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P&I Club Defence Cover: A Comparative Evaluation

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Introduction

Given the volume of maritime disputes, legal costs can quickly become significant for shipowners. The purchase of freight, demurrage, and defence (FD&D) cover can make the rebuttal or pursuit of a claim far less onerous.[1] The provision of general advice and assistance — how to proceed with the dispute, which lawyers/experts to appoint, and an assessment of the chances of success — can be particularly valuable.

Level of service and policy terms should be an important consideration when deciding whether to purchase FD&D cover — and where from.

With one exception, all International Group (IG) protection and indemnity (P&I) clubs offer their members FD&D cover. They intend the class of business to be profitable over a number of years, although it is not necessarily designed to generate large premium income. (The exception is the UK Club, where cover is instead provided by its cousin, the UK Defence Club — UKDC — which will accept entries from any suitable owner or charterer, irrespective of where their P&I cover is placed.[2])

Most IG clubs prefer not to offer standalone FD&D cover, but will do so in certain circumstances, usually for marketing reasons, where the club hopes it will lead to a P&I entry.

In practice, therefore, shipowners and charterers wanting FD&D cover have very little choice where to place their business.

IG clubs' FD&D facilities purchase no common reinsurance (there is no pool), and are not constrained by quotation restrictions (as found in the International Group Agreement). As a result, FD&D policies' terms, limits, and cost can vary — and often do, quite significantly.

[1] Some clubs, such as Britannia, Steamship, London, and North still use the old title for this class of cover, "Freight, Demurrage, and Defence," while most simply refer to it as "Defence" cover. SOP has opted for the more individual (and accurate) "Legal Costs Cover" — after all, it not just covers defense but also intends to cover attack costs. For the purposes of this paper, we use the British spelling for "Defence" as it is most commonly used by the P&I clubs.

[2] The UKDC's board of directors and its funds are totally separate from the UK Club, though it shares the same management company and there is a considerable amount of cross-marketing.

When deciding whether to take FD&D cover and, if so, whether to consider one of the limited number of options available, shipowners and charterers should take account of the following factors:

1/ The importance of FD&D to each club in terms of service levels (dedicated FD&D staff, publications, and so on).

2/ Available limits, deductible structure, and flexibility.

3/ Extent of discretion granted to the managers.

4/ Differences in policy style (narrow terms or an "all risks" approach).

5/ Potential impact of individual club exclusions (for example, disputes involving crew members or claims under management agreements).

6/ Support available for matters affecting their interests.

Relative Size

In terms of size of FD&D income in 2019/20, the market leaders appear to be UKDC, North, and Gard. Several clubs' financial statements did not show their FD&D premium separately from their P&I premium. Of the clubs that did, North had a total gross premium income of approximately US$20 million, making Britannia's FD&D income look low at just US$7.4 million. The London Club, with the highest ratio to P&I (see Figure 1), had about US$11 million.

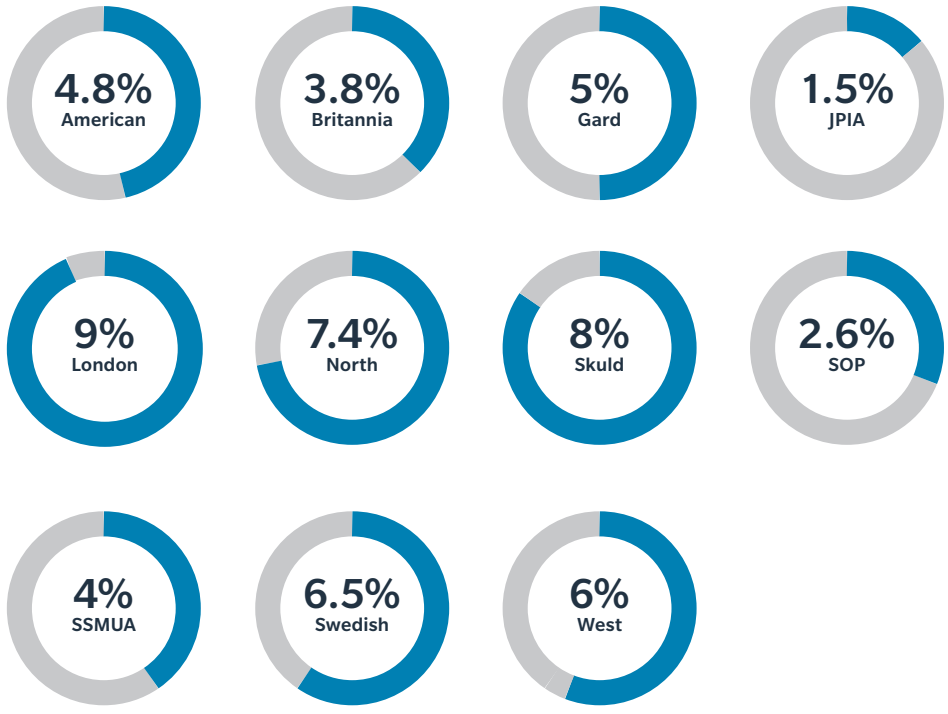
The UKDC advised that approximately 30% of its membership came from clubs other than the UK Club. Its premium income was about US$21 million — just ahead of North.

Gard was one of the clubs that did not separately disclose its FD&D income, but FD&D income at 5% of its combined P&I and FD&D income (see Figure 1) indicates a figure slightly below North and UKDC.

FIGURE 1

London, Skuld, and North had the largest proportional FD&D premium income.

SOURCE: MARSH JLT SPECIALTY



(Gross FD&D premium as a percentage of each club's combined gross P&I and FD&D premium in 2019/20.)

The very low percentage of JPIA's overall premium that comes from FD&D (see Figure 1) is probably due to the nature of its membership — many Japanese owners settle disputes without recourse to third-party assistance.

Conversely, the London Club's relatively large FD&D premium income probably reflects the large proportion of its members that take FD&D cover.

Comparative Limits

There is considerable variance in available upper limits, and also the structure of a member's contribution by way of deductible (see Figure 2). Several clubs indicate a possible willingness to be flexible in the structure and limits — subject to the premium charged, of course.

Many clubs reason that members are less likely to pursue claims that have little merit, if they have to contribute significantly to the cost of pursuing a claim.

Clubs handle most claims without the need to consult lawyers — so the deductible may never come into play — but if a formal legal opinion is needed, the costs involved accrue very quickly. On that basis, UKDC's option of no deductible looks simple and attractive. Likewise, the Britannia cap at US$150,000 will be attractive where there is a large dispute, despite the member having to bear one third of the share. If the entry was instead placed in Gard, the member's contribution would be less (25%), but there is no cap.

FIGURE 2

Levels of cover and applicable deductibles can vary significantly between clubs.

SOURCE: MARSH JLT SPECIALTY

	Limit on cover (per claim) in US$ million	Standard deductible(s) (per claim)
American	10	Typically 25% subject to a minimum deductible of US$5,000.
Britannia	10[3]	No deductible for first US$7,500; thereafter one third up to a cap of US$150,000.
Gard	10[4]	Minimum deductible of US$5,000 and 25% of all costs thereafter.
JPIA	13.9[5]	Deductible of US$1,000 and thereafter one third of the claim.
London	7.5[6]	25% of all costs, with a minimum and maximum to be agreed.
North	No limit[7]	25% with a minimum of US$10,000 and a maximum of US$150,000.
Skuld	5[8]	25% of total costs with a minimum of US$12,500 per dispute.
SOP	5	Deductibles are bespoke.
Standard	5[9]	25% subject to a minimum of US$10,000. No upper limit.
SSMUA	10	One third of all costs each dispute, with a minimum of US$5,000 and a maximum of US$30,000.
UKDC	15	None.
Swedish	5[10]	US$12,000 and 25% on costs above of US$250,000.
West	10[11]	Deductible of US$5,000, then 25% of all costs capped at US$50,000 (new building disputes capped at US$100,000).

[3] US$2 million limit for newbuilding and conversion disputes.

[4] US$1 million limit for newbuilding, mortgaging, alterations, and conversion disputes (rule 66, sale and purchase — S&P — exempted).

[5] JPY1,500 million.

[6] Newbuilding and conversion risks are often written with a lower limit.

[7] US$250,000 for newbuilding, S&P, conversion, and repair disputes (unless otherwise agreed).

[8] Limits up to US$10 million are possible; US$300,000 for building, conversion, alteration, purchase, mortgage, or sale.

[9] Can extend to US$10 million on a selective basis. Newbuilding contracts and so on are usually limited to between US$1 million-US$5 million.

[10] Can extend to US$10 million or even higher, if required. No cover for disputes worth less than US$7,500.

[11] Including newbuilding disputes. Higher limits up to US$15 million in the aggregate can be arranged if required.

Claims

Purchase of FD&D insurance requires a lot of trust on the part of the shipowner or charterer. It is unlike almost any other insurance a shipowner purchases: It gives the insurer almost total control over whether or not to provide the cover, and, if it does, to what extent.

All clubs have virtually the same provisions. Britannia's (rule 31) is particularly clear:

"The managers shall have the right, if they so decide, to control or direct the conduct of any claim or legal or other proceedings ... [and] require the member to settle, compromise, or otherwise dispose of such proceedings in such manner and on such terms as the managers see fit."

Most clubs also set out the considerations applied when deciding whether or not to support an insured member. For example, Gard's rule 67 makes it clear that cover may be declined where:

"(a) There is no reasonable relation between the amount in dispute and the costs that are likely to be incurred.

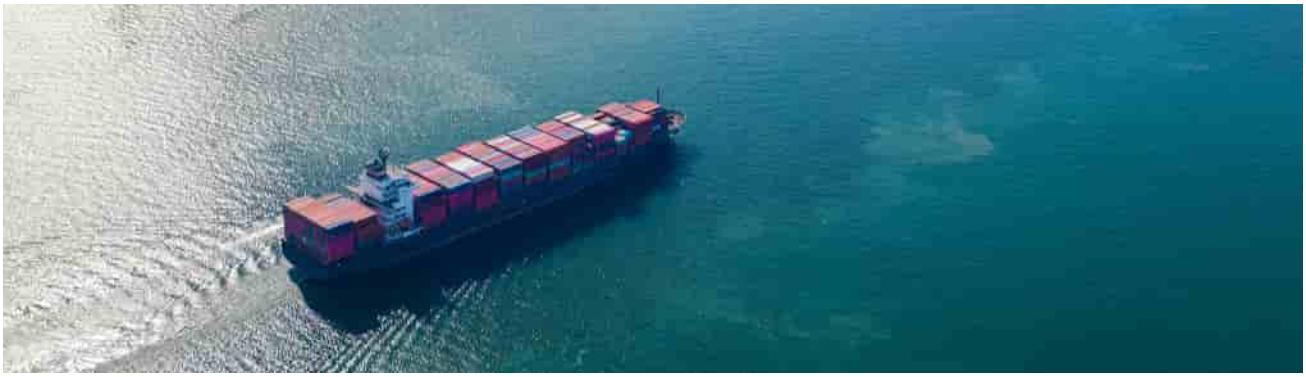
"(b) There is no reasonable relation between the prospects of succeeding in establishing a claim or of having the claim enforced or the liability averted... ."

Notwithstanding the club's need to be "reasonable" (and mindful of the fact that it is a mutual), this could be an area of potential conflict.

Shipowners might find it hard to be told that their only claim that year did not have sufficient merit to attract cover or qualify for a rebate of premium.

How important is this? There are probably relatively few disputes as to whether a claim has sufficient merit or not. Clubs trumpet the fact that a significant majority of claims are resolved without legal recourse, and some highlight their role in providing general advice.

In other words, you get a lot for your premium as long as you use the service. For many, the provision of unlimited advice on many issues, usually where no formal legal or expert opinion is required, is more than enough to justify the cost.



Matters of Policy — Contracts of Carriage

All clubs' FD&D policies are similar, but they are not the same. There can be fundamental differences in style. Britannia stands at one end of the spectrum with a separate rulebook running to 62 pages, while Standard — which also has a separate rulebook — covers everything into just seven pages, including the index.

Likewise, some clubs set out their covered risks in considerable detail. Steamship's rule 9, for example, refers to claims/disputes relating to:

"i. Freight, deadfreight, hire, despatch, demurrage, or other remuneration earned or to be earned from the employment or use of the ship or a part thereof arising under a charterparty, contract of affreightment, bill of lading, waybill, or similar contract in respect of, or by way of quantum meruit or other compensation for, such employment or use ... .

"iii. Formation, breach, non-performance, or the existence or exercise of any right under any charterparty, contract of affreightment, bill of lading, waybill, or other contract relating to the employment whether current or future, or operation of the entered ship or any duty or obligation arising in connection with such employment or obligation."

Gard, North, Skuld, and Standard take a more minimalist approach. This is Gard's rule 65:

"(a) Contracts of affreightment, charterparties, bills of lading, or other contracts of carriage ... ."

Which policy provides the broadest cover? Or do they actually say the same thing?

North's policy makes no mention of bills of lading or waybills. The club maintains that its cover is just as broad as any other facility, despite the omission, explaining that claims under bills of lading to recover freight, demurrage, or hire would be covered under its rule 19(1), (i), and (iii).

There are rare cases, however, where North accepts that cover might have to be considered under its omnibus rule. This is elaborated on in its publication, *On Your Side*.

Contracts of affreightment (COA) also deserve consideration. Skuld requires that COAs first be approved by the club ("provided [they are] agreed at the time the relevant contract is entered into"). Steamship requires that a vessel must already have been nominated in writing to perform under the COA.

Other clubs' rules are silent on the point. This issue arises when there is alleged non-performance of all, or part, of a COA and no vessel has actually performed or been nominated. There is, therefore, no "entered ship" for the purposes of cover. A club's underwriters can usually set up an entry that will respond, but that would need to be pre-agreed.

Britannia clearly lists its risks covered under rule 18, while Gard provides guidance notes to each rule, together with useful examples. The guidance notes are specifically said not to be legally binding as an interpretation, but they indicate approach very usefully.

It is arguable that how the rules are drafted might also indicate a difference in approach — all-embracing and as wide as possible, or hedged in by caveats and the need for each claim to come within a more precise definition. All clubs have an omnibus clause that can theoretically pick up grey-area claims. But cover is not guaranteed until the board of directors gives its decision and that is usually when the dispute is concluded.

Matters of Policy — Disputes Involving Crew Members

Clubs can take very different approaches, giving cover to members in respect of liabilities for/under:

"Persons on board ... excluding disputes in respect to masters, officers, and crew under, or in connection with their contract of employment or collective agreement." — *Steamship rule 9(xiii).*

"Crew employment contracts." — *Skuld rule 27.1.4.*

"Claims by or against seamen ... on or about the ship providing always that there shall be no cover under this rule for claims by or against seamen which arise under or in connection with a collective agreement or an agreement of service."
— *Britannia rule 18(12).*

"Claims, disputes, or proceedings ... concerning officers, crew ... on or about the ship."
— *UKDC section 2 (3)(j).*

Gard does not mention crew in its FD&D rules and does not cover claims under contracts of employment.

West takes a broad approach in its rule 2(7) (disputes covered), by stating that members are covered for claims, disputes, or proceedings that arise under "any other contract in relation to the insured ship." West has confirmed that it covers agency and employment disputes as long as the dispute relates to an entered ship and arose during the period of entry.

Matters of Policy — Quirks and the Omnibus Rule

It pays to read the exceptions carefully because there can be surprises. For example, Skuld excludes disputes arising "under a management agreement" (rule 27.2.6). Other clubs have confirmed that they would cover disputes under a management contract, as long as the management company was not also named on the certificate of entry (as a joint assured).

Shipowners occasionally express the view that clubs could do more to support their interests generally, even where they go beyond the confines of insurance. The IG has declined to venture too far afield, but North specifically refers in its rules to cover for:

"The procuring and supplying information and advice as to all matters affecting shipowners with respect to their rights and liabilities either towards the government or any department thereof or any public body charged with the control of the mercantile marine, and also by cooperating with any of the above public authorities in all matters affecting the interests of shipowners.

"Procuring the alteration and improvement of existing laws, usages, and customs at home or abroad, which are prejudicial to shipowners, and delaying and preventing the enactment of such laws or the establishment of such usages and customs."
— Rule 19(7) and (8).

These rules are probably little used — and they must be read in the context of North's scope of cover (see the introduction to rule 19 and rule 3) — but they are doubtless inserted to demonstrate a general approach to this class of business.

Steamship has similar provisions at rule 9(xvii) and (xviii), but has also inserted the following proviso:

"The club will not normally undertake cases which concern a substantial body of shipowners rather than an individual member unless all or the majority are entered in the class; nor cases which should properly be the subject of diplomatic action or action by national or international bodies."

Other clubs, not having expressly referenced these risks, may present such disputes to their boards under their omnibus rules.

Standard's omnibus rule is one of the most succinct. It states that there will be cover for "all other matters in respect of which a member should, in the opinion of the board, be supported by the club" (section C 3.15). Almost all clubs require that cases be concluded before they will consider the question of cover, so this might present an uncomfortable wait for the petitioner who, up until that point, will have borne all costs.

However, many managers have wide delegated authority from their boards to exercise discretion under the omnibus rules, and cases are rarely passed to the board for a decision.

Conclusion

If a shipowner or charterer is prepared to trust a club with the entry of their P&I cover, they should also be able to trust that club with their FD&D work.

However, clubs' approach can be quite different. The degree to which discretion is exercised in a member's favor is key to knowing the scope of the cover purchased. In a sense, the provision of cover for every FD&D claim that incurs a cost is discretionary.

If FD&D cover is important to a shipowner and they also want quick, authoritative advice, finding out as much as possible about the cover on offer and how matters are handled should be an important factor when deciding where to place their business. Some owners/charterers use their FD&D cover more than their P&I.

Contact your usual Marsh JLT Specialty representative for advice and assistance in making the right choice for your FD&D cover.

For further information, please contact your local Marsh office or visit our website at marsh.com

MARK CRACKNELL
Head of P&I
Marine & Cargo Practice
+44 (0)20 7558 3816
mark.cracknell@marsh.com

Insurance Brokers
Chartered