Rebuilding of vessels – pitfalls in the yard’s general liability insurance

The Norwegian Supreme Court recently gave a decision concerning the scope of a standard Norwegian general liability insurance policy. A yard was left without liability cover after being held liable for damages to an icebreaker which nearly sank alongside quay, only weeks after redelivery from the yard.

The Supreme Court decision underscores the importance of carefully considering insurance cover when carrying out more extensive rebuilding contracts. Otherwise yards risk suffering substantial losses that are not covered by any insurance. A builder’s risk insurance would in many cases be a valuable supplement to the yard’s general liability insurance, and would also serve the owners and their H&M insurers in case of a recourse claim against the yard.

The Supreme Court’s decision of 7 October 2013
In the decision of 7 October 2013 (HR-2013-2094-A), the Norwegian Supreme Court was invited to consider an exclusion in If Skadeforsikring NUFs (“If”) standard general liability cover.

Simonsen Vogt Wiig’s Frithjof Herlofsen represented the H&M insurers and the owners of “Vass”, a small ice-breaker that nearly sank alongside quay, only 6 weeks after going through an extensive rebuilding at a yard in Tromsø, Norway. The H & M insurer had covered the owner’s losses and sought recourse from the yard and its liability insurer If.

Hålogaland Appeals Court held that the yard had been negligent in the construction of the bilge system. As a result of the breach, the vessel took in a substantial quantity of water which led to damage to other parts of the vessel. The cost of repairing the cause of the damage, the bilge system, was insignificant. The majority of the H&M insurer’s losses were related to the costs of repairing damage suffered to other parts, mainly the engine, electrical components and the furnishing of the vessel. The greater part of the damage was inflicted on parts that were included in the scope of work in the rebuilding contract between the owners and the yard.

The Appeals Court found that the yard was liable for the costs of repairing all the damaged parts. However, the Appeals Court concluded that the damages suffered to the engine, the
electrical components and the furnishing fell within an exclusion in If’s liability policy related to the insured’s contractual liability, and that If was therefore not jointly liable with the yard for the claim.

The exclusion is widely used in the Norwegian liability insurance market, with only minor differences between the different insurers’ policies.

Both the yard and the owners filed an appeal, but the Supreme Court only allowed the owners’ appeal to be heard. The Supreme Court thus only considered if the yard’s liability insurer was jointly liable for the yard’s liability. The relevant exclusion the Supreme Court considered had the following wording (our translation):

“Unless otherwise agreed, the insurance does not extend to liabilities:

5.1. for expenditures/costs/ losses related to the fulfilment of the insured’s contract (ie. The agreed performance, supply, work, construction contract, etc.) including

a) damage to the assured supply, work or construction contract when the damage is caused by errors or defects that existed at the time of the delivery”

The appellants argued that the damages to other parts than the bilge system, e.g. the engine, the furnishing and the electrical components, did not fall within the wording of the exclusion as it did not relate to the “fulfilment” of the yard’s contract. The effect of the exclusion should be limited to rectifying the defective part or parts and components that had a functional connection with the bilge system.

The Supreme Court ruled in favor of If, holding that the wording “related to the fulfilment of the insured’s contract” gave no room for limiting the exclusion to the defective part and parts that were functionally connected to the defective part. Furthermore the Supreme Court held that there were no indications that “damage to the assured supply” could be understood any different than stressing that damages suffered by any part that was included in the scope of work in the rebuilding contract would fall within the scope of the exclusion.

**Practical significance of the decision**
Many businesses taking out liability insurance may not be aware of the potential insurance pitfalls they face when carrying out extensive work under one single contract. This is clearly an issue when it comes to rebuilding or major overhaul of vessels, but it could also be relevant to other businesses. Liability insurance will cover non-contractual liability such as incidental mishaps even if related to contractual work, as well as incidental damages to parts that are not a part of the contract. However, it will not cover incidental accidents to parts that were included in the contract, even if they have no direct relation with the breach.

Due care should therefore be exercised when considering the terms of cover that is offered. Norwegian yards should consider taking out traditional builder’s risk insurance on Nordic Plans conditions in addition to general liability cover.

While the costs of renewing the bilge system would not be covered under the NMIP builder’s risk insurance, the subsequent damages would normally be covered.

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### The Nordic Marine Insurance Plan


The basis for the Plan is the Agreement of 3 November 2010 between The Nordic Association of Marine Insurers (Cefor); the Danish Shipowners’ Association; the Finnish Shipowners’ Association; the Norwegian Shipowners’ Association; and the Swedish Shipowners’ Association. The agreement established a Standing Revision Committee (SRC) that has drafted the Plan and is also given authority to draft future amendments to the Plan text and Commentary.

The Plan is widely used in the Norwegian and International market for Hull & Machinery insurance. Chapter 19 of the Plan deals with Builder’s risk insurance, previously aimed primarily at covering newbuildings. However, the wording has now been adapted for use in connection with rebuilding of ships and building of other units.