

BULLETIN

21 June 2016

To LNG carrier Members

P&I COVER

LNG Terminal Conditions of Use (COU)

Members may recall the Club's Bulletins 05/09 of October 2009 and 17/12 of June 2012. This is a revised version of those Bulletins, updated to take into account subsequent developments.

1. Introduction

The Club is fortunate in having a substantial number of entered LNG carrier Members, who regularly submit LNG Terminal Conditions of Use (COU) for approval of cover by the Club. The terms of COUs are frequently complex and invariably impose potentially substantial liabilities on the Member. This Bulletin is a guide to the Club's requirements for the approval of cover for a Member's P&I liabilities under a COU. It sets out the applicable provisions of the Pooling Agreement, and the rationale behind both the International Group's and the Club's approach to the risk.

Nevertheless, Members should always contact the Club's Managers to seek prior approval of any COU.

2. General - International Group Pooling and Reinsurance

The Britannia Steam Ship Insurance Club Limited is a member of the International Group of P&I Clubs. The International Group (IG) consists of thirteen P&I Clubs, each being an independent, non-profit making mutual insurance Club, providing cover for its shipowner and charterer Members against common categories of liability. Collectively, the IG P&I Clubs insure more than 90% of the world's blue water tonnage, which includes all LNG tankers.

The IG is bound by the terms of the Pooling Agreement. The Pooling Agreement provides an efficient form of claims sharing. Each Club agrees to pay a pre-determined contribution to any claim falling on the Pool. In order for the concept to work, the Pooling Agreement contains the conditions on which claims may be pooled, the way in which claims are to be handled and reported, and the method of dealing with reinsurance and overspill claims.

Under the Pooling Agreement, from 20 February 2016 participating Clubs share individual claims in excess of a Club's individual retention (currently USD10 million) up to the pool limit (currently USD80 million). The pool is currently divided into two layers, the first being between USD8 million and USD30 million and the second between USD30 million and USD80 million. For the second layer, the Clubs use a protective cell captive insurance company called Hydra which reinsures each individual Club for all liabilities on the upper pool layer between USD30 million and USD60 million.

Collectively the IG purchases reinsurance beyond the USD80 million pool limit, with that reinsurance providing protection for any one vessel any one event of up to a further USD1 billion for oil pollution liabilities and up to USD3 billion for passenger and crew liabilities or up to USD2 billion solely for passenger liabilities. There is also provision for "overspill" which takes cover for other claims to a figure currently in excess of USD7.7 billion. The Clubs have a co-insurance liability in respect of the first layer (USD500 million) of the Group's reinsurance programme which is, again, reinsured by Hydra. That co-insurance liability has different percentages within the first layer, but broadly amounts to 30%.

The Pooling Agreement completely excludes certain risks such as nuclear, biochemical, and war risks, and liabilities which, other than under the terms of a contract, would not have arisen under the applicable law.

The terms of the Pooling Agreement are designed to protect the mutual system against a shipowner accepting excessive liabilities, which would be unfair on other mutual shipowners trading on more reasonable terms. However, the Pooling Agreement also recognises and makes allowance for certain trading necessities where a shipowner, in order to trade, may have little alternative other than to agree to additional liabilities, e.g. towage contracts and LNG Terminal COUs.

It is in this context that the Pooling Agreement includes provision for pooling Members' liabilities arising out of a COU for an LNG Terminal. The requirements to allow pooling are detailed below.

3. Pooling Agreement Guidelines in respect of LNG Terminal COUs

Indemnities in an LNG Terminal COU are now poolable if, as a minimum:

- a) The COU is subject to the applicable statutory limitation (e.g. LLMC 1976 or the 1996 Protocol to LLMC 1976) or (if the limit has been waived or if there is no such limit) a contractually agreed limit of either United States Dollars One Hundred Fifty Million (USD150,000,000) or LLMC 1976 or the 1996 Protocol to LLMC 1976.

The right to rely on such limitation must:

- (i) Not be conditional on the performance of insurance or other obligations which cannot be reasonably expected of an owner when complying with its terms and conditions of entry with its P&I Club; and

- (ii) In respect of a contractually agreed limitation, encompass all liabilities under the COU arising from one event.

AND

- b) Unless liability falls under the mutual knock for knock provisions (described further below) of the COU, any indemnity from the owner excludes any liability of an owner arising from the sole negligence of the party being indemnified.

The exceptions to (a)(ii) and (b) are that liability for crew or wreck removal of the Member's vessel under the COU may still be poolable if the P&I Club determines that best endeavours have been exercised to ensure that the COU did so comply.

Subject to the exceptions noted, the Club will not be able to provide full cover for an LNG COU where the Member accepts liability either directly or by way of indemnity, or both, for a broad range of incidents regardless of the fault of the shipowner or where there is no acceptable overall limit of liability.

4. Further guidance on P&I Club's approval of LNG terminal COUs

- a) Who are the parties to the agreement?

It is important to be clear who are the parties to the contract, and who takes the benefits and obligations under the contract. The Club frequently sees COUs where there are a number of parties to the contract, including terminal and port interests, which may give rise to questions as to the involvement of affiliates, subsidiaries and agents, and their respective responsibilities and liabilities under the agreement.

- b) Definitions and Interpretation

Definitions assist interpretation, but sometimes there is reference to another document which the Club may not have been shown and which it is important to see. It is also important for the Member to be aware that broad collective definitions of the parties may include remote subsidiaries and subcontractors of the shipowner (e.g. berthing tugs).

A definition of "Vessel Interests" used as a term of the COU may, for example, include "all affiliates of the owner" and "all entities other than the terminal" which is unacceptably wide. In such an example, the Member should seek to restrict the definitions of "Vessel Interests" to the actual ownership of the vessel or to limit such definitions to only when and to the extent such other parties are engaged in the operations, transiting, berthing, departure or other services of the vessel within the LNG terminal/port or in connection with the vessel's call at the LNG terminal/port.

c) The relationship of the COU with any other agreements between the parties

If there are a number of agreements it is essential to check which agreement takes precedence in the event of conflict, since it may alter the allocation of risk. The benefit of a COU which is acceptable to the Club in terms of liability and limit may be swept away by restructured liability arrangements under an overriding purchase or trading agreement, in respect of which the Club may not be able to respond.

d) Limits of liability

For Club cover to apply, the COU must limit the vessel's liability to that specified in the applicable statutory limitation (e.g. LLMC 1976 or the 1996 Protocol to LLMC 1976) or (if there is no such limit or if it is waived) a contractually agreed limit of either United States Dollars One Hundred Fifty Million (USD150,000,000) or LLMC 1976 or the 1996 Protocol to LLMC 1976.

It is common for an otherwise applicable statutory limit to be waived, with the COU providing for a contractually agreed limit of USD150 million for any claims under the COU. This is acceptable for P&I cover as long as that limit applies to all claims arising out of the same incident, subject to the noted potential exceptions in respect of wreck removal and crew claims. We have also seen wording in COUs which provides for the Terminal's right to revise (upwards) the USD150 million figure in the event that the Clubs decide to provide a higher coverage. That is acceptable, but it should be noted that there is no current intention by the P&I Clubs to increase the limit.

In contrast, Members should resist any wording that provides for a higher limit (beyond USD150 million) if it is based on the vessel owner being able to purchase additional market coverage. Such market coverage would be available, with Members then having to bear an additional premium for the excess beyond regular P&I cover.

e) Knock for knock clauses

Knock for knock clauses provide that each party shall be liable for certain of their own losses/claims regardless of fault and without recourse against the other party. They are usually linked to cross indemnities between the parties. Within COUs, it is common for Members to be liable for personal injury/death claims of the vessel's crew while the terminal is liable for personal injury/death claims of its employees. Such knock for knock provisions are acceptable to the Club even though they can result in a liability on the Member despite the Terminal being solely at fault.

However, knock for knock clauses (and the reciprocal indemnities) should be checked to determine that a fair balance is achieved.

f) Responsibility of the vessel interests for safe operation of the LNG vessel in the port

This usually describes in a straightforward way the Master's responsibility as a representative of the Vessel Interests. It may be linked to a clause dealing with pilotage and in most cases makes it clear that the Master is responsible for the safety of life, the vessel, the environment and third party property. Such a clause is common and is acceptable under P&I cover.

- g) The basis on which the LNG terminal interests may be liable for any damage caused to the LNG vessel

This is a common clause and should be checked carefully with regard to the extent of liability and the remoteness of damage, and the interconnection with other provisions in respect of fault, limitation and exceptions to liability including *force majeure*. While not a P&I risk, it may also be sensible to consult with your H&M insurers.

- h) The basis on which vessel owner interests may be liable for any damage caused to the LNG terminal or port

For the Member this is a critical clause. Remoteness of damage, the apportionment of fault, and other limitation provisions must be checked carefully, particularly if there is exposure to consequential loss at a busy terminal. The vessel's liability for the mistakes of berthing masters, tugs and pilots may be incorporated into the clause and there may be reference to *force majeure* limitations and also to terrorism.

It is clearly more equitable for liabilities to be shared on the basis of the proportionate fault of the parties, and an increasing number of COUs incorporate proportionate fault provisions.

However, for Club approval, as a minimum it is essential that the liability clause does not mean that the Member will indemnify the other party (e.g. the Terminal) even if that other party was solely at fault. As noted elsewhere, there are very limited exceptions to this requirement, namely in respect of liability (a) under a mutual knock for knock clause or (b) in certain circumstances, for crew or wreck removal of the Members' vessel. It is important that the Managers' approval is sought on any COU where liability is being accepted even though the Terminal is solely at fault.

- i) Oil pollution

The LNG terminal interests will often insist on the right to conduct necessary clean-up operations and to recover costs from the Vessel Interests if there is an oil spill from an LNG vessel. The terms need to be checked carefully with a view to achieving a reasonable balance, by which the vessel does not give total control to the terminal for pollution avoidance and/or clean-up measures while remaining liable to pay the Terminal regardless of fault.

While the 1992 Civil Liability Convention ("CLC") does not apply to LNG vessels, the concept of recoverable damage is often qualified by reference to what would be admissible under CLC.

In contrast, the Civil Liability for Bunker Oil Pollution Damage 2001 (Bunkers Convention) does apply to LNG vessels; albeit as noted above it would be acceptable for Members to have agreed a contractually higher limit of USD150 million.

j) Wreck Removal

Vessel interests may be made responsible for wreck removal. In some contracts responsibility may be qualified by the parties' proportional fault. It is common for a COU to provide that the Terminal has the right to remove a wreck and claim the cost from the Vessel Interests, if the latter fail to act. Further, in some contracts, wreck removal is not triggered by the vessel becoming an obstruction or danger, but merely by the fact that the Terminal takes the view that a wreck should be removed.

The Club will encourage negotiation of clauses to ensure that any right to order a wreck to be removed is placed on a reasonable footing, in particular with reference to a formal order/notice of the relevant local authority. When reviewing the wreck removal clause it is important to know whether the terminal has any statutory or equivalent powers to order wreck removal, independent of any right of the vessel to limit liability in that jurisdiction.

k) Waiver and third-party claims

In some COUs, the terminal may seek an unlimited blanket indemnity for third party claims. This will not be approved by the Club. In contrast, the parties may agree either not to seek indemnification from each other in respect of third party claims or may agree that indemnification follows each party's proportional fault, which will be acceptable to the Club.

l) Insurance

There is usually a requirement that each party has customary insurances, specifically liability insurance. In respect of a vessel, this will be P&I insurance as well as H&M insurance.

Any provision requiring an undertaking by the Club to notify the LNG Terminal interests that notice has been given to the Vessel Interests of cancellation of the policy will generally not be acceptable to the Club. If such a request is made, the Member should immediately discuss this with the Managers.

m) Subrogation

There is sometimes a requirement on the part of insurers to waive subrogation rights in respect of claims against either party. Unless the waiver is designed to support mutual knock for knock provisions in the COU, it will not be acceptable to the Club.

n) Governing law

While English law would be a natural preference of the Club because of its perceived greater certainty and predictability in determining the risk allocation in legal agreements, the Club accepts that the national law of the terminal will often apply to the COU.

o) Arbitration

It is quite common to have disputes determined by arbitration, and given the nature of the contract this is arguably a more favourable process.

5. Market cover for non-poolable risks

If a COU or part of it has non-poolable risks, the Member may be able to obtain cover for those risks by purchasing appropriate market insurance. This can usually be arranged by the Club for Member's account.

Summary

Many terminals have accepted the minimum exceptions and limitations needed to enable Members to access poolable P&I cover without the need for expensive additional insurance. In many cases the end result has been a reasonably balanced agreement where liability follows proportionate fault and limitation is preserved by contract alone or by a combination of statute and contract. The Managers recognise that fair balance is often achieved through careful negotiation between the Member and the LNG Terminal. It is hoped that this revised Bulletin will assist Members in those discussions.

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