

Mining Losses

2008 saw unprecedented losses for the mining industry and mining underwriters; rising commodity prices, equipment malfunctions, severe weather events and events effecting utility supplies have resulted in property damage, business interruption and contingent business interruption claims escalating. This article explores some key issues and how the relevant industries are tackling them.

Weather Events and Number of Occurrences/Events

South Africa and Australia have suffered severe weather events in 2008, with sustained rainfall causing disruption to mining activities. The nature and duration of weather events affect policy limits and deductibles at the direct insurance level, and ability to aggregate losses from different insureds at the reinsurance level. At either level, the number of events will be material.

Commodity Prices

Commodity prices have a significant impact on business interruption claims. Business interruption policies measure the loss sustained as a comparison of pre and post damage revenues and turnover. Complications arise when the insured event itself has an impact on prices. A spike in prices solely attributable to an insured event, requires difficult distinctions to be drawn. The approach following hurricane Katrina and the 2004 Tsunami may provide useful guidance.

Machinery Breakdown, Root cause Analysis & Subrogation

Failure of equipment at a production bottleneck, results in a huge impact on loss of profit. Identification of the specific failed component is crucial, affecting both recovery and subrogation. Subrogation is a key issue in the resolution of claims arising as a result of machinery breakdown as insurers seek to reduce the impact of major claims by seeking recovery from the manufacturer, supplier or service provider concerned. Where important relationships have been built with suppliers/manufacturers, insureds and insurers should negotiate, in order to avoid subrogated claims, thus preserving the insured's business relationships.

Supplier Failure

Contingent business interruption claims - based on property damage at the premises of a supplier or customer - are not new. The mining industry is heavily reliant on utilities providers; water, gas and electricity. This year there have been significant problems with gas supplies in Western Australia following the Varanus Island explosion and uncertainties over the continuity of supply in South Africa. Whilst policies vary, there is often extended cover for named suppliers and loss of utility supply. With deregulation of utility supplies, the identity of the contractual supplier is often different from the source of supply, raising issues of whether or not the policy responds to business interruption as a result of damage at source.



Market Response

Reaction to the year's problems have varied. Policy holders are seeing increased premiums and being forced to consider self insurance. Analysis of the true benefit of risk transfer, especially when experiencing friction in resolving claims issues with insurers, is increasingly important.

Insurers are seeking to exclude troublesome components and undertaking comprehensive reviews of policy wordings to ensure that future losses are ascertainable and manageable. Agreed values, fixed at the start of the policy periods, are becoming more common to combat fluctuations in commodity prices.

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The Captive Market Returns?

Captive insurance solutions appear to be making a comeback.

Recent corporate activity combined with anecdotal evidence suggests that in the anticipated hardening market, captive insurance vehicles will play an important role within the enterprise risk management function of commercial businesses.

Put simply, as insurance rates increase, it becomes more efficient for businesses to retain risk within wholly owned or pooled captive operations. This will present complex commercial opportunities for intermediaries, and insurers.

Further there is increasing commercial interest in the legacy captives that are unwanted for commercial reasons or were duplicated during the M&A boom. It is expected that these will be consolidated using established legal mechanisms, promoting efficient use of capital and perhaps triggering tax advantages.

Advantages and Disadvantages of Captives

Captive operations are especially useful in respect of lines that are regarded as expensive or for which there is no developed homogenous market. Captives allow direct access to the reinsurance markets and give the owning businesses greater control over the terms and conditions of the insurance policy, including claims handling. Investment income accrued within the captive may be retained within the owning business. It is also arguable that the

interposition of captives promotes improved risk management within the owning business as the impact of losses is felt directly and transparently.

Balanced against these advantages, the management time which has to be devoted to establishing a captive (and running it to develop claims experience), together with the various costs which are necessarily incurred can be high, and these costs are front-end, so the owning business has to be prepared to take a long-term view of a captive project. Insofar as taxation drives the location of the captive, local regulations may limit the size and type of risks which can be covered by the captive, so limiting their use.

Captives may in addition require complex fronting or claims handling facilities to be provided by the insurance market, which are indicative of the complex matrix of contracts that must underpin a successful captive.

The Future?

We see this development of the captive market continuing, despite current market conditions. Certain structural and technical issues are underpinning this trend.

To give an example, in the second half of 2008 the captive industry lobbied with some success to amend the draft Solvency II Directive to account for the relatively simple nature of the risks which are (generally) housed within a captive by way of recognition that the Solvency II Solvency Capital Requirement ("SCR") for captives (generally monoline, single customer, simple risk structure) should be treated very differently to that of a composite insurer (multi customer, multi territory, range of risks), specifically that the nature, scale and complexity of the businesses of the captive should be assessed in the SCR.

The practical effect of this success is to enhance the attractiveness of Europe as a captive location.

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Pratt v Aigaion - Warranty narrowly construed

Mr Pratt owned the 21 metre motor fishing trawler "RESOLUTE". He insured the vessel for 12 months with Aigaion. The insurance contract contained a warranty that:

"Warranted Owner and/or Owner's experienced Skipper on board and in charge at all times and one experienced crew member"

After a day's fishing, the vessel was safely tied up alongside and the crew left to go ashore. The same evening, a fire broke out in the galley resulting in the constructive total loss of the vessel. At first instance, His Honour Judge Mackie QC held that "at all times" meant what it said, the owner and/or owner's experienced skipper had not been on board at the time of the fire, the warranty had been breached and Mr Pratt's claim failed because insurers were not on risk.

The Court of Appeal disagreed. Distinguishing two yacht cases where breach of crew warranties had been upheld ("The Milasan" and "The Newfoundland Explorer"), the Court held that insurers had not established a breach of warranty and allowed the appeal for the following principal reasons:

- Fishing vessels were often tied up for days between trips (e.g. as a consequence of European fishing regulations) and during that period the skipper and crew could not be expected to live on board. Even when the vessel was manned, the skipper would be expected to go ashore from time to time for operational or recreational activities.
- The reason why an "experienced skipper" was to be on board was to protect underwriters from risks which a skipper would be needed to guard against. The primary purpose of the warranty was, therefore, to protect the vessel against navigational hazards and this interpretation was underlined by the reference to "one experienced crew member".
- The warranty is ambiguous because it does not make clear to what extent "at all times" should be qualified (it was recognised by the trial judge and conceded by insurers that the expression "at all times" cannot be given its ordinary and natural meaning). In these circumstances, it was to be construed *contra proferentem* i.e. against the party seeking to rely on it.
- The standard terms of the policy show that the vessel was to be subject to cover in circumstances where no one could sensibly have thought that any crew should or could be on board.

This case is a warning to insurers and brokers that when drafting widely expressed warranties, care must be taken not only to define

the parties' rights and obligations completely and precisely but to also consider the reasonableness of the warranty and its context in light of the contract as a whole and its surrounding circumstances.

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Legislative Reform Byelaw

The Legislative Reform (Lloyd's) Order (Market Provisions) Byelaw (No.1 of 2009) (the "Byelaw") came into force on 12 January 2009. The Byelaw gives effect to the market reforms contained in the Legislative Reform (Lloyd's) Order on which we published an article in our December bulletin. The Byelaw covers:

- Managing Agent business plans.
- Acceptance and placement of business (including from non-Lloyd's brokers).
- Amendments to the Intermediaries, Definition and Central Accounting byelaws.

The Byelaw can be viewed at: <http://www.lloyds.com/NR/rdonlyres/CA8596AB-5DE8-40ED-8B63-887D98761120/0/eReformLloydsOrderMarketProvisionsByelawByelawNo1of2009.pdf>

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Conferences and Events

Global Risk Management Forum

Mandarin Oriental Hotel, San Francisco (10 February 2009)
[Paul Wordley](#)

Forensic Investigation of Fire Claims

HFW, London (3 March 2009)

Denying Coverage for Illegitimate Claims Conference

Grange City Hotel, London (18-19 March 2009)
[Andrew Bandurka](#), [Paul Wordley](#), [Nigel Wick](#)

12th Annual D&O Liability Insurance Conference

Grange City Hotel, London (24-25 March 2009)
[Costas Frangeskides](#), [Nick Hutton](#)

JLT CommTech Forum

Schlosshotel Fuschl, Salzburg, Austria (5 - 8 May 2009)
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