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MARINE INSURANCE COVERAGE FOR OIL AND LNG TANKERS

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DELIVERABLE SUMMARY SHEET

Short Description
The report gives an overview of the main conclusions of the INSROP project and the development that has taken place after that. The general development in the world's energy sector and the related changes within Russia are well covered. The current atmosphere within major stakeholders in the marine risk management business has been studied through a number of interviews and meetings.

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Arctic Operational Platform (ARCOP)
Sub-Project: WP 2.4

***Marine Risk Management for the Northern Sea Route-
Marine Insurance Coverage for Oil and LNG Tankers***

INTERIM REPORT—May 2004

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Sub-Project Synopsis: Activities March 2003-May 2004

- i) ARCOP Workshop, Helsinki, 25-27 March 2003
Presentation of Paper entitled: “Marine Insurance Related to the Northern Sea Route and Russian Barents Sea” by Dr. Douglas Brubaker, Fridtjof Nansen Institute (FNI), Oslo, Norway
- ii.) Research Contact Visit, Helsinki, 10-11 June 2003

[♦] Based at the Centre for Maritime Law, University of Queensland, Brisbane, Australia

Visit by Prof. Edgar Gold, (FNI) Sub-Project WP2.4 Leader to Kvaerner Masa-Yards Offices and meeting with Dr. Kimmo Juurmaa, ARCOP Project Leader and other ARCOP colleagues

iii.) Research Visit, London, 16-21 November 2003

Visit to London for extensive research with the London marine insurance market by Marine Insurance Specialist Peter L. Wright, Sub-Project Research Associate to Prof. Edgar Gold

iv.) Interim Report Preparation, May 2004

v.) Workshop Report Preparation for ARCOP Workshop, Helsinki, September 2004

vi.) Continuing research/review of Arctic/NSR marine insurance developments

Introduction

1. The principal purpose of Sub-Project WP 2.4 is to provide an assessment on the viability and availability of adequate and appropriate risk coverage for vessels navigating the Northern Sea Route and Russian Barents Sea. Of particular interest is the availability of adequate marine insurance coverage for tank vessels carrying potential pollutants and hazardous and noxious substances. It is obvious that without adequate and appropriate risk coverage Northern Sea Route and Russian Barents Sea navigation would not be economically or environmentally viable.

2. The questions raised by this aspect of Northern Sea Route navigation were initially discussed under the International Northern Sea Route Programme (INSROP) during a six-year period, 1993-1998.¹ At that stage it was determined that whilst limited Arctic commercial navigation had been taking place for many years in Russian and, to a lesser extent, Canadian Arctic waters, this trade had not resulted in the establishment of clearly discernable marine insurance market patterns. This was due to the fact that such existing shipping had either been very specialized or very limited. On the other hand, until recent times, the more vigorous Russian Arctic shipping sector had its marine insurance coverage underwritten by a variety of state-sponsored schemes that did not permit or were not designed to establish clear actuarial records of the various marine risks involved. In other words, the most

¹ See: E.Gold, J. Cantello, and P. Wright, *Shipping and Marine Insurance on the Northern Sea Route: Conclusions 1993-1998* (Oslo: INSROP Working Paper No. 124, 1999)

important global marine insurance markets simply did not have access to the information for Arctic waters navigation that is normally required before the various marine risks may be covered. This also meant that risk coverage for Arctic waters and Russian Barents Sea navigation that was in operation, would have to be underwritten on a case-by-case basis. This was a very expensive proposition and resulted, in certain instances, in shipowners or charterers covering a large percentage of the risk themselves.

Northern Sea Route Navigation Risk Coverage: The Existing Knowledge Base

3. As already indicated, the earlier INSROP research was able to establish a significant knowledge base on almost all aspects of Northern Sea route navigation.² However, there are also distinct and important differences between the work carried out under INSROP and that which is now in progress under ARCOP. The former attempted to provide scientific, environmental, technical, legal and economic data for the Northern Sea Route as transit route as well as an access route to Russian Arctic region resources. On the other hand, ARCOP is developing a practical data base required for economic investment in the Russian Arctic/Barents Sea region. In other words, the two projects are quite complementary, with ARCOP building on INSROP, but moving several steps further. It may be correct to state that INSROP had to explore the possibility of extended, regular Northern Sea Route navigation and determined that such navigation was indeed possible. On the other hand, ARCOP has accepted the viability of such navigation but must now determine how it can actually be further developed as well as implemented in a cost-effective manner. ARCOP Sub-Project WP 2.4 addresses this aspect in terms of marine insurance coverage.

4. The conclusions of the INSROP marine insurance project focussed on responding to eleven specific questions in order to determine if risk coverage for Northern Sea Route navigation were feasible.³ These responses provide the knowledge base that existed in this area at the commencement of ARCOP.

² BOOK

³ See: Douglas Brubaker, "Marine Insurance Related to the Russian Northern Sea Route and Russian Barents Sea". Paper presented to the ARCOP Workshop, Helsinki, 25-27 March 2003.

i.) It was found that shipowners were reluctant to risk high-value vessels, such as large, new-generation container vessels on the Northern Sea Route. This was due to the fact that such vessels are not generally constructed for navigation in ice and also as the shipping industry still had to carry out a substantive economic analysis of the overall NSR advantages.

ii.) If year-round navigation on the NSR were not feasible, vessels would have to be re-positioned at least once or twice per year. This has significant cost implications even if feeder services were established. On the other hand, it was found that limited low-value, bulk cargo operations might take place for most of the year—depending on ice conditions.

iii.) If extensive NSR navigation would become feasible, ice-strengthened and/or purpose-built vessels would be required by marine underwriters. However standard, non-strengthened vessels might be able to navigate in the ice-free season.

iv.) Although there appear to be certain time- and cost-saving advantages in using the NSR over the Panama/Suez Canal routes, the exact economic advantages are not known. This is also due to the lack of detailed knowledge related to costs for ice-breaker assistance, ice-pilots, possible delays, cargo damage due to temperature variations, possible ice damage and higher marine insurance costs.

v.) It was also determined that in the short term the existing Russian ice-strengthened merchant fleet was probably capable of meeting initial international charter requirements. However, this had to be seen against the background of the general economic difficulties that exist in Russia. There was little indication of fleet renewal in Russia.

vi.) Although single-hull tankers and bulk carriers were in operation to and from Russian Arctic region ports, it was determined that such operations would not last very long, given the increasing International Maritime Organization (IMO) ship construction requirements as well as tightening IMO, EU and Russian environmental regulations.

vii.) Questions also remained about the capability and cost of Russia's ice breaker fleet. Russia owns and operates one of the largest and most advanced ice-breaking fleet in the world, and it appears that this fleet would be capable of providing services to any foreseeable NSR navigation. On the other hand, if this fleet seeks full cost-recovery for such services, the economic advantage of the NSR may well be lost. In addition, there were some concerns about the age, maintenance standards, and safety of Russian nuclear-powered ice breakers.

viii.) Of particular interest to marine insurers are the additional navigational skills required for vessels operating in ice and also in close proximity to ice-breakers, especially nuclear-powered vessels.

ix.) It was found that there appeared to be insufficient interest by cargo exporters and importers in Japan and Europe in the NSR. At this stage it appeared that other trade routes provided cost-effective and reliable alternatives.

x.) It was also found that there was only very limited interest by European and Japanese energy and other mineral resource interests in having access to Russian resource areas. Only Finland, which had strong investments in certain Russian Arctic resource regions, appeared to have a commitment.

xi.) Finally, it was found that there was only limited commitment by the various levels of Russian government in providing the necessary, reliable services that are required for operating a regular shipping service to and from the Russian Arctic/Barents Sea region. This is due to the general disarray that pervades government operations in Russia, including overlapping or inadequate jurisdictions, ineffective legislation, and a general shortage of funds.

5. However, the overall conclusion of the INSROP marine insurance project was that the international marine insurance market would be prepared to underwrite NSR navigational and related risks. In other words, marine underwriters voiced the firm opinion that if shipowners wished to use the NSR, marine insurers would provide the necessary risk coverage.

6. This is basically the knowledge base on NSR navigation and its marine insurance coverage that was in place when INSROP ended some six years ago. One of the principal purposes of ARCOP Sub-Project WP 2.4 will be to determine what has changed in the intervening time.

Northern Sea Route Navigation Risk Coverage: ARCOP Aspects

7. Although it will be helpful to refer back to the INSROP conclusions in order to illustrate changed scenarios, it is also necessary to point to the major global aspects that have occurred since 1998 which have a specific effect on NSR navigation generally and marine insurance coverage specifically.

General Changes

8. Firstly, a growing world economy requires ever more natural resources, including energy resources. In May 2004 global crude oil prices had reached USD 40/barrel, i.e. the highest level in over a decade.

9. Secondly, the world's premier energy-producing region, the Gulf area, is still beset by political instability. A number of other oil producing regions have or are reaching depletion.

10. Third, China is expected to become one of the world's largest economies within a decade and will further strengthen its role as a major import and export market.

11. Fourth, the post 9/11 global security concerns have also focussed on the safety of energy supplies including its transportation aspects.

12. Fifth, increasing global, regional and national marine environmental concerns have focussed on the shipping industry and its regulatory regimes that will result in the phasing out of older vessels, including single-hull tanker. This is also directly linked to strengthened liability and compensation regimes for marine pollution.

13. Sixth, the world shipping industry, including its ship-construction sector, has been experiencing significant growth and increased profitability.

14. Finally, the global marine insurance market, despite regular, serious losses continues to be strengthened by new investments interests, the broadening of its base and ever greater competitiveness. This appears to underline a willingness by the market to accept new risks.

Specific Changes

15. There are also a number of changes that have taken place in this area since the conclusion of INSROP that can be compared to the points already outlined above:

i.) There is still no indication that shipowners are willing to operate high-value vessels, such as new-generation container vessels on the NSR. At this stage, Russian vessels are still chartered for specific, break-bulk or bulk cargo operations. Only certain Finnish shipowners have entered into specific NSR operations that involve the export of Russian energy and other resources from the Russian Arctic, Barents Sea region. The vessels involved are insured in the international insurance market.

ii.) Although there continue to be some year-round NSR operations, mainly involving Russian and Finnish vessels with Russian ice-breaker assistance, most operations are seasonal, i.e. weather and ice condition dependent.

iii.) As already indicated, a number of purpose-built Finnish and Russian vessels operate regularly in NSR waters. New vessels are in the building or design stage. However, increased purpose-built vessels construction continues to be dependent upon the development of shore infrastructure, i.e. ports and terminals. This is lagging behind due to lack of international investments.

iv.) The advantage of the NSR passage over the Suez/Panama Canal routes has become less relevant for ARCOP as resources from the Russian Arctic/Barents Sea region will not involve transit passage. On the other hand, if Japan and, possibly, the

US and China become involved, substantive economic feasibility studies will have to be undertaken.

v.) Russia's present Arctic fleet is ageing and will soon no longer be operative. There has been relatively little new construction, although vessels that have been built have been constructed to the highest international standards. Most of the older vessels will not be able to meet international standards when new IMO regulations enter into force.

vi.) Although single-hull vessels are not yet precluded from operating on the NSR (or anywhere) their operational viability is strictly time limited. New IMO regulations (strongly supported by the EU) will phase out single-hull tankers by 2007.

vii.) The current status of the Russian ice-breaker fleet is uncertain. Although several new vessels have been constructed, many others are laid up, including most of the larger nuclear-powered vessels. There appears to be insufficient funding for proper maintenance. Furthermore, there continue to be questions of whether ice-breaking should operate on a full cost recovery basis. Some ice-breaking services operate on a specifically negotiated 'private' fee basis.

viii.) There is no new evidence that training in ice navigation is offered outside Russia, Finland and, to a limited extent, Canada.

ix.) At this stage there appears to be little new evidence that cargo exporters and importers have expressed further interest in the use of the NSR. However, there may be more up-to-date information forthcoming from other ARCOP research sectors. Furthermore, should Middle East instability affect the Suez Canal route and/or if continued drought conditions affect the Panama Canal, this situation may change rapidly. On the other hand, as the ARCOP project is less concerned with actual transit passage, this aspect may not be considered essential at this stage.

x.) There is clear evidence of renewed interest by European and North American energy and other natural resource importers in the development of Russian Arctic/Barents Sea resources. Although Finland has been the leader in this thrust,

there is also investment interest from other states. Given the general, global energy situation, the major focus is on crude oil and natural gas. However, other mineral resources, such as ores and coal, as well as forestry products, are also of increasing interest. This has and continues to result in limited infrastructure investment in order to access these resources. It is not yet clear if Japan, which during the INSROP research period, expressed little interest in Russian resources, has had a change in policy.

xi.) Although Russia's national administrative structures are still in some disarray, there appears to be evidence that Russian Arctic/Barents Sea administrative policies have been further developed. Much of this is due to a certain amount of privatization in areas such as exporting companies, ports, terminals etc. On the other hand, it is less clear if services to shipping, i.e. charting, pilotage, towage, salvage, repair facilities, electronic and other communications systems, are sufficiently developed for increasing NSR navigation. There still appear to be severe budgetary difficulties combined with policies that seek total cost recovery for all services. This will continue to cause concerns for ship operations and, obviously, marine insurers. However, it remains to be seen if other sectors of ARCOP research can provide clearer answers to this critical aspect.

Marine Insurance Aspects

16. As already indicated above, at the end of the INSROP research period, it was clear that the global marine insurance industry was willing and able to underwrite NSR navigational and related risks, provided that appropriate and adequate information structures on the risks involved could be presented to underwriters. The risks that require cover are: hull and machinery risks; cargo risks; third-party liability (protection & indemnity) risks; and a number of miscellaneous risks.⁴

17. Nevertheless, in this area ARCOP faces a basic difficulty similar to that experienced by INSROP. This is due to the fact that the marine insurance industry is generally unwilling to provide information on risk coverage based on hypothetical or

⁴ P&I Handbook

theoretical questions. This is an immensely practical industry that responds quickly and positively to real risks. In other words, if marine underwriters are presented with a factual situation, i.e. full information on a named vessel, information on the route to be taken, the cargo to be carried, the duration of the voyage, and such other information that a prudent insurer may require, it appears to be certain that a realistic insurance rate would be quoted by the insurance broker(s) involved. However, at this stage, ARCOP is not in position to provide this type of information. As a result, this Sub-Project will continue to operate in a 'theoretical vacuum' unless other ARCOP research sectors are able to provide the type of tangible information necessary.

18. On the other hand, during the Sub-Project's research visit to the London marine insurance market in November 2003, it was confirmed that marine insurers are still very positive about covering risks that may arise out of Arctic/NSR/Barents Sea navigation. London continues to be the principal global marine insurance centre and it is likely that when regular NSR navigation develops that the risks involved will be underwritten in this market. Research contacts involved:

i.) Marine Insurance Underwriters: Meetings were held with several major underwriters who all expressed considerable interest in ARCOP and the future of Arctic navigation. One of these is a major German underwriter with wide experience in the European marine insurance market. Another company was already writing significant Russian business, through its Moscow office and also numbered Kvaerner-Masa amongst its client base. Discussions were held not only on hull and machinery risks, but also on cargo insurance, business interruption coverage, war risks, terrorism, and protection and Indemnity (P&I) coverage.

ii.) Marine Insurance Brokers: Meetings with several principal brokers also revealed not only keen interest in what ARCOP was developing, but also significant and expanding experience in the Russian market. Some brokers have been handling cargo insurance involving the Russian Arctic for over a decade and are very positive on further development.

iii.) Joint Hull Committee: A meeting was held with the Secretary of the Joint Hull Committee, who is also a Special Advisor to the International Underwriting

Association (IUA). This group works with both Lloyd's and Company Insurers and, as a result, has an extensive grasp on the market's interests and capacities. There was very positive reaction to NSR planning.

iv.) The Salvage Association: Marine insurers rely on recommendations on risks made by the Salvage Association. This meeting revealed that the Association had considerable interest in environmental matters as well as fleet technology. When regular NSR navigation is further developed it is likely that the Salvage Association will undertake specific studies in the area.

v.) Marine Reinsurance Representatives: Meetings were also held with several major reinsurers. It goes without saying that without reinsurance there would be no viable marine insurance. The reinsurers contacted all have significant experience in the shipping sector and requested to be kept up-to-date on NSR developments.

vi.) Joint Cargo Committee: Meetings with representatives of cargo marine insurance interests at Lloyd's also confirmed interest in NSR development. This market has extensive experience in dealing with Russian aspects.

vii.) International Chamber of Shipping (ICS): As the principal representative body of shipowning interests the ICS requested to be kept informed of the progress of ARCOP's research. It was also suggested that contacts be made with the Oil Companies International Marine Forum (OCIMF) and the International Association of Independent Tanker Owners (INTERTANKO). This will be followed up by the Sub-Project in due course.

viii.) Protection and Indemnity Underwriters (P&I Clubs): A meeting was held with the world's largest P&I club, which has extensive experience in Russian operations through its Russian fleet memberships and Arctic operations. It was confirmed that the leading P&I clubs would be able to provide liability coverage for any member involved in Arctic/NSR/Barents Sea operations. However, it was also made clear that more information on Russian services to NSR shipping, the environmental risks involved, as well Russian legislative development, was needed.

ix.) Maritime Law Firms: London is the base for most of the major maritime law firms with a global/Russian client base. As a result, contact was made with several firms in order to report on ARCOP and NSR developments. No major impediments to NSR development was seen, although the uncertainty of the Russian administrative and legal system, as well as the possibility of environmental claims was raised. It was also confirmed that the 'new' Russia was now much more commercially oriented with reliable, experienced members of the local shipping industry who were more attuned to 'Western' requirements.

Conclusion

19. This interim report covers the activities undertaken by ARCOP Sub-Project WP 2.4 during its first 15 months of operations. As indicated above, marine insurance coverage for NSR/Russian Arctic/Barents Sea shipping operations continues to be an essential component. The work carried out was assisted by a retrospective examination of the conclusions of the INSROP research as it permitted some comparisons of shipping and marine insurance developments between INSROP and ARCOP.

20. At this stage, it can be confirmed that marine insurers appear to be willing to underwrite the various risks involved in NSR shipping operations. However, this cannot be fully confirmed until more tangible, practical evidence of the actual planned shipping services can be provided. It is, therefore, hoped that a number of other ARCOP sub-projects will provide some of this information during the next stage of the project's development.
