Insight Article

The interface between hull and machinery insurance and P&I from the P&I claims handler's perspective

Gard News has a look at the cover for collision liability and liability for contact damage to third party property under the most common standard hull terms and the P&I Rules, and considers how the two types of cover interact in practice.

P&I insurance is primarily intended to cover a shipowner or operator's liability to others and it generally excludes damage to the insured's own property.1 Hull and machinery is basically insurance for the client's ship as its primary asset. Where the two types of insurance interact is in the area of collision liability and liability for contact damage to third party property.

Is it necessary for those handling P&I claims to understand the basics of hull and machinery terms? For those handling liability for property claims, the answer is a definite "yes". Hull and machinery and P&I are often complementary when it comes to collision liability and liability for damage to piers, loading cranes and other third party property. As a matter of fact, the first need of protection insurance (the "P" in P&I) arose because hull underwriters in the mid-1800s were not prepared to cover more than three-fourths of shipowners' collision liability. Mutual insurance associations of shipowners evolved to protect each other in respect of losses arising out of bearing one-fourth liability as self-insurance.

Published 06 October 2009

Liability arising out of Collision or Striking

Collision liability means the liability of the insured to third parties who sustain injury, damage or loss as a result of the collision of the insured vessel with another vessel. Such third parties can be the owner of the other vessel involved in the collision, owners of cargo on board the other vessel, persons on board the other vessel who may sustain injury, or other parties affected by the consequences of the collision, e.g., by the escape of bunker oil from the other vessel.

All standard hull conditions cover collision liability, but English terms cover only three-fourths. Hence, under English conditions it is envisaged that the assured will place insurance for the remaining one-fourth liability elsewhere – typically added to the P&I insurance. Such addition must be explicit in the P&I terms of entry.

Under the Norwegian Marine Insurance Plan, a shipowner may insure his full (four-fourths) collision liability with the hull underwriter, but even in such a case there are certain liabilities arising out of a collision that would not be covered, e.g., liability in respect of death or personal injury sustained by persons on the other vessel, or liability for pollution arising out of a spill from the other vessel. 2

A limitation that applies to all standard hull conditions is that the owner is insured for collision liability up to the insured value of the vessel, but no further. In certain circumstances, the collision liability may exceed that insured value, in which case the P&I insurance will respond. This is the so-called “excess collision liability cover”.

Another intriguing aspect is that there are variations in the standard hull conditions in different markets on the extent and type of collision liability cover. One example: if the other vessel sinks as a result of the collision and a wreck removal is ordered by the authorities – would the hull cover respond to the collision liability proportion of the wreck removal costs? The answer will differ across conditions and markets, 3 and since the P&I insurance will respond to the liability that falls outside the hull insurance, the P&I underwriter must obtain information as soon as possible in order to properly assess the exposure and protect his interests.

1. Rule 63 of Assuranceforeningen Gard’s 2005 Rules for Ships excludes damage to the ship or any part thereof unless it forms part of a claim for confiscation under Rule 49. Rule 50, however, allows recovery where the member is the owner of the damaged property and would have been liable had the property been owned by a third party.
2. Liability for the cost of cleaning the other ship oiled in a collision, however, is covered by hull insurance to the same extent hull insurance covers collision liability.
3. For example, Norwegian and German hull conditions include removal of the wreck of the other vessel as a collision liability. English and Swedish conditions do not.

Some shipowners have placed full (four-fourths) collision liability under their P&I insurance. This collision liability cover would be the most comprehensive liability cover, because all third party liability arising out of the collision would in principle be covered without restrictions or monetary limitations. However, the shipowner would still need his hull and machinery insurance to deal with the loss of or damage to his own vessel.

Standard hull and machinery conditions also provide cover in respect of liability arising out of the striking by the insured ship of third party property other than a ship. The insurance covers the risk of loss or damage caused by physical contact between the hull or the insured vessel (or equipment permanently affixed to the vessel) and third party property, for example a pier or buoy. Americans sometimes refer to such incidents as "allision" but this is not a universal term. FFO (damage to fixed and floating objects) is the shorthand for striking damage under the English terms.

Whereas collision liability is sometimes apportioned three-fourths/one-fourth between hull and P&I, the FFO liability risk is very rarely split in this way. Standard English hull conditions exclude the FFO liability risk, which the shipowner would then add to the P&I insurance. Under Norwegian conditions, the FFO liability risk is usually placed under the hull insurance. The same goes for German conditions, which also provide cover for damage to third party property caused by the movement of the insured vessel even absent any physical contact – e.g., property damage caused by a wave created by the insured vessel passing at excessive speed.

Again, the cornerstone of the P&I insurance is that it responds to liabilities that are *not* covered under the hull insurance. Hence, the P&I insurance would cover "wave damage" liability when the ship is insured on English hull conditions.

There are also variations in standard hull conditions across markets as to the scope of cover for liabilities not caused by collision or striking as defined above. Examples are property damage caused by the use of the ship's equipment in the course of operations, for instance the dragging of a sub-sea fibre cable by the ship's anchor or the damage to terminal equipment by the ship's crane. Again, the P&I insurance will respond to liabilities that fall outside the terms of the hull insurance.

Summary of conditions for collision and FFO cover under main hull and machinery terms available

English – ITC Hull 834	German – D.T.V.5	Norwegian Marine Insurance Plan (and other Scandinavian hull terms)
Running Down Clause (RDC): Three-fourths to be covered by hull and machinery terms, one-fourth to be covered by P&I. Fixed and Floating Objects (FFO): Four-fourths to be covered by P&I	Collision (RDC) and striking (FFO) covered by hull and machinery terms plus liability for damage caused by movements of the vessel or navigational measures including wave damage.	Collision (RDC) and striking (FFO) covered by hull and machinery terms.

Comparison of conditions

It is beyond the scope of this article to set out all the variations in standard hull conditions around the world, but some of the more important differences between English, German and Norwegian conditions are tabled below.

P&I cover for collision, striking and other property damage

The P&I insurance is designed as a named risk cover, where only risks that are positively mentioned in the terms of entry and the Club's Rules will be covered. The member is covered for the risks specified in Parts II, III and IV of the Rules as are agreed between the member and the Association. P&I cover for collision, striking and damage to property begins only where standard hull terms leave off. This is made explicit in Rule 71. 6

Rules 36, Collision with other ships, 7 and 37, Damage to fixed or floating objects, 8 cover the liability not covered by the hull insurance. Further, Rule 39, Loss or damage to property, 9 will pick up liability for property damage that is not customarily covered by standard hull terms. For example, liability for damage to third party property caused by the ship's use of equipment is not covered by standard hull terms. Thus, damage to the dock caused by the ship's cargo gear while engaged in cargo operations would be a P&I liability. Because standard hull conditions differ, and because P&I is designed to pick up liability only where standard hull terms leave off, the P&I claims handler must know the facts of the incident and the terms of the hull policy before deciding whether the particular property claim falls within the P&I cover.

1. The Institute Time Clauses, Hulls, 1.10.83 (ITCH 83) remain the most widely-used version of English conditions. Under their latest version (International Hull Clauses 2003) four-fourths RDC and FFO are optional.
2. Deutschen Transportversicherungs Verband; DTV Hull Clauses 1978, revised in 1982, 1984,1992 and 1994.
3. “Rule 71 Other insurance The Association shall not cover: Liabilities, losses, costs or expenses which are covered by the Hull Policies or would have been covered by the Hull Policies had the Ship been fully insured on standard terms (...)”.
4. “Rule 36 Collision with other ships The Association shall cover liability to pay damages to any other person incurred as a result of a collision with another ship, if and to the extent that such liability is not covered under the Hull policies on the Ship, including: – one fourth of the liability incurred by the member; or – four fourths of such liability; or – such other fraction of such liability as may be applicable and have been agreed with the Association (...)”.
5. “Rule 37 Damage to fixed or floating objects The Association shall cover: (a) liability for loss or damage to any fixed or floating object by reason of contact between the Ship and such object, when not covered under the Hull Policies (...)”.
6. “Rule 39 Loss or damage to property The Association shall cover liability for loss of or damage to property not specified elsewhere in Part II of these Rules.”

Claims handling considerations

What considerations drive a shipowner to place collision and striking (FFO) risks with either hull and machinery or P&I? A vital factor will always be price, but there are other important factors as well. From a claims handling standpoint, there are certain benefits of placing the full collision and FFO liabilities with one insurer that ought not to be overlooked.

In a serious collision or FFO incident, the interplay between the shipowner and affected underwriters is of vital importance. Several aspects must be considered and co-ordinated at an early stage. One such aspect is security for claims to third parties in order to prevent the arrest of the insured ship. Such an arrest may cause material losses as it will delay the inspection and repair of the ship, which may increase the exposure for the hull and loss of hire underwriters. Hence, there will usually be some pressure on the underwriters to provide security. The more “patchy” the conditions of cover, the more difficult this is likely to be.

Sometimes the P&I underwriter is requested to provide a P&I Club letter of undertaking (LOU) to cover liability that should properly fall on the hull underwriters, e.g., in a collision case where the hull underwriters cover three-fourths of the liability. One reason is that an LOU from an International Group Club is more often accepted than letters of undertaking from the hull underwriters, and can be arranged more quickly and with less cost. Gard's policy in these circumstances is that a P&I Club LOU can be "injected" as security for liabilities covered by the hull underwriters if Gard Marine has claims lead on the hull policy. Gard P&I will do so against a letter of counter-security from Gard Marine covering all hull underwriters. No bail fee will be charged by Gard P&I from Gard Marine in such a case, but Gard Marine will require adequate counter-security from each of the other hull underwriters for their respective shares of the potential liability and charge a bail fee from each of them.

If, on the other hand, the hull insurance is placed elsewhere, Gard P&I may be prepared to issue an LOU as security for any liability cover by hull, but only against adequate counter-security from *one* provider (lead hull, bank or other financial institution) with an acceptable credit rating. The collection of a multitude of counter-securities from various underwriters who participate on the hull "slip" in sometimes very different markets – all of which are subject to varying credit ratings and enforceability terms – is not attractive for Gard when attempting to assist a shipowner member in need.

In such cases, Gard P&I will charge a bail fee of one per cent of the security amount. An additional bail fee of one per cent per annum will start to accrue if the Gard LOU is pending one year after it was issued.

Conclusions

Effective claims handling in high value property cases rests on the ability of the claims handler to understand how the facts of the incident may interplay with different hull conditions. In essence, where should a loss fall at the end of the day? When the interplay between hull terms and P&I is determined early, there will be more effective decision-making regarding the roles of the various insurers. Before deciding on placing the RDC and FFO risks with a particular hull underwriter, owners should consider the service aspects that come with the insurance; i.e., what will be the likely response to the incident from the underwriters involved when the need for assistance arises? There is more to this equation than the insurance compensation at the end of the day. Immediate, attentive and specialised casualty handling that is well co-ordinated under insurance arrangements that are seamlessly aligned will save money. Gard P&I and Gard Marine are both in the position of being able to provide the full range of insurance and service that shipowners need to sleep easy when it comes to collision and FFO risks.

Any comments to this article can be e-mailed to the Gard News Editor .

Gard News is published quarterly by Gard AS, Arendal, Norway.