incurred by Other Assureds who own, operate, charter or assume responsibility for watercraft. Why would oil & gas companies want to expose their own policy (and their own loss record) to the liability risks of their contractors and sub-contractors? Especially as such contractors and sub-contractors should already have their own Liability insurance programs in place.

The aforementioned "watercraft exclusion" similarly excludes liabilities incurred by the Principal Assured when they, the Principal Assured, own, operate, charter or assume responsibility for watercraft. However, in practice, this should not unduly concern oil & gas companies on whose behalf platforms are being constructed and installed. Ordinarily, it will be the contractors and sub-contractors that own, operate, charter or assume responsibility for watercraft during the project, not the oil & gas companies.

Whilst the reference to "use... of watercraft" in the exclusion could be debated, the WELCAR 2001 policy form is not understood to deny the Principal Assured coverage should they, the Principal Assured, be held to be liable due to an incident arising from watercraft owned, chartered, operated or within the responsibility of an Other Assured. For example, an oil & gas company operator could be held liable when procuring a large piece of machinery for transit to the offshore site. The oil & gas company operator (on whose behalf the platform is being built), in the capacity of Principal Assured, may erroneously advise the vessel owner as to the dimensions or weight of the machinery.

This could result in the cargo being dropped during loading or unloading, causing damage to "Third Party" property, with the fault being attributed to the Principal Assured.

Notwithstanding the "watercraft exclusion", the *Liability* section of the standard WELCAR 2001 policy form would be expected to respond and provide cover in the event that the oil & gas operator was held liable.

Existing Property/Contractual Exclusion & Buyback Endorsements

The main body of Section II of the WELCAR 2001 policy wording automatically provides coverage in respect of liabilities incurred under written contract. For example, an operator, in order to facilitate the export of their own product from the new offshore facility, may tie-in to another platform that is wholly or partly owned by other parties. In such instances, the owners of the new assets may become contractually liable to the other parties in the event of damage being caused to the existing platform during the tie-in exercise.

However, shortly after the launch of WELCAR 2001, underwriters realised that such policy terminology could expose them to a range

of unknown contractual liability exposures, especially instances where the policyholder may be assuming liability under contract beyond any liability that may exist absent of such contractual provisions. For example, strict, **"no fault"**, contractual liabilities.

Accordingly, shortly after its release, underwriters subscribing to the WELCAR 2001 policy form routinely applied an Existing Property / Contractual Exclusion Buyback Endorsement which was accompanied by an Existing Property / Contractual Exclusion Buyback Endorsement. This approach sought to give underwriters control over the terms and conditions of coverage they were prepared to provide for contractual liability exposures, faced by the Principal Assured, in respect of damage to property of others. (Although a "School of Thought" exists that even in the absence of an Existing Property / Contractual Exclusion Endorsement, the extent of a policyholder's contractual liabilities may well be deemed to be material and thus require declaration to underwriters.)

The terminology of the standard WELCAR 2001 Existing Property / Contractual Exclusion Endorsement and the Existing Property / Contractual Exclusion Buyback

Endorsement is as follows:

"Existing Property / Contractual Exclusion

The coverage provided under Section II of the attached Policy shall not apply to any claim for damage to or loss of use of any property for which the Principal Assured:

- 1) owns that is not otherwise provided for in this policy;*
- 2) has use of, custody, physical control, access, right of way or an easement to by operation of a contract or agreement; or*
- 3) is liable or claimed to be liable by operation of any indemnification, hold harmless or similar provision contained within any contract or agreement. All other insuring agreements, terms, conditions, definitions, exclusions, notice requirements, schedules and endorsements of the Policy remain unchanged."*

"Existing Property / Contractual Exclusion Buyback

Notwithstanding the Existing Property / Contractual Exclusion contained in this Policy, it shall not apply to any claim for: Physical loss of and/or physical damage to existing property identified on the attached schedule of insured property. All other insuring agreements, terms, conditions, definitions, exclusions, notice requirements, schedules and endorsements of the Policy remain unchanged."

By virtue of the format of the Exclusion and Buyback Endorsements, and specifically exclusion 1, the opportunity arose for operators (and their joint venture partners) to declare their own existing property that was at risk from project works. However, for the avoidance of any doubt, the addition of terminology such as “owned surrounding property” within the Buyback Endorsement was advisable. Such practice was employed by certain Principal Assureds having new assets built and installed in the vicinity of their own existing infrastructure and wishing to protect the loss record of their operational insurance program in the event that such owned surrounding property sustained significant damage. However, certain offshore construction underwriters resisted supporting such practice.

Technip Saudi Arabia Limited v The Mediterranean and Gulf Cooperative Insurance and Reinsurance Company [2023] EWHC 1859 (Comm)

Technip were contractors to the Al-Khafji Joint Operation. The project in question involved improvement to certain production assets in an oil & gas field offshore Saudi Arabia. As part of the project activity, Technip chartered an anchor-handling tug from Mardrive & Oil Services SAE.

On 16th August 2015, whilst returning to port, the anchor-handling tug impacted with an existing wellhead platform, causing significant damage to the platform. The existing wellhead platform was owned by the Al-Khafji Joint Operation but did not form part of the project works being undertaken by Technip. However, in accordance with the contract Technip entered into in relation to the project work, Technip were responsible for damage to such surrounding property. Such contractual responsibility extending to encompass negligence of Technip's subcontractors.

An insurance contract had been arranged, based upon the WELCAR 2001 Offshore Construction Project Policy, whereby Technip was a Principal Assured in addition to joint venture parties within the Al-Khafji Joint Operation.

The policy contained a “Watercraft Exclusion Endorsement” that provided as follows.

“Subject always to the terms and conditions of the Policy hereunder, Underwriters hereby agree that the Watercraft Exclusion 5 of Section II is deleted subject to watercraft associated with the Project maintaining Protection and Indemnity (P&I) cover up to a minimum of hull value.”

Technip submitted its claim under Section II, Liability, of the policy in the sum of US \$31,038,265 plus €458,052.

In the case of *Technip Saudi Arabia Limited v The Mediterranean and Gulf Cooperative Insurance and Reinsurance Company*, the existing wellhead platform, that sustained significant damage, was not declared and scheduled under the Existing Property / Contractual Exclusion Buyback Endorsement. Accordingly, underwriters sought to establish that the loss was excluded by virtue of the Existing Property / Contractual Exclusion Endorsement.

With regards to exclusion 1 within the Existing Property / Contractual Exclusion Endorsement (“any property for which the Principal Assured owns”), Technip sought to overcome the absence of a

declaration in respect of the existing wellhead platform that sustained the damage. Specifically, they contended that Technip did not own the platform and that the Exclusion (and therefore the Buyback) only applied if the actual Principal Assured claiming under the policy owned the platform. Technip further contended that the Court should disregard the fact that the damaged platform was owned by another Principal Assured under the policy (i.e. the party that engaged Technip to carry out the project work.) However, it was held that the Exclusion and Buyback provisions applied to existing platforms owned by **any** Principal Assured. Although Technip was granted leave to appeal on this point.

It will be recalled that exclusion 3 within the Existing Property / Contractual Exclusion Endorsement excludes *"any property for which the Principal Assured is liable or claimed to be liable by operation of any indemnification, hold harmless or similar provision contained within any contract or agreement"*. Technip did have a responsibility, detailed under contract, for damage to nearby existing structures. However, the Court was of the view that the loss in question was a **fault-based** liability and as such did not fall within the meaning of an *"indemnification, hold harmless*

or similar provision" requiring declaration to underwriters for their agreement.

Conclusions

The case of *Technip Saudi Arabia Limited v The Mediterranean and Gulf Cooperative Insurance and Reinsurance Company* highlights the fact that the WELCAR 2001 Offshore Construction Project Policy was not designed to provide contractors with Liability coverage and was not drafted for contractors to assume the role of Principal Assured.

A dedicated Liability insurance program, designed for a contractor performing the role such as the one carried out by Technip, should have the objective of providing cover for the loss under consideration. In view of the "contract work" exclusion contained within Protection & Indemnity Club rules, such an insurance program would no doubt have to involve an effective interface between a contractor's mutual Marine Liability risk transfer arrangements and bespoke Liability coverage available from within the commercial market. By adopting the role of a Principal Assured, under a policy form designed for oil & gas companies, Technip encountered difficulties in securing a settlement from underwriters. Specifically, underwriters were successful in

denying Technip coverage based upon an Exclusion and Buyback mechanism that was designed for oil & gas companies and not contractors.

The possibility exists that a pure "turnkey" style contract, between the main contractor and the oil & gas company operator, could leave "First Party" insurable interest in project property resting with the contractor during the construction activity. In such circumstances, the contractor may need to assume responsibility for arranging cover for loss of and damage to project property. In such an eventuality, the contractor would still need to ensure the most effective Liability policy terminology was in place to address their exposures during the project, including risks in respect of surrounding property. For example, perhaps placing the project property Physical Damage coverage on a "stand alone" basis, separate from a dedicated Liability program designed to address the contractor's exposures.

Notwithstanding the Court's view that Existing Property / Contractual Exclusion 3 did not require the declaration of any fault-based contractual exposures, for the avoidance of any doubt, oil & gas companies employing the WELCAR 2001 policy form are strongly advised to declare any contractual liability exposures to

underwriters for their agreement. Furthermore, careful consideration should be given as to how such exposures may arise. For example, in certain instances, such exposures may arise not via a direct contractual relationship with the owner of another surrounding platform but via a contractual hold harmless granted to the contractor performing work in the vicinity of the other party's infrastructure.

The main body of the WELCAR 2001 policy form expressly provides liability cover in respect of loss of use of property of others. However, it should be noted that the Existing Property / Contractual Exclusion Buyback Endorsement only refers to cover for *"Physical loss... and/or physical damage..."* The Buyback Endorsement does not provide cover for contractual liability exposures for loss of use. Accordingly, at the time of submissions under the Buyback Endorsement, oil & gas company operators (and their joint venture partners) should clarify with underwriters the extent of coverage they are prepared to provide in the event that exposures exist for contractual liability for loss of use relating to property of others. As necessary, specific amendments may need to be made to the terminology of the standard Buyback Endorsement.

If underwriters are prepared to accept declarations under the Buyback Endorsement, from oil & gas company operators (and their joint venture partners), in respect of damage to their own surrounding property, underwriters could be reluctant to extend such coverage to encompass loss of use exposures. In effect, this would mean offshore construction underwriters were providing the oil & gas companies with Business Interruption (Loss of Production Income) cover. If such Business Interruption coverage is required, same would ordinarily expect to be provided by operational package policy underwriters. Any oil & gas companies requiring such Business Interruption coverage, from their operational underwriters, should pay particularly careful attention to the policy terminology if they are seeking to arrange the Physical Damage cover away from the package policy.

It will be appreciated that in view of the terminology of the WELCAR 2001 Existing Property / Contractual Exclusion and Buyback Endorsements, in situations when owners of a new build platform have a partial interest in a nearby platform that is being tied-in to, particularly careful attention will need to be paid to the basis upon which any declarations are made to underwriters for

their consideration.

In conclusion, in respect of surrounding property risks during an offshore construction project, it will be appreciated that oil & gas companies and contractors should work closely with their respective insurance advisers, well in advance of the project, to carefully analyse their potential exposures and ensure appropriate coverage has been negotiated.

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