

Special Edition: Offshore

Welcome to the seventh edition of the *Standard Bulletin: Offshore Special Edition*. We are pleased to report that the offshore book of business continues to grow with the addition of three new supply boat members and one new Floating Production Storage Off-take (FPSO) operator this year.

FSPO

FSPOs are an area of the market that we have focused on for over 25 years and one which we will continue to focus on in the coming years. In this edition we have three articles concentrating on the FPSO industry:

- Charles D’Alton, underwriter of Standard Asia, gives his perspective on the Asian FPSO market
- Sharmini Murugason, our offshore syndicate claims director, looks at some of the legal issues currently being address within the industry as to whether an FPSO is a ship or a platform
- Julian Hines, of our safety and loss prevention department, looks at some of the regulatory issues that face the FPSO industry.



Swire Blue Ocean *Pacific Orca*

Activity

The offshore market appears to be weathering the economic turbulence of the last four years with more fortitude than the blue water shipping market. We believe that this is the case as the number of contracts that are reviewed by the club continues to significantly increase; there has been an increase of more than 50% over the last three years.

In the main, the contracts that we review are for supply and maintenance operations that will take place within a 12-month period. That said, installation and construction projects are longer-tailed and typically involve project engineering timelines spanning up to five years. For example, the club reviewed 35 tenders for various elements of the Gorgon Project LNG development off Barrow Island. As the project has matured the contracts are now contributing to a significant increase in demand for offshore support craft in Australia. The increased level in offshore development activity anticipated in contracts approximately 18 months ago appears, on current evidence, to be continuing and strengthening.

The levels of capital expenditure in the offshore industry are difficult to track, and it is therefore difficult and dangerous to predict the strength of individual markets. However, we would like to thank both Fearnley Offshore in Norway and Clarksons Research Services for taking the time to contribute their views respectively upon the offshore supply and support market in the North Sea and the growth and

Setting the Standard for Service and Security

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development of the offshore drilling sector. The drilling market in particular is a key market driver for both supply and anchor handling services and it is interesting to see their perspectives on these two very different but symbiotic markets.

Risk allocation

Whilst there is good news for the offshore market as a whole there are some market trends in contracting that present significant insurance issues. These are not always capable of being solved by the club as many of the risks contemplated within offshore contracts fall beyond the scope of P&I cover. One of the challenges for our contract review team is to manage the ebb and flow of liabilities under contracts that cascade down from field operators; many of these risks may be covered under different insurance covers. The most frequent example of this is in respect of the interface between P&I and Construction All Risks (CAR) covers. We routinely face questions in respect of the access of marine contractors to CAR covers and Gayner Warner from Marsh has generously offered her insight in to this complicated interface from the perspective of the marine contractor.

Contracting trends

Contracting trends are subtle and take some time to identify. However, Joseph Divis, our offshore syndicate deputy underwriter, shares some of his contracting insights. We are always interested in receiving feedback from our membership and one item identified is more visibility of the trends in contracting. We hope that this article goes some way to addressing that. There has been an increase in requirements for insurance covers to be fronted by local insurance

companies. John Croucher, offshore syndicate underwriter, addresses some of the issues raised by this development.

Our team

A critical element of our ability to service the offshore sector is the quality and training of our offshore syndicate team members and the growth and development of the team. I am pleased to welcome Leanne O'Loughlin to the syndicate as a claims executive who moved to us from another team at the club. Leanne is admitted to the New York State Bar and was practicing as a qualified solicitor for six years before joining the club. Finally we are pleased to announce the promotion of Sian Meadows to syndicate deputy underwriter.

Reinsurance

The club's non-pool programme continues to offer industry leading limits of cover. This tower of insurance cover supports most of the entries of the offshore book of business either as the security underpinning the extensions to mutual cover as provided by the Standard Offshore Extension or as the security underpinning the Standard Offshore Rules. There are still significant inflationary pressures in the worldwide insurance markets. These are principally driven by increasing claims costs coupled with greater market discipline and tightened rating following sustained underwriting losses.

We would like to thank all of the contributors. We are always interested in hearing from you with suggestions for content in our bulletins or offshore forums. We look forward to welcoming you to our 12th Offshore Forum on 3 October 2012 at Trinity House in London.

North Sea OSV market



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North Sea activity levels are at an historically high level, and with the renewed optimism from the recent discoveries, the activity is expected to remain high. However, the heavy influx of new ships to the market is a worry.

We record a renewed optimism in the North Sea now. Just a few years back, there was a consensus that the sun was about to set for the Norwegian and UK oil industries and that production levels would decline. However, the recent discoveries have turned this around. 2011 was a game-shifting year in terms of oil discovery. There had been quite a few new discoveries in previous years, but none of them were of such significant size as the discoveries in 2011 such as Skrugard, Havis and Johan Sverdrup in the Norwegian sector.



Platform supply boat

The industry's positivity was confirmed with the immense interest in the latest licence round on the Norwegian continental shelf early in July this year. A large number of oil companies submitted bids for the different new blocks located in the large areas in the Barents Sea and offshore Mid-Norway.

The current North Sea activity is almost at an all-time high. There have never been as many offshore vessels operating in the North Sea as there are today. The number of rigs certified to work on the Norwegian continental shelf is a cooling factor on the heated exploration activity, but with more rigs now approved for operations in the North Sea, Norwegian Sea and the Barents Sea, the demand for support vessels, both production support vessels and anchor handling tug (AHT) supply vessels, will increase.

Subsea solutions will play an important role in oil and gas development and production in the coming years. The demand for subsea construction tonnage will be strong, and we also believe that the market will absorb supply tonnage equipped with cranes and

remotely operated vehicles, and hence nourish a good activity level for AHTS and platform supply vessel (PSV).

The last couple of years have seen a large influx of AHTS ships originating from the contract boom in the years before the financial crisis and the trend continued into 2011 with almost 200 ships leaving yards worldwide. Fortunately for owners in this segment, we are now at the end of the AHTS delivery wave, and the orderbook for the coming years is more modest for larger ships. The situation is different for PSVs. More than 100 new orders were placed in 2011, and almost 50 ships have been ordered so far this year, adding to an already bulging orderbook. We will experience two to three years with a rapidly growing fleet of PSVs, especially large PSVs of more than 4,500dwt. Many of these are targeted for Brazil, Australia and West Africa, but some of these will search for work in the North Sea. As charterers prefer new ships over older ships, this is a threat to the existing ships, which might need to mobilise to other areas (with lower day rates).

The recent year's exploration frenzy has been good for the supply/demand balance in the North Sea. The high oil price has justified exploration drilling in 'expensive' areas with harsh environments and/or large water depths, and many ships have been mobilised out of the North Sea. Examples are the 10 to 12 ships chartered to Cairn Energy for drilling in Greenland, and several ships mobilised to the Mediterranean Sea to support the deepwater drilling in Egypt. The current anxiety relating to the development of the oil price may affect the attractiveness of exploration campaigns where high-end tonnage is needed.

Currently, the supply/demand relation is only at balance at peak activity periods. This means that most of the time there is quite a lot of idle tonnage, often as many as about 10 to 12 ships fighting for work.

The first half of 2012 has been very volatile. Large PSVs could obtain about £10,000 per day in the beginning of the year (£20,000 for a large AHTS). A few months later, in March and April, the same ship could obtain £22,000 (large AHTS £40,000), and today (early July) the fixing level is again down at about £10,000 for large PSVs (about £25,000 for large AHTS). The number of ships trading in the North Sea is expected to increase, with more than 10 new PSVs in the next couple of months, most of them leaving the yard without firm work. The number of new ships entering the market is likely to keep the utilisation low in the short run, but hopefully for the owners of North Sea tonnage the market will pick up as a result of the renewed optimism.



Mobile offshore drilling unit

Offshore market commentary



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The following commentary is taken from Clarksons' annual Mobile Drilling Register and provides a basic introduction to the sector and a review of key developments in this important and quickly growing market. The commentary was produced by the Offshore Market Research team at Clarksons Research and their managing director, Steve Gordon, would be happy to discuss any feedback readers may have. Clarksons Research produce registers reviewing each of the major offshore fleets and oil producing regions, details of which can be found at www.crs.com.

Mobile Offshore Drilling Units (MODUs) are moveable structures designed to drill exploration, appraisal and development wells offshore. The MODU fleet comprises four major sub-groups: jack-ups, semisubmersibles, drillships and drill barges/tenders, each capable of performing drilling operations at different water-depths (see Figure 1).

Major sub-sectors of drilling rigs Types and capabilities of drilling rigs

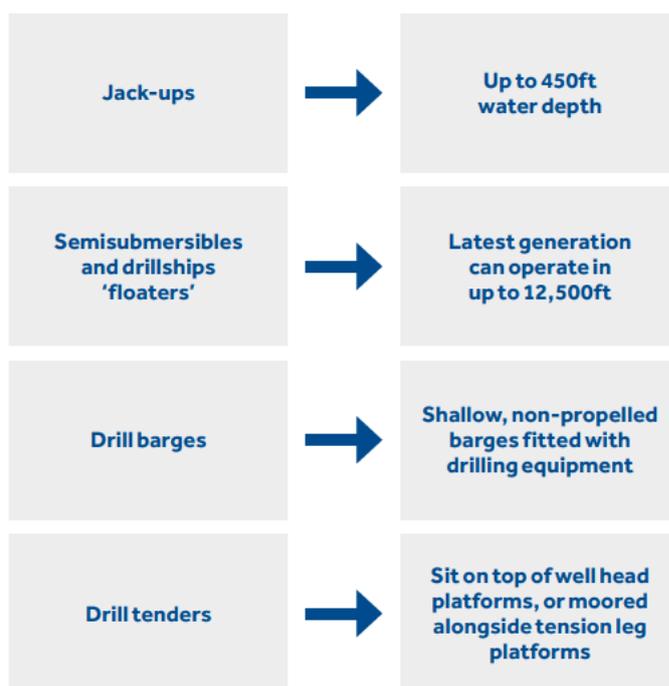


Figure 1 – Overview of the MODU sector. Source: CRSL.

Offshore drilling operations range from benign, shallow-water locations in the Middle East and Asia/Pacific, through to ultra-deepwater areas offshore Brazil and West Africa. Moreover, offshore exploration and production (E&P) is increasingly moving into the harsh Arctic environments of the Beaufort Sea off Canada and Alaska, and the Norwegian and Russian Barents Sea.

The type of MODU structure used in any given location depends primarily on water depth and climatic conditions. Drill barges are shallow-water units designed for benign water conditions, and often operate on inland lakes and rivers. Drill barges are not self-propelled vessels, and instead must be moved to location by tugs. Jack-ups range from older, lower specification, mat-supported slot-type units, limited to water depths of up to 250–300ft, through to modern, independent leg cantilever units, capable of operating in depths of up to 450ft. Jack-ups are tugged into position, and are equipped with steel legs that are extended to the sea floor, allowing the structure's working platform to rest above the water.

Deepwater drilling often involves the use of a 'floaters', in the form of a Semisubmersibles or drillships. Semisubmersibles use submerged pontoon-like structures that lower the unit partly underwater once it has moved to location. Semisubmersibles are the most stable type of floating MODU structure, and while the first generations of units were capable of operating in water depths up to 5,000ft, more recent generations can be used in depths up to and beyond 12,500ft (see Figure 2). Drillships, meanwhile, are capable of operating in almost any depth, and can be more easily moved from one location to another.

Floaters generations

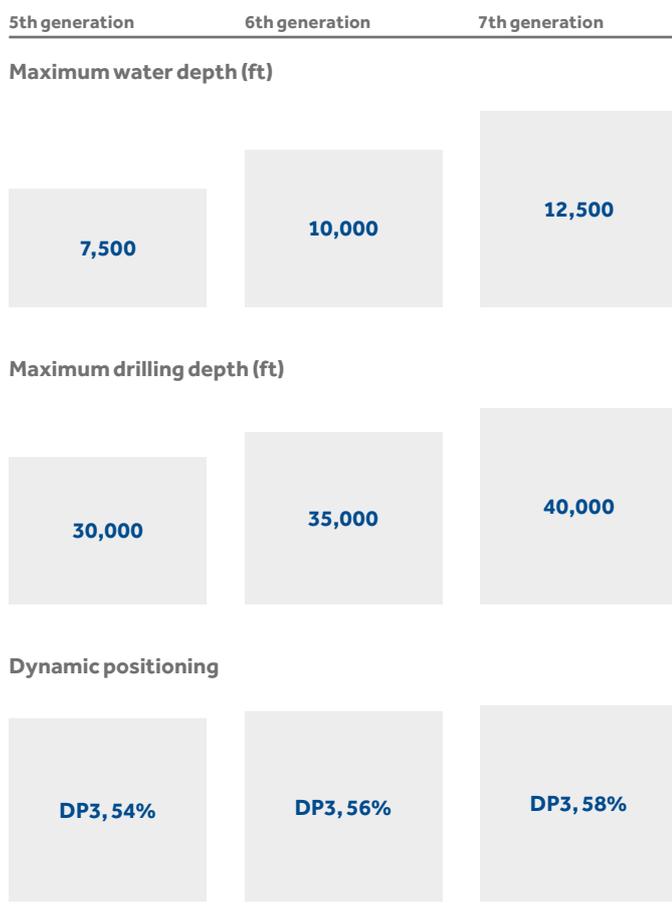


Figure 2 – Development of floating MODU designs. Source: CRSL

The MODU market is driven by the relative size of energy companies' budgets for E&P. As a result, the underlying dynamics of the market, as with all other offshore sectors, are oil price and global energy demand. Over the past decade, growing energy demand and rising oil prices have led to impressive growth in the MODU sector, with energy companies committing ever greater sums to invest in offshore drilling. As traditional centres for oil production continue to mature and decline, E&P is increasingly looking to offshore, and to remote and frontier areas in particular, to meet future demand.

Fleet development

In a little over 10 years, the MODU fleet has grown by 33%, from 729 units to a total of 970 units, as of 1 June 2012. The jack-ups sub-sector is the largest in the MODU fleet, with almost 52% of all units, while semisubmersibles, drill barges/tenders and drillships equate to almost 23%, 16% and 9% of the fleet respectively.

The changing profile of the MODU fleet over the past decade reflects the shift towards deeper water drilling. Increased numbers of jack-ups (over 300ft), semisubmersibles (over 5,000ft), and drillships have accounted for much of the growth in the MODU sector since 2002. Numbers of jack-ups (over 300ft) are up by 158% from 62 in 2002 to 160 today. Similarly, semisubmersibles (over 5,000ft) are up by 126% from 39 to 88, while the number of drillships has more than doubled from 40 to 83.

By contrast, drilling units designed for shallow-water operations today constitute a smaller proportion of the MODU fleet. Jack-ups (under 300ft) today make up 35% of all MODU, down from 43% in 2002, while drill barges have seen their share of the total fleet fall from 16% to 13% over the same period. 14 new units have been delivered into the MODU fleet so far in 2012. By the end of the year, a further 33 units are scheduled for delivery, which will bring the total figure for deliveries in line with the numbers seen in the latter part of the previous decade.

The increased numbers of drillships, deepwater jack-ups and deepwater semisubmersibles reflect the growing demand for MODU capable of operating in the remote, deepwater locations and harsh environments found offshore Brazil and West Africa, and in the Gulf of Mexico, the North Sea and more recently, the Arctic region.

Orderbook

The number of units on order in the MODU sector grew rapidly in the second half of the 2000s. Between 2002 and 2005, the average size of the MODU orderbook totalled just under 29 units, before rising to 62 units in 2006 and peaking at 179 units in 2009. The orderbook total fell in both 2010 and 2011, but has since recovered, and as of 1 June 2012 currently stands at 179 units (equal to 18% of the current MODU fleet).

The orderbook currently comprises 92 jack-ups, 21 semisubmersibles, 54 drillships, and 12 drill barge/tenders. Just under three-quarters of the 113 jack-ups and semisubmersibles currently on order are deeper-water units (i.e. jack-ups over 300ft and semisubmersibles over 5,000ft). Drillships have increased their share of the orderbook from 3% in 2002 to 30% today, reflecting the growth in demand for MODU capable of operations in deepwater and remote locations. Although their overall share of the orderbook has fallen in recent years, the steady number of jack-ups (under 300ft) and drill barges on the orderbook shows that there is still a requirement for MODU in shallow-water and benign locations in areas, such as the Middle East and Asia Pacific.

Contracting

Since the start of 2002, a total of 451 orders for MODU have been made, with the 10 years to the start of 2012 seeing an average of 42 new orders per year. Continuing demand for MODU capable of operating in deepwater areas has led to a spate of new contracts in recent years. Between 2002 and 2004, there were on average just nine orders each year, rising to 59 orders a year between 2005 and 2008. Orders peaked in 2008, when 77 contracts were placed for new vessels, before dropping to 30 and 35 contracts in 2009 and 2010 respectively. In 2011, the sector enjoyed a recovery, witnessing a record 94 new vessel contracts, although the trend for 2012 year-to-date is down by 26% on an annualised basis.

The major story in the MODU sector in recent years has been the growing shift towards deepwater drilling. Huge potential petroleum reserves have been located in hitherto undeveloped areas such as Brazil and West Africa, where extreme water depths prohibit traditional offshore drilling techniques. As a result, MODU with the capacity to operate in deepwater (drillships and semisubmersibles), have seen rapidly rising demand from operators and considerable recent investment (see Figure 3). Investment value in new build drillships has significantly outweighed investment in other MODU sub-sectors in recent years, although this trend has been less apparent so far in 2012. Investment value in jack-ups and semisubmersibles was at comparable levels in 2007 and 2008, but has since shifted significantly in favour of jack-ups.

Recent MODU investment trends

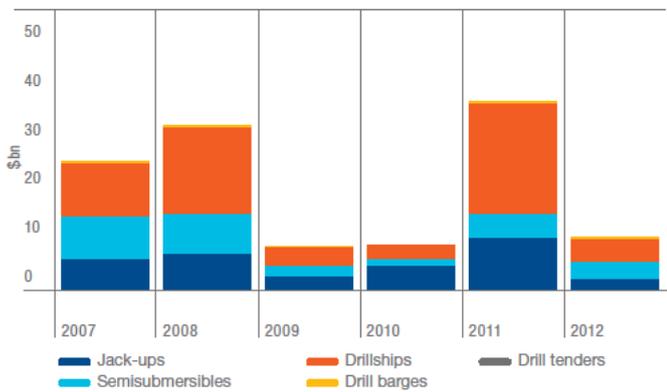


Figure 3 – Recent MODU investment by sector. Source: CRSL

With the onset of the global economic crisis in 2007 and 2008, the offshore industry witnessed a sharp downturn in drilling activity, and a concomitant drop in demand for MODU (see Figure 3). However, 2011 saw a recovery for the sector, and with high oil prices and strong demand expected for the foreseeable future, the general outlook for the sector is positive.

MODU new build prices

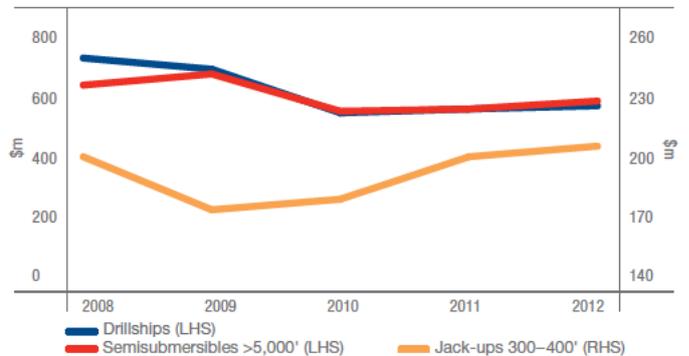


Figure 4 – MODU new building prices by sector. Source: CRSL

N.B. annual MODU prices for the period 2008–2010 are averages for the full year. The prices listed for 2012 are as of 1 June 2012.

Like most sectors in the maritime and offshore industries, MODU new build prices dropped off in the aftermath of the credit crunch and subsequent recession (see Figure 4). Despite previously strong demand, drillships prices saw the most significant fall, dropping from a \$710m average annual price in 2008 to \$538m in late 2010 (a decline of 24%). Prices for semisubmersibles saw a less marked decline, falling by around 18% from a 2009 high of \$660m. New build prices for jack-ups, meanwhile fell 10% over the same period to an average of \$180m. Since their 2010 nadir, new build prices for MODU have made a steady, if somewhat slow recovery. Average prices for jack-ups are today up by around 17% since 2009, while drillships and semisubmersibles have seen average price rises of 4% and 6% respectively since 2010.

Average charter rates



Figure 5 – MODU charter rates. Source: CRSL

In a further sign of market positivity, average MODU charter day rates have improved steadily in recent years (see Figure 5). Average floater (semisubmersibles and drillships) day rates have risen by 11% since September 2010, with average jack-ups rates up by 34% over the same period. Of the 29 orders placed so far this year, there have been contracts for 11 jack-ups, seven drillships, six semisubmersibles and five drill tenders. However, this figure could increase to around 70 units, if future new build options are taken up before the end of the year.

Utilisation

MODU utilisation figures were significantly down following the start of the global economic downturn in 2007 and 2008, as demand for vessels dried up (see Figure 8) and in the aftermath of the *Macondo* oil spill in April 2010. From a mid-2008 high of 92% and 93% respectively, jack-ups and floater utilisation rates dropped as low as 71% and 84% in early 2011. Over the past 12 months, however, utilisation rates have made a significant recovery, as demand for drilling units has picked up. In June 2012, utilisation rates had reached 77% for jack-ups, and 88% for floaters.

Floater and jack-ups utilisation

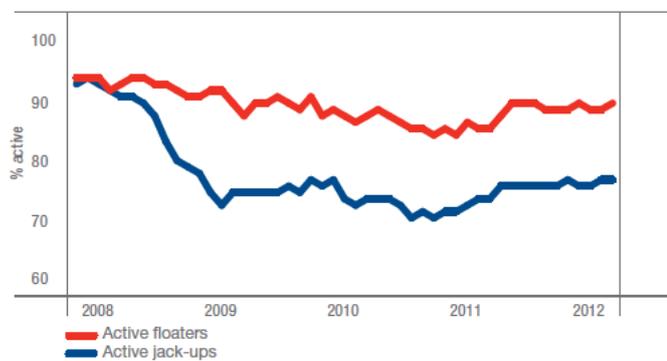


Figure 6 – MODU utilisation. Source: CRSL

Deliveries

There have been a total of 274 deliveries into the MODU fleet since the beginning of 2002 and an annual average of 26 in the 10 years to the start of 2012. Deliveries increased rapidly after 2007, in line with higher contracting levels from 2005 onwards. Between 2002 and 2006, deliveries into the fleet averaged just 10 units per year, before rising to an annual average of 42 units between 2007 and 2011, and a high of 51 in 2009.

A number of companies have significantly increased their MODU fleets in recent years. Seadrill's current fleet includes 32 MODUs delivered since the start of 2002, while China Oilfield Services Ltd (COSL), ENSCO and Transocean currently have 19, 18 and 16 units respectively that were delivered over the same period.

Deliveries in 2012 are currently down by 34% on an annualised basis. In spite of this drop, recent deliveries continue to reflect high demand for deepwater drilling. Of the 14 units that have entered the fleet so far this year, six have been drillships, along with three large semisubmersibles.

Removals

Removals from the MODU fleet, including scrappings, conversions and total losses, have been relatively limited in recent years. Since the start of 2002, a total of 32 units have left the fleet, 24 of which have been either drill barges or jack-ups (under 300ft) and semisubmersibles (under 5,000ft).

Notable jack-ups losses include the Russian built '*KOLSKAYA*' platform, which sank during violent storms whilst under tow from Kamchatka, off Sakhalin Island in December 2011, and the Chevron chartered '*KS ENDEAVOR*', which was irreparably damaged by fire whilst drilling off Nigeria in January 2012. A further eight jack-ups have been reported as total losses since 2000 in the wake of hurricanes Lilli, Katrina and Ike in the US Gulf of Mexico.

Semisubmersible casualties include the '*ABAN PEARL*', which sank off Venezuela in 2010, following a problem with its floatation system, and the much publicised loss of the '*DEEPWATER HORIZON*', which experienced a blowout while drilling the deepwater *Macondo* well in the US Gulf of Mexico.

Fleet deployment

As of 1 June 2012, the fleet for jack-ups, semisubmersibles and drillships stands at 810 units, of which 657 units are currently under deployment.

The leading region for jack-ups deployment has been the Middle East/ISC, which currently hosts 32% of all units that are currently deployed globally. The Asia Pacific and North America have the second and third largest deployment of jack-ups units, with 23% and 18% respectively.

South America has the largest share of floater MODU with 31% of all units that are currently deployed worldwide. North West Europe and North America also have sizeable shares of the floater fleet, both with 16% of global units.

Regional MODU demand changes since 2007

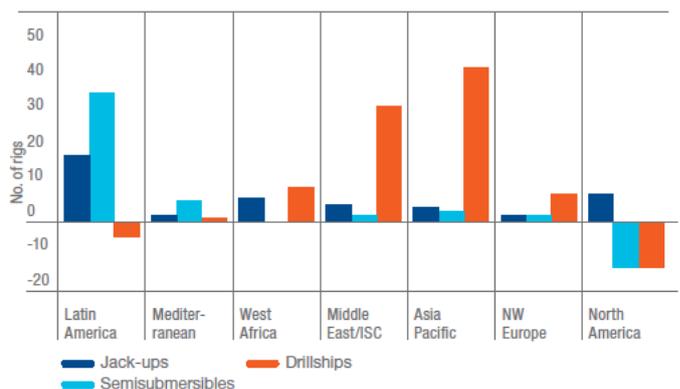


Figure 9 – MODU deployment changes by region. Source: CRSL

Offshore regulatory issues



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On 27 October 2011, the European Commission (EC) proposed a new law that will ensure that European offshore oil and gas production will meet the world's highest safety, health and environmental standards everywhere in the EU. The new draft regulation sets clear rules that cover the whole lifecycle of all exploration and production activities from design to the final removal of an oil or gas installation.

http://ec.europa.eu/energy/oil/offshore/standards_en.htm

The Standard Club considers herein the impact of these proposed changes for the future of safety in the North Sea, and how existing EU regulations compare with areas in other parts of the world.

For ships trading in the North Sea, it is clear that they must comply with IMO regulations such as SOLAS, MARPOL, ISM, etc. These are enforced by classification societies and port states. However, for offshore oil and gas units, their compliance is governed by five continental shelf regulators (Norway, Denmark, Germany, Netherlands and UK), each with different rules and regulations.

Most of the North Sea oil and gas comes from the UK and Norwegian sectors, but both of these countries have taken different strategies in relation to legislation; the UK uses the safety case regime and the Norwegian authorities use a more prescriptive route. Both countries have considerable resources and experience in offshore oil and gas, and each has had to learn from major disasters including *Piper Alpha* and *Alexander Kielland*. These incidents have been thoroughly investigated by the respective continental shelf regulators, and the circumstances of the incidents, key points and recommendations have been implemented and circulated through regulations and by the industry.

In practice, both regimes have produced high safety and environmental standards, but as an operator there remains a lack of standardisation between the regulators. EU countries are developing their offshore oil and gas reserves. Therefore, operators are faced with numerous regulatory standards under the umbrella of EU legislation. A common framework and standardisation of EU regulations has the potential to raise standards, which the Standard Club in principle would be in favour of, but with the proviso that the regulations do not create a culture of compliance with minimum standards but rather actively encourage best practice.

A one-size-fits-all EU standard of offshore oil and gas operations is ambitious, and there is already a natural split between the North West European Area (NWEA), which has a high level of established and proven health and safety standards, and the Southern European states (Mediterranean and Black seas) which are in their infancy in developing their offshore oil and gas reserves. The North Sea standards should be used as the point of reference to drive EU-wide standards up, but not as the European Commission press release states "[to ensure] operators respect the minimum standards".

Operators within the EU should be encouraged to adopt best practice standards across their fleet, irrespective of the particular jurisdiction where their offshore operations are carried out.

The North Sea has a good reputation for safety practices for a number of reasons, namely:

- over 40 years' experience;
- a highly skilled and trained workforce;
- a culture for continued development; and
- a number of industry forums such as Oil & Gas UK, The Oil Companies International Marine Forum and the International Marine Contractors Association where information is shared between operators and voluntary standards are implemented, usually over and above the minimum operating standards.

Steering committees are made up of a cross-section of operators that report on regulators' boards, with the net effect being that the North Sea to some extent, is self-regulating. The new EU Oil and Gas Advisory Group is offering much the same with the sharing of best practices and the improvement of safety standards. However, the concern is this will be made up of member states, not operators, and this may create another bureaucratic layer.

It is generally accepted in the marine offshore industry that the highly regulated North Sea sector has the highest standards for quality, safety, loss prevention and risk management. These demanding standards offer marine offshore operators a benchmark for minimum compliance with health and safety procedures within their management systems. Other continental shelf regulators around the world have comparable standards. However, the Standard Club's experience has shown that there is a level of variation of how standards are applied outside North Sea areas. In West Africa, for example, the competence of the local regulatory bodies varies considerably and they may fail to identify defects, non-conformities and/or they do not have the ability to enforce compliance.

Likewise, it is evident that not all flag states are equipped with sufficiently experienced surveyors to carry out meaningful or effective inspections of offshore units. Therefore it is insufficient to rely upon classification societies, flag states or regulators to police standards of maintenance and control. Some offshore operators have identified that whilst their unit is on location, thus not internationally trading, then IMO regulations do not apply and that they can remove classification and withdraw from ISM compliance. Whilst this is technically correct, we would expect such an operator to demonstrate that its in-house management systems are equivalent to flag state or class standards and robust enough to maintain the unit and evidence that independent verification is in place.

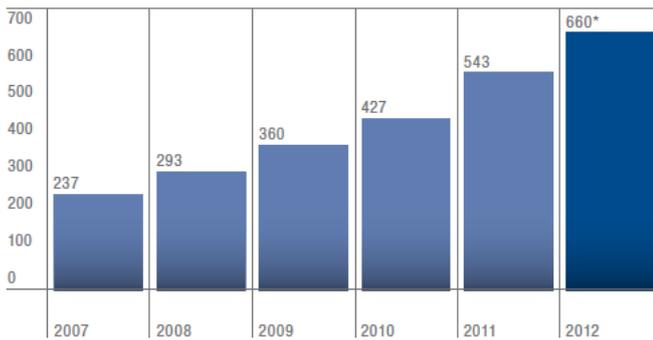


Contract exposures



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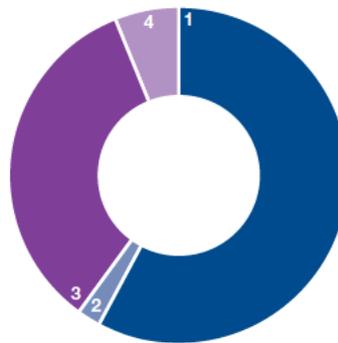
Each year, the club reviews a large number of contracts for its members. Last policy year the club reviewed 543 non-knock-for-knock contracts for its membership and new business enquiries. Through the contract review process, the club aims to proactively advise members of the effect of the contractual arrangements they have concluded in relation to their P&I cover. The purpose is to provide a level of comfort to members in respect of their P&I insurance cover before any potential liabilities arise. It is equally important in highlighting where club cover cannot respond so that members can arrange cover in alternative markets for such risks as they deem appropriate.



*2012 – 212 reviewed in first four months of the year
 Projection for 2012 = 660

The contracts presented to the club for review range from unamended BIMCO approved forms that may apply to supply boat charterparties, through to drilling and production contracts and other complex and high-value Engineering, Procure, Install and Commission (EPIC) contracts for large offshore construction projects. Contract review is relevant both for members who have poolable cover and those who have non-poolable cover. The latter can be members either who have extended covers added to a poolable entry or those members entered in the club under the **Standard Offshore Rules**. The following chart shows the percentage of contracts reviewed in 2011 by business type/sector, which largely mirrors the spread of the club's offshore membership, with supply representing the largest proportion.

Contracts reviewed in 2011



1	Supply	58%
2	Drill	2%
3	Construction/Installation	34%
4	Production	6%

Offshore ship types by number

Not only does our contract review process allow us to provide feedback to our members on a number of contractual pitfalls that we repeatedly see, but through the process of reviewing a large number of contracts, the club is able to identify how certain contractual trends develop. Although different sectors of the industry show certain contract trends (which will be discussed individually below) a common theme that we are seeing in many offshore contracts is the incorporation of exceptions for gross negligence and wilful misconduct. This can be problematic as the offshore industry has traditionally relied upon knock-for-knock contracts whereby the parties privy to the contract, take on responsibility for loss of, or damage to, their own property or injury or death of their personnel, regardless of fault, and receive a respective indemnity from the other party.

When risk is allocated in this way it provides the parties with legal certainty, promotes exchange of information, reflects contractual freedom, avoids costs of proving fault and minimises duplication of cover. Each party is best positioned to manage the risk of injury to its people and damage to its property as these are risks within their spheres of control. Knock-for-knock contracts allow operations that would appear to have disproportionate liabilities (for example towage of a drilling unit by a supply vessel) and which are commonplace in the offshore industry, to be undertaken.

Exceptions for gross negligence/wilful misconduct effectively erode the knock-for-knock regime and force the contractor out of its acceptable liability regime. It also introduces an element of subjectivity into what should be a completely objective knock-for-knock liability matrix. The determination whether a particular standard of behaviour is either grossly negligent or due to wilful misconduct will have to be made by a court or arbitration tribunal. Rather than cleanly delineating risks between the parties under a freely negotiated contract, the parties will have to rely upon a court or tribunal to interpret the contract. This introduces subjectivity and unpredictability; for example, there is no definition of gross negligence under English law. If the court is in the jurisdiction where an incident took place, particularly one that involves pollution or loss of life, there may be a perceived desire to see the party at fault held liable. If so, the owner may lose the benefit of the indemnity that they may have otherwise been expected to rely upon.

The gross negligence/wilful misconduct exceptions under a contract may be limited to the conduct of a defined figure or class of individuals (for example, the master or crew) rather than the controlling mind of the company. Therefore, the standard of behaviour triggering the gross negligence exception may be reduced. In these circumstances, the actions and decisions of the master or crew may obviate the entire contractual risk allocation balance. The desire for accountability for a party's actions is understandable. However, such exceptions act as a catalyst for litigation, increase insurance costs and firmly introduce uncertainty.

The inclusion of exceptions for gross negligence/wilful misconduct in indemnity provisions can prejudice club cover. Liabilities for gross negligence may be covered under a contractual cover. Under the rules, no claim is recoverable if incurred owing to the privity or wilful misconduct of an insured party (unless the board decides otherwise). This is in addition to the statutory exclusions under the **Marine Insurance Act 1906**.

We recommend that members avoid any reference to gross negligence/wilful misconduct when negotiating contracts and should, as far as possible, contract on knock-for-knock terms. The club works with our members to achieve this by reviewing contracts and providing advice and support during contractual negotiations. If a knock-for-knock allocation cannot be achieved the member and their advisers should bear in mind the additional insurance costs and consider whether there is an insurance appetite and capacity for the risk.

Drilling and Production

Post *Macondo* there has been a perception of an increase in efforts by operators to negate indemnity coverage in the event of a party's gross negligence or wilful misconduct. Drilling contracts for work in the US Gulf of Mexico have addressed new post *Macondo* regulatory requirements relating to blow-out-preventer certification and testing. However, the perception of significant changes to drilling contracts is perhaps unfounded outside of the US Gulf of Mexico. Industry standard terms are published by the International Association of Drilling Contractors.

The industry tends to use an unamended 'day rate' drilling contract, which contains knock-for-knock terms in respect of each party's people and property. We do see both 'fault based' and 'non-fault based' assumptions in respect of operators' property. These are onerous and need further consideration by underwriters to allow proper rating of the risk. Recently, we have also seen provisions that allow the company to step in to try and regain control following a blow-out, in which case the company becomes responsible for all risks, including the member's people and property. Such a provision improves the risks for members and demonstrates that the oil and gas industry is implementing improvements in contracts following recent events.

Normally pollution risks are allocated on a 'fault based' or a 'location of source' basis. In both drilling and production contracts, we have seen allocations for pollution risks which fall outside the scope of usual club cover. For example, a member may be contractually responsible for 'pollution above water'. This is unclear but it can be construed as a contractual assumption of pollution emanating either due to the other party's fault or from their equipment/property. Therefore, it is important to understand the definition of the unit under our rules. For drilling, the unit does not include anything below the rotary table.

The basic premise is that pollution from the unit is not covered from below the drill floor or rotary table. For production, the unit does not include anything on the well side of the well control equipment closest to the unit and means that pollution from the unit is not covered well-side of the pipeline end manifold (PLEM). Therefore, any pollution risks assumed under contract may not be covered by the club and may need to be insured elsewhere (for example under an operator's extra expense (OEE) cover). Again, the club will aid the member in identifying these potentially non-covered exposures through our contract review process.

Construction

Like production operations, the commercial reality of the offshore installation market is that there is no standard industry wording allocating the obligations of each party. Each contract is bespoke. Deviations from the knock-for-knock regime with the use of contractually assumed liabilities can often represent the exclusions or deductibles applicable to other insurances (for example, CAR/energy exploration and development). P&I insurance is a monoline insurance designed to provide cover for third-party liabilities arising out of the operation and management of the entered ship/unit.

Extensions to cover can be given for members performing construction and installation through our specialist operations buyback extension. This cover is still subject to exclusions for loss of or damage to contract works and failure to perform. We have seen some construction/installation contracts whereby the member is assuming liabilities for cargos (such as topsides) without limit. This would bring the club closer to becoming a direct underwriter for loss of cargo/property and we are therefore unable to class some of these exposures as a marine liability risk. The provision of such cover may conflict with CAR/EED/cargo underwriters whose policies can respond to loss of or damage to contract works and removal of project property and debris, which are excluded under club cover.



Swire Blue Ocean *Pacific Orca*

Supply

Supply contracts represent the largest proportion (58%) of the club's 2011 contract reviews. We have seen a trend in these contracts becoming more onerous, with supply boat owners being required to purchase increased limits. We have had instances where the supply boat owner has felt it prudent to purchase \$1bn contractual cover as a result of a complete waiver of the right to limit in respect of very high-value property. Clearly, it is not equitable to expect shipowners to bear expensive insurance costs for what can be excessively high exposures, especially since the owner's overall benefit from the project is typically below that which can be expected by the oil company field operator.

The club, through our reinsurers, has the capability of providing additional cover for such risks. However, the purchase of this insurance capacity will not be cheap, and the risk to the shipowner may be greatly in excess of the value of his contract. We recommend that these exposures should be passed up the contractual chain to the field operator in order to prevent a disproportionate risk allocation.



Supply boat

Conclusion

We expect to see typical contractual provisions to change and it is inevitable that contract drafters will respond and adapt to external events (for example, *Macondo* and the supply and demand for certain classes of tonnage). This is likely to continue as the offshore industry is complex and is extremely susceptible to changes in global financial and political conditions. Through technological innovation, the industry is also rapidly advancing, with increasingly complex projects and operations occurring in more hostile environments. By reviewing a high volume of contracts, the club gains a further insight into member's risk and risk allocation, and can pass on knowledge and recommendations to our membership to provide them with certainty of cover and aid them in their contractual negotiations. We believe that our contract review process reduces members' risk exposure and costs.

Suitability of CAR cover for offshore contractors



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Oil and gas companies (the 'principal') often maintain in contractual negotiations that any Construction All Risks ('CAR') cover provided will adequately protect the majority of contractors' or subcontractors' insurable risks based on the main policy form available, Welcar 2001. However, as most offshore contractors and service providers will have experienced, the coverage provided by the principal is often not able or adequate to protect those risks to the extent the contractor desires.

There is often a lack of empathy between the parties as to what constitutes a reasonable insurance product brought about by fundamental differences in the risk appetites of the principal and the

contractor. The principal has a balance sheet that can exceed those of the international insurers, whereas the contractor's balance sheet, which does not benefit from the ultimate revenue stream of the field development, is not as well adapted to assume risks arising from less than clear indemnity regimes.

Oil and gas companies remain the main buyers of offshore CAR insurance and as such, the suitability of insurance products offered by the offshore energy insurance market is generally more focused on the principal's risks and retention appetite (and losses) rather than on those of a contractor in isolation.

As such, it is vital that contractors are aware of the scope of cover under the standard Welcar policy form. Whilst some exclusions of cover are absolute, some aspects of cover are voluntarily deleted or limited by the principal with the associated risks merely passed down through the contract to the contractor.

For example, contractor access to these policies is often limited. Often, 'Other Assured' status can be only implied or significantly qualified under the contract (i.e. valid only subject to certain onerous quality assurance/quality control restrictions). This presents an obvious issue for recovery of costs related to damage to contract works. However, even if unqualified 'Other Assured' status is available under the contract, the standard Welcar 2001 wording limits direct access to the policy to those with 'Principal Assured' status. In a difficult commercial relationship, the contractor may feel reticent about conducting the claims process via their customer.

What alternative does the contractor have if the principal is not willing to offer the equivalent of 'Principal Assured' status in this respect?

'Contingent' or 'contractor scope only' CAR cover is available from the offshore energy market to deal with most of the shortfalls in choice of cover (if not the absolute exclusions of cover, of course) albeit from a restricted market of interested underwriters. However, even if available, it is often not commercially viable for contractors as the aspects of cover that are being sought are those that attract the highest rating.



Crane barge

Where a legal or contractual liability can be determined, P&I clubs have successfully developed alternative solutions for their offshore contractor members, such as the pollution from well extension, which can work, as the clubs have provided enough of a distribution mechanism to present a spread of risk to their reinsurers that would otherwise not be available to them. As such, it is perhaps natural also to question whether this could be achieved for 'damage to contract works' for a low limit or on a contingent basis.

Clubs can approach their reinsurers on a facultative basis for additional risks and if these clubs can obtain a quote, their purchasing power may confer some pricing benefit to club members. However, an equivalent damage to contract works insurance product has not yet manifested itself. With the reinsurers of offshore P&I clubs operating under increasing restrictions over the last two years, one can assume that further extensions of club cover into alternative product lines (i.e. energy/property damage covers) will probably not be achievable in the foreseeable future.

FPSOs in Asia Pacific



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The Asia Pacific region (APAC) has, in recent years, witnessed a surge in offshore field discoveries and start-ups. Of the seven global oil-producing regions, APAC has seen the most fields discovered and brought on-stream for the last 10 years. In 2011, approximately a third of global discoveries came from the APAC region. The emergence of the Australian and Vietnamese offshore sectors alongside China, Malaysia and Indonesia will ensure that the future for this sector looks bright.

Regional demand for floating production solutions has soared in the crude oil sector, where converted tankers are still the cost-effective norm, particularly in regions where the water depths are generally shallow. Perhaps the most exciting development is in natural gas, where the immense scale of projects such as Gorgon, Wheatstone and Ichthys have made larger, bespoke new building solutions more financially viable, such as Shell's *Prelude* FLNG.

It is a good time to be in FPSO construction in Asia. Keppel in Singapore is brimming with conversions and topside modules, and South Korean yards such as Samsung Heavy Industries (which is building the *Prelude*) are jostling for a piece of the action in building units 'from scratch'.

So, where can the Standard Club help at this early stage? Our offshore syndicate reviews over 180 construction contracts every year and can consult with our members on the liability exposures and pitfalls they may encounter. It is not unusual to see a hull being converted in Korea, then being towed to Singapore for topside integration. The topside elements will include machinery imported from all over the world. It is a complex process and the liabilities that flow from this reflect that complexity.



Singapore port

However, it is not all about FPSOs entering the market. The fact remains that many FPSOs are not redeployable after decommissioning, since the on board production and separation facilities are, in most cases,

unique to the hydrocarbons particular to an individual field. It is estimated that 33 FPSOs are nearing the end of their life and many of those are destined for scrap. This situation has a profound impact on P&I risk exposure. As FPSOs near their demise, the capital expenditure, injected by oil companies and contractors, and required for maintenance and upkeep, reduces. This inevitably results in an enhanced risk, especially with regards to the likelihood of a costly oil pollution and/or wreck removal incident. The club counters this risk through a rigorous survey programme designed to act as a second pair of eyes to highlight problems, such as structural deficiencies or a drop in operating standards, so that they can be rectified before resulting in a casualty and therefore cost for both member and club. Proactively gauging and managing operational risk is central to the club's philosophy.

In conclusion, the role of the FPSO or FLNG in the APAC region will be integral to offshore production solutions for the foreseeable future, and with careful safety and loss management and an intelligent survey programme, the liability exposures for such units can be controlled. For those seeking insurance for such units, the Standard Club can provide P&I cover up to a limit of \$1bn. In total, the club insures 57 FPSOs, of which two are jack-ups units and seven are tankers under conversion. In terms of market share, this represents 30% of the global fleet. To get a comprehensive idea of the full cover provided, the Standard Offshore Rules (SOR) can be found on the [website](#).

Definition of a ship – applicability of CLC 1992 and Fund Convention 1992 and 1976 LLMC to FPSO and FSU



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This article examines the ability of a FPSO and a floating storage unit (FSU) to limit liability in a pollution situation under the Civil Liability Convention 1992 (CLC 1992), the International Convention on the Establishment of an International Fund for Oil Pollution 1992 (the Fund Convention 1992) and the Convention on Limitation of Liability for Maritime Claims 1976 (1976 LLMC), as amended by the 1996 Protocol.

There is no existing international regime, which can expressly, and with certainty, respond to pollution from these offshore units. The need to consider such an initiative had been tabled by the Indonesian Government at the IMO following the *Montara* oil spill offshore Australia. However, the most recent discussions at the IMO in April 2012 concluded that for national sovereignty reasons, pollution from offshore units were more appropriately dealt with by bilateral, multilateral or regional agreements, and that the IMO would commence work to provide guidelines for such agreements.

In the absence of an international regime, do the existing CLC 1992 and Fund Convention 1992 or the 1976 LLMC, which are for the benefit of the maritime community, extend to these offshore units when they operate off the coasts of signatory states? There is no clear legal guidance in the interpretations of these conventions. FPSOs and FSUs are increasingly being used in the offshore oil and gas industry and may pose a danger of oil pollution. Should these units be treated like tankers and also benefit from the limitation provisions in these conventions? The definitions of ship within the respective conventions governs these units' right to limit.



FPSO

FPSOs process hydrocarbons received from the seabed and the resultant oil or gas is stored until it can be offloaded onto an offtake tanker or transported through a pipeline to a terminal. FPSOs can be converted tankers or can be purpose-built, and their shapes can vary from being ship-shaped, to box-shaped barges with varying dimensions. As technology advances, so too do the design and capabilities of these units. They can be designed for the life of the field in which they are located. Some of them are designed to disconnect from their risers to avoid adverse weather conditions and a few are designed for grazing marginal fields and transporting the oil to refineries. However, once they are moored, they are considered to be permanently or semi-permanently attached to the seabed, albeit floating.

FSUs are usually converted tankers that store oil received from a producing platform or FPSO, or are connected directly to a live well.

CLC 1992 and the Fund Convention 1992:

These two IMO conventions complement each other and provide for strict liability (save for very limited defences) and compulsory insurance for shipowners in respect of oil pollution damage. They allow victims of pollution direct access to a shipowner's insurer, but in return, the shipowner is allowed to limit his liability. The CLC 1992 is the first tier of funding and this is provided by the shipowners via their P&I clubs or similar insurers. At present, 125 member states have signed up to this convention, with the notable exception of the USA (see comments below).

Presently, the maximum limit under CLC 1992 is SDR89.77m or about \$136m. A second tier of funding is provided by the Fund Convention 1992 ratified by 105 member states with levies from oil companies or recipients of oil, and is limited to SDR203m or about \$307.5m (there is a further third tier known as the supplementary fund, with only 26 member states signed). The combined limits of the first two tiers practically guarantees a fund of some \$443.5m, which is of great comfort to victims of pollution damage as well as shipowners that are able to limit their liabilities.

The preamble makes it clear that the purpose of the CLC 1992 is to respond to the "*dangers of pollution posed by worldwide maritime carriage of oil in bulk*" to ensure adequate compensation is available to victims of oil pollution from ships. A ship is defined as any seagoing vessel and seaborne craft constructed or adapted for the carriage of oil in bulk as cargo, provided the ship is capable and does actually carry oil in bulk as cargo and during any voyage.

This means that the oil has to be carried, i.e. transported during a voyage. The current definition does not capture permanent or semi-permanent units such as FPSOs or FSUs, even though these units maybe ship-shaped or function as 'stationary' tankers. It is contended that they would fall within the definition of ship when they are disconnected for operational or weather reasons, and navigating to shelter from weather conditions or for repairs/dry-docking or transiting to a terminal to discharge cargo (although some academic comment has been made that the first two scenarios may not be considered to be a voyage).

The Greek Supreme Court in the *Slops* case (case number 23/2006) held that a permanently anchored storage unit whose propeller was removed and engine was deactivated and sealed should be regarded as a ship within the meaning of the CLC 92, since it stored product in bulk and could move under tow. The unit had been in situ for some five years operating as a 'floating facility' receiving and processing waste oil, when she had a fire on board and some of her 5,000m³ oily water was spilt. This decision has been widely criticised as wrong, but the definition of ship was given a wide interpretation by the court presumably due to expediency in order to compensate the clean-up operators for costs incurred due to the insolvency of the owners of the *Slops* and the lack of liability insurance.

The Fund Convention 1992 was obliged because of this decision to pay for the costs from the ground up.

There has been recent debate within and pressure from the shipping community to extend the definition of ship to include FSUs (not connected to a live well) as it is correctly recognised that compensation to victims of oil pollution is necessary. Resistance to this widening of the definition is coming from the largest contributors to the Fund Convention 1992, including Japan and Korea, which are importers of oil with no or negligible offshore units in their waters. This debate continues and the momentum towards such a change is growing, with a Working Group being convened by the Fund Assembly at the IMO to review this issue in April 2013.

In contrast, the **US's Oil Pollution Act 1990 (OPA 90)** sets out the liability and compensation regime in the event of oil pollution and expressly applies to both ships and offshore facilities, which include FPSOs and FSUs. Such offshore facilities have an unlimited liability for clean-up costs but can separately cap their liability for all 'other damages' as a result of pollution to \$75m. There is an argument that these units could be classified as ships and thereby avail themselves of a lower limit according to their tonnage for both pollutant removal and other damages. However, in the event of a casualty, we would anticipate a narrow definition would be given in favour of victims of pollution.

1976 LLMC as amended by the 1996 Protocol:

The definition of a ship comes under more scrutiny in the 1976 LLMC and enacting national legislation. Whether a FPSO or FSU is a ship takes into consideration various factors such as its shape of the ship, its capability and frequency to navigate and the frequency thereof, and what it was doing at the time of the casualty.

The 1976 LLMC entitles a shipowner (as defined) to limit its liability for certain claims calculated according to the tonnage of the ship, with a separate calculation for property damage and higher limit for personal injury or death. The 1996 Protocol increases these limits further and following the decisions of the IMO's legal committee in April 2012 we will see the limits increase significantly (by 51%) in April 2015. The six heads of claims set out in **Article 2** include:

- injury or death and/or property damage on board or in direct connection with the operation of the ship;
- claims resulting from infringement of rights other than contractual rights occurring in direct connection with the operation of the ship; and
- claims in respect of measures taken by third parties to avert or minimise loss and further loss caused by such measures.

These heads of claims can respond to typical claims encountered in a casualty situation, including oil pollution. **Article 3** excludes claims for oil pollution that fall within the meaning of the CLC 1992. However, if these units are not ships within the meaning of the CLC 1992, they are not caught by the Article 3 exclusion.

'Ship' is defined in the 1976 LLMC as any seagoing ship and **Article 15 (5)** expressly excludes the application of the Convention to floating platforms constructed for the purpose of exploring or exploiting the natural resources of the seabed or the subsoil (referred to as offshore craft exclusion). While a seagoing ship is a ship that is used in navigation on the seas (see comments below), there is a view that a FPSO (but not a FSU) is a floating platform constructed for the purpose of exploring or exploiting the natural resources of the seabed or the subsoil and thus is caught by the Article 15 (5) offshore craft exclusion.



Mobile Offshore Production Unit

The UK's Merchant Shipping Act 1995 (MSA), which enacts the 1976 LLMC, however deletes the Article 15 (5) offshore craft exclusion. The MSA provides that the right to limit under the LLMC applies to ships. By Article 1 (2) of the 1976 LLMC, this right is limited to 'seagoing ships'. So in the UK, whether a FPSO can limit depends on whether it is a ship. The MSA further defines ship (Section 313) to "include every description of vessel used in navigation". Similarly Singapore's MSA deletes the Article 15 (5) offshore craft exclusion and further defines ship to mean "any kind of vessel used in navigation by water, however propelled or moved and includes ... an offshore industry mobile unit". As a starting point, the deletion of the Article 15(5) offshore craft exclusion looks promising for FPSOs and FSUs to be treated as ships. Are these units 'used in navigation' in order to fall within the definition of ship?

Used in navigation:

Earlier English law cases equated 'used in navigation' to transporting people and property by water (*Steedman v Schofield* 1992 2 LLR). In *Perks v Clark* (2001 2 LLR), the Court of Appeal held that a jack-up rig that was towed from one location to another for the purpose of drilling for oil was indeed a ship and concluded that so long as navigation is a significant part of the function of the unit, "the mere fact that it is incidental to some more specialised function such as dredging or provision of accommodation does not take it outside the definition". However, the court did concede that there was "an issue of the degree as to the significance of the navigation" and that this would be a question for a fact-finding tribunal. As such, the courts have moved away from the 'real work' or primary purpose test (which might have otherwise disqualified the rig from being a ship).

The English courts have concluded that it is sufficient for navigation to be part of the unit's function and indeed that the unit is capable of and used in navigation, however infrequently. As to degree of significance, this is difficult. Some FPSOs are positioned on location for the intended life of the field, or unit itself, but are arguably capable of navigating. Indeed they can be used to navigate to the field location and, once disconnected, navigated for disposal or unplanned repairs following a casualty. Such a unit does not cease to have the capability or expectation to navigate once it is in the relevant field location.

The position is simpler for FPSOs which are designed to be easily disconnectable from the risers due to weather conditions and therefore do navigate. The *Cossack Pioneer* (2005 AATA) is a case in point where the Australian Administrative Appeals Tribunal found a disconnectable FPSO to be a ship within the meaning of "a ship used in navigation by water" pursuant for the **section 6 of the Navigation Act 1912**; however, bizarrely, it may not be considered a ship under the Australian enactment of the 1976 LLMC due to the Article 15 (5) offshore craft exclusion.

To conclude, while FPSOs and FSUs are not considered to be ships within the meaning of the CLC 1992 and Fund Convention 1992, there is more scope for each unit to be considered a ship for the purpose of the 1976 LLMC, provided that in the case of a FPSO, the Article 15 (5) offshore craft exclusion is deleted. This is very much dependent upon local law. There are no definitive cases on the application of the 1976 LLMC to these units and this article points out the difficulties that arise in seeking to analyse whether the LLMC is capable of applying to them. In the final analysis, it will depend upon the courts around the world to give meaning to the definition of ship, inviting an inconsistent approach and highlighting the need for an international standard.

Fronting/local content requirements



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Local content requirements are an increasingly popular government policy in jurisdictions where oil and gas exploration and production is still a developing industry. Such a policy is aimed at balancing a desire for foreign investment whilst advancing local knowledge and skills.

Operators from more developed jurisdictions clearly seek opportunities in unexplored fields, whilst the exploration potential of developing countries is often used to attract investment in local people, services and infrastructure.

The challenges for offshore operators include not only to keep abreast of often rapidly changing requirements, but to ensure that they remain compliant with local laws without reducing their operational standards, either by employing crew that perhaps lack knowledge or experience, or by being obliged to employ service providers that are unfamiliar with ever more sophisticated operations.

One of the requirements that is often faced by our members is that their insurance cover must be 'fronted' locally at additional cost. This is a requirement whereby insurance for certain classes of business must be insured by a locally registered insurance company which will be reinsured, either in whole or in part, by a non-domestic insurer.

The initial questions that need to be answered relate to the scope of the local fronting obligations – this will include asking 'what is the scope of the activities is that would fall to be included under the relevant local statute?'. For example, would it include fixed platforms only, or does it extend to floating production systems? What about floating storage or offtake tankers, or support ships such as supply boats or AHTS. Also important is the jurisdictional reach of the relevant local statute – for example, does it apply to risks in the territorial waters or the exclusive economic zone of a particular jurisdiction?

We have had recent experience in the Standard Offshore team of arranging compulsory insurance fronting in a number of jurisdictions, including:

- Turkmenistan
- Mexico
- Kazakhstan
- Azerbaijan
- Vietnam
- Angola

In addition to this, Nigeria has been expanding its local fronting requirements recently, and we are investigating the extent to which recent legislation demands that P&I cover is fronted through a local insurance company. We will keep our member advised of these developments.

If there is an underlying poolable entry with the club, we are only able to front poolable cover and limits by using an entity that has been pre-approved by the International Group (known as a 'grandfathered' entity). If there is no such pre-approved entity, it may be that a fixed limit cover is required, which will usually be placed to limits defined under the operating contract of a particular ship or offshore unit.

If the unit is not poolable (such as drilling or productions risks) we are not bound by the constraints of the International Group pooling agreement and can arrange a number of fronting solutions, albeit to a fixed limit, up to a maximum of \$1bn.

Where we are fronting cover with a fixed limit on a non-poolable basis, we would typically front the minimum limits required under contract in order to save the member costs in respect of local insurance taxes and fronting fees. The underlying club entry would sit behind the fronted insurance so that the member retains the limits of cover that they would usually have direct with the club.

It is unusual, but not unheard of, for the local insurer to retain some of the risk. Typically, we would seek to persuade the local insurers that they are not capable of retaining any of the liability themselves given that they are fronting P&I cover, with unlimited reinstatements of an approximate \$6.9bn limit in the case of poolable cover, or up to a \$1bn limit under the **Standard Offshore Rules**. This is usually sufficient for them to seek 100% reinsurance from the club.

Whether or not there had been some level of retention by the local insurer, we would consider ourselves to remain the primary ground-up insurer for the P&I risks arising out of the ship or unit and that the local fronting requirements really represent an operational cost for the member.

Where we arrange fronting, this is usually evidenced by including a clause in the certificate of entry noting the 'original insured' and the 're-insured' entities, and by signing a slip prepared by a local broker, including agreement between the member, the club and the local insurer that there is a premium cut-through clause, so that the premium due to the club does not get caught or delayed in the local jurisdiction, and a clear claims control clause making it unequivocal that the handling of a claim is to rest with the club.

Should you have any queries regarding fronting requirements or the impact that our local content requirements have on club cover, please speak to your usual contact at the club, who will be more than happy to help.

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**Charles
Taylor**