New Insurance for Newbuildings

The Swedish Club is one of very few marine insurance companies that offer a range of products broad enough to cover most of the needs of shipowners.

We will soon complement the products we have by adding an insurance that specifically targets the needs of shipowners with newbuildings on order. Our first contact with owners has traditionally been when they have started to look for suppliers of H&M, P&I and FD&D insurances. We do in some cases cover FD&D for newbuildings and for the crew whilst travelling to and from the shipyard just prior to delivery.

We feel that owners need to start looking at their insurable interests long before delivery, as there are risks relating to the newbuilding that could affect owners adversely. Only a few owners currently do this.

Our Newbuilding Risks Insurance is one product and it encompasses three areas:

1. Cover for liabilities in respect of superintendents and other shipowners’ personnel attending newbuildings.

This insurance includes liabilities under the terms of the employment contract to pay damages or compensation for personal injury, illness or death of the superintendent whilst attending the NB site or travelling to and from the site.

- Hospital, medical, repatriation, funeral or other expenses necessarily incurred in relation to the superintendent whilst attending the NB site.
- Legal liabilities, whether statutory or framed in tort, as well as approved contractual liabilities and legal and other costs incurred to protect or defend against recoverable liabilities.
- Cover for personal injury liabilities and liabilities to third parties due to the acts of superintendents/personnel.
- The limit of the cover is USD 6 million for each accident or occurrence.
- Deductible USD 5,000.

2. Cover for the financial loss a shipowner will have if the vessel on order is not delivered or is delayed

This cover can be tailor-made to encompass only non-delivery or to include different aspects of physical damage and/or other events resulting in a delay of the delivery of the vessel.

- Bankruptcy of the shipyard can also be covered, as can political risks.
- The value of a vessel might have risen during the time between signing the contract and the actual delivery. If the vessel is lost prior to delivery, owners will only receive their down-payments back. Any increase in the price of newbuildings or in freight rates is not insured. If a vessel is built on the back of a charter contract, the charterers will be able to cancel the contract and the owner will lose out on the revenue generated by the contract. The cost of acquiring similar tonnage will in most instances, mean additional costs for shipowners. The same principle applies for linear operators, as lead times of acquiring similar tonnage will in most instances, mean additional costs for shipowners. The same principle applies for linear operators, as lead times of acquiring similar tonnage will in most instances, mean additional costs for shipowners.
- Limit of cover – between USD 500,000 and USD 5 million, but can be higher and can be variable.
- The cover can be extended to include physical damage to the vessel, delayed delivery and insurance of refund guarantees.
- There will be limited capacity for this product as the risk for a total loss is considerable in certain areas of the world, due to the risk of earthquakes and severe weather. This means that we will have to limit the number of risks written in a certain yard, area or region. Once the limit has been reached, we may have to decline cover or revise premiums to properly reflect the aggregation of risk.

3. Cover for legal disputes relating to the newbuilding contract.

This is a traditional FD&D cover for newbuilding disputes.

The P&I cover

The key word in P&I insurance, “liabilities”, denotes legal liabilities, i.e. liabilities that follow from shipowners’ undertakings under contracts or liabilities that follow from applicable mandatory law. The point of departure for any P&I risk is furthermore that the shipowner is covered in respect of liabilities incurred by him in his capacity as owner, operator or charterer of the entered ship; as opposed to being a shipowners’ general liability cover.

As regards liabilities in respect of persons, the P&I insurance accordingly covers legal liabilities that arise as a direct consequence of the operation of the entered ship. Consequently, liabilities in respect of persons during newbuildings are excluded from P&I cover.

Shipowners, however, often provide crew for a new ship prior to taking over the ownership (during building or when taking delivery of the ship) and the crew then normally signs on under the terms of the crew contract, under which the shipowner is liable. What is more, liabilities towards other personnel attending at the building site, superintendents, are also excluded from P&I cover. This is also the case for liabilities to third parties, such as the yard, that are incurred by the
Traditionally, cover has been available from the insurance market for:

1. The consequences of physical damage to the vessel under construction or to the shipyard or subcontractors’ facilities. The indemnity payable in event of loss would be loss of future charter hire or profit, or increased cost of replacement.

2. Loss of stage payments paid into the shipyard as a result of a failure to honour a bank guarantee following cancellation of the shipbuilding contract.

Recent developments both in the shipping and shipbuilding industries and in the insurance market, have made this whole subject more interesting.

Industry Developments

Shipyard order books in most of the major shipbuilding nations are full until 2009 or beyond. Slots for newbuildings in shipyards have become an increasingly valuable commodity that can be traded in their own right. Newbuilding values and contract prices have increased steeply.

Shipowners with ships on order for delivery in the next two or three years should ask themselves the following questions:

- What will my newbuilding be worth at current prices on delivery, either to me or to another owner?
- Is the shipyard required to deliver a replacement vessel if the cause of non-delivery is force majeure?
- Could the delivery of my vessel, or series of vessels, be affected by an event that occurs even before the keel is laid for my first vessel?
- What would be the consequences if the newbuilding is not delivered as specified in the terms of the building contract?
  - Charter cancellation
  - Loss of profit on anticipated sale
  - Loss of “embedded value”/overvalue in current contract
  - Increased cost of replacement for the vessel
  - Loss of “non–contractual expenditure”, such as legal expenditure

The Club may, as a service to future P&I and FD&D members, insure the newbuilding contract against FD&D risks. This FD&D cover is provided on an ad hoc basis and is subject to special conditions and entails that the member will enjoy legal support as well as cover for legal costs in case there will be a dispute under that contract. The member will be greatly assisted, when assessing the risks of the newbuilding process, to know that he has access to legal expertise in the event of a dispute. In addition, the cover enables the Club and the member to develop an early business relationship.

The newbuilding contract is in essence a sales contract between a yard, (the builder) and a buyer. One fundamental question under this contract is at what point of time title is passed. Usually, title (and risk) in the construction remains with the builder until delivery, but occasionally does the contract provide that title is passed to the buyer after the first instalment has been paid. In all circumstances, the buyer is required to pay huge sums in advance, and the buyer will clearly be concerned about the extent to which his assets are protected in the event that the vessel is not delivered. The Club would like to take this opportunity to address two questions that are frequently raised.

1. What are the buyer’s rights to damages in the event of non-delivery due to total loss of a ship during the construction process?

Where there is a total loss during the construction this will most likely mean a complete end, frustration, to the newbuilding contract and the contract itself is likely to provide for the mechanism by which it is to be terminated and what the implications are. Under most contracts, the buyer will then be entitled to have all the instalments repaid to him. However, repaying the instalments will usually be the limit of the builder’s liability and if so a buyer can obtain additional insurance to get protection against the effects of non-delivery. In the absence of contractual provisions, the result under English common law is the same in that the newbuilding contract becomes frus-
Cover for liabilities in respect of superintendents and other shipowners’ personnel attending at newbuildings

Continued from page 22

shipowner through these persons.

Additional cover requested

This is, therefore, an area where additional cover is often requested. The Swedish Club offers, as do most of the other Group clubs, what is known as “Pre-Delivery Crew Cover”, which extends the P&I cover towards crew for a period prior to the delivery of the ship. The Swedish Club also offers “Crew Familiarisation Cover”, which is an additional cover for liabilities arising from the presence of crew and other shipowners’ personnel onboard, i.e. liabilities towards third parties, on ships for which the member has not yet taken over the ownership. The observant reader will now have noted that liabilities towards other shipowners’ personnel, i.e. other than the crew, are not covered under either of these extra or additional covers.

New Swedish Club insurance product

Owing to an increasing demand and in order to avoid potential gaps such as the one just identified, The Swedish Club has developed a new product to provide cover for liabilities towards and in respect of third party liabilities incurred by the shipowner through superintendents and other personnel instructed to supervise a newbuilding at the yard. The article “New Insurance for Newbuildings” in this newsletter gives further details and describes how the product is designed to be combined with Newbuilding FD&D and the Builder’s Financial Risk cover. The cover can of course also be underwritten separately.

The cover in respect of persons is modelled as an additional P&I cover and thus it provides the additional cover that is needed, while remaining a practical and logical solution to the demand. This means that liabilities in respect of superintendents and other personnel attending a newbuilding are covered to the same extent as the crew are under ordinary P&I insurance, with a limit of USD 6 million for each accident or occurrence.

The risk assessment, the claims handling and the understanding of the risk are very similar to those of the ordinary P&I cover, which we consider to be a major advantage. And, since the P&I insurance is an insurance of liabilities, it follows that there is no need for enumeration and the cover is therefore consistent. We believe that this cover will serve our members well in preventing gaps between different types of insurance and in providing a coherent solution.

Further information can be provided by our underwriters on request.

Cover for the financial loss a shipowner will have if the vessel on order is not delivered or is delayed

Continued from page 23

penses, financing expenses, corporate establishment expenses, superintendency costs.

Insurance Market Developments

The insurance market has become more flexible, and adapts to the needs of its clients. We will focus here on a few of the areas that prospective owners may not have considered, or that they may have considered to be unavailable:

1. Insurance for physical damage coverage is traditionally purchased for the latter stages of the construction of the vessel. The values now and the values that are potentially at risk in shipbuilding contracts have led many shipowners to consider purchasing more comprehensive cover, both in terms of conditions and period.

   Destruction of a shipyard today by an earthquake or hurricane, for example, may result in the non-delivery of the buyer’s vessel contractually due in three year’s time. The financial loss sustained will be no less painful simply because it was caused by an event that occurred two years before the keel was due to be laid. Consideration should be given to purchase of cover at the point when the exposure is identified, not when the physical asset becomes visible!

2. Non-delivery may not be caused by physical perils. Many people can remember the disruption to shipbuilding contracts caused by the break up of the former Yugoslavia in the late 1980s, and by the subsequent problems in the Russian economy. These two factors resulted in a number of contracted vessels remaining undelivered. More recently, the financial problems of some Polish shipyards have resulted in contractual defaults.

   It has traditionally been possible to purchase coverage from the insurance market only for the loss caused by the non-honouring of the state or national bank refund guarantees that support the shipyard’s responsibility to repay stage payments when a contract is cancelled. New developments in the market now mean that it is possible to extend this type of policy in a tailored manner to cover also the overvalue and/or “non-contractual expenditure” caused by such an event. It is thus possible to come close to locking in potential profits or avoiding the potential of unrecoverable losses.

3. It may also be possible to insure refund guarantees that are provided by private banks, as the availability of effective credit insurance is much improved.

4. Alternatively, if the credit rating of the counterpart makes the inclusion of credit risks impossible or unrealistically priced, coverage may be bought to indemnify losses resulting from contract cancellation caused by specified force majeure perils. These will commonly include most of the catastrophic perils that may have a dramatic and wide-ranging effect on the shipyard’s ability to deliver, such as war, embargo, epidemics, destruction of infrastructure, etc.

The Swedish Club is well-placed to assist members with any of the risks described in this article, either through its own internal capacity and facilities, or through our excellent connections with other specialist markets.
Newbuilding contracts from a FD&D perspective

continued from page 23

trated. However, whether or not instalments should be repaid will be subject to the Court’s decision to allow the builder to retain expenses incurred.

In the event the contract is not terminated immediately but instead continues to run beyond the agreed delivery date, the buyer will usually be entitled to liquidated damages, which is a pre-estimation of the buyer’s losses. The usual standard form newbuilding contract will entitle the buyer liquidated damages up to a certain number of days, after which he will have the right to terminate the contract. If the buyer exercises that right, he will normally lose his entitlement to liquidated damages that have accrued, and instead he will get a refund of the pre-delivery instalments that he has paid up to the date of termination. However, force majeure and other special circumstances can permit the delivery date in the contract to be extended and in that case the builder will not be liable to pay liquidated damages.

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If the total loss is due to negligence or a breach of contract by the builder and if the contract does not limit the buyer’s compensation to repayment of the instalments (or liquidated damages), the buyer may be entitled to sue the builder for damages corresponding to the buyer’s actual losses that were reasonably foreseeable at the time of the contract. Presumably, these would include additional costs (if any) of having the yard or another yard build the same ship e.g. if the cost has gone up and the loss in the rate of hire that the buyer might have charged for the use of the ship in the market.

2. How does a buyer secure pre-delivery instalments that are paid to builder?

The pre-delivery instalments that the buyer pays to the builder during the construction process are normally secured by a “refund guarantee”, which is an undertaking from a bank or other security provider that it will make the payment on the builder’s behalf if the builder should fail to do so. This guarantee often includes accrued interest. The buyer should seek to obtain an “on-demand” guarantee, since he will otherwise need an arbitration award or court judgement in order to invoke the guarantee.

Standard contract forms do not normally contain provisions that require the builder to provide a refund guarantee, and it is therefore often necessary to insert this as an addendum.

The Götheborg arrives in Guangzhou

The Götheborg has finally arrived at her destination – Guangzhou. On July 18th 2006 a crowd of over 3000 people were waiting on the passenger pier in Guangzhou to welcome and celebrate the arrival of the ship. The masts of the ship first appeared over the horizon at about 11.00 am. On board were their Majesties, the King and Queen of Sweden and other dignitaries. The ship sounded eight cannon shots and the arrival was celebrated by people dancing, singing and applauding, amid scenes of great jubilation.

The ship did not berth at the terminal from which the sailing ship The Götheborg departed 264 years ago, because the configuration of the Pearl River bank has undergone changes and the old terminal area is no longer navigable. Götheborg has been at sea for over nine months, calling at eight ports in Europe, South America, South Africa and Australia en route. She departed from her home port of Göteborg, Sweden, where The Swedish Club is located, on October 2nd 2005.

The City Government and Guangdong Provincial Government staged a number of grand welcome ceremonies and celebrations during the week. These included a welcome ceremony on the ship’s arrival at Guangzhou; a dinner party for their Majesties, the King and Queen; a dinner banquet for the sailing ship Götheborg attended by 800 people including their Majesties, the King and Queen; an open-air concert at night on the bank of the Pearl River by the ship, etc. The city maintained a festival atmosphere for the entire week.

The ship remained in Guangzhou for a month. She was open for public visits, but the number of visitors per day was limited to 5000. Tickets sold out quickly.

Just as shipowners are increasingly trading with China, so too The Swedish Club has been very successful in recent years in attracting new business from China. The visit of the Götheborg served as a reminder to the people of China of a long-established trade relationship that has always been mutually beneficial to both countries.