Marine K&R
an above “Average” Marine Insurance
by Capt. Thomas Brown

It would appear to the casual observer looking in on the marine insurance industry that confusion continues to reign over the way in which the marine insurance industry has reacted to the modern day threat of piracy and the ensuing cases of kidnap for ransom of ships and their crews off the Horn of Africa.

The sheer size of the international waters in which the attacks take place and the randomness of these attacks in the Gulf of Aden and Indian Ocean off Somalia have taken the industry by surprise. Ship-owners whose vessels transit these waters now face the real possibility of incurring large losses as a consequence of this illegal activity. However, unlike other marine emergency and casualty situations ship-owners may have faced in the past, it is by no means certain to whom they should turn when faced with a ransom demand for the release their vessel and crew.

Their traditional marine Hull, P&I and War underwriters all have legitimate reasons why NOT to get involved. None of the coverages offered by these traditional marine insurances have properly dealt with this unique set of circumstances that have conspired to give rise to the risks associated with this modern day threat of piracy.

In this article we will try to look behind the patchwork of traditional marine insurance coverage to see what is covered where and by whom and look at how the risks can be properly covered.

Historically the losses resulting from piracy attacks have been adequately covered by P&I, hull, war and cargo insurers. Prior to the onset of the current scourge of Somali piracy attacks mariners had to contend with the Indonesian piracy threat when transiting the Malacca and Lombok Straits and all waters connected therein.
The modus operandi of the Indonesian pirates was quite different to that of the Somali pirates of today. Indonesian pirates would go “shopping”, the local euphemism for boarding a vessel with the intention of stealing money from the ships’ safe as well as the personal belongings of the crew, before making off with their bounty down bamboo poles hooked onto the ship’s rail leading to their fast getaway craft. The losses from “shopping attacks” relate to theft of money and personal possessions and the death of, or injury to crew members who attempt to resist these attacks, all such losses are covered by the owner’s P&I insurers.

Alternatively the Indonesian pirates would take a vessel to order. They would be paid to hijack a vessel and cargo. The vessel would then be cloned and sold on to their client for an agreed price or even scuttled to allow for a claim on the hull insurance, whilst the cargo would often be sold to the highest bidder.

Such an attack was a far more serious matter for the vessel’s master and crew as their lives would be placed in grave danger as they represented no value to the pirates attacking the vessel. Often the crew would be killed, thrown overboard or set adrift. Losses arising from these attacks related to loss and/or damage to the ship which would be covered by the hull and/or war underwriters, loss and/or damage to the cargo which would be covered by the cargo insurers and death or injury sustained by the crewmembers with the associated personal injury claims being covered by the owner’s P&I Club.

In all of the abovementioned scenarios it would generally fall to the owners P&I Club claims executives to handle the claims arising and ensure that the losses fell to the appropriate insurers. Ship-owners knew where to turn for help and who would pay their losses; this is not the case with Somali pirate attacks.

Unfortunately the Somali pirates willingness to hijack and ransom a vessel and crew has caused confusion amongst marine insurers about just where the losses should lie and has in turn created an opportunity for traditional non-marine Kidnap and Ransom insurers to step in to fill the gaps in coverage that have appeared.

Before we look at specialist marine kidnap for ransom insurance policies we should first look at what happens during a Somali piracy attack when specialist K&R coverage is not in place, which is the far more common scenario.
In the majority of cases when the vessel and crew are taken by Somali pirates and the owners receive a ransom demand for their release, the owner is effectively self insured, to explain why the owner is on his own we need to look back at the Indonesian examples. In the Indonesian examples “property”, whether it is cash, the ship or cargo was always at direct risk of loss or damage thereby triggering a claim under one or more of the traditional marine property or liability insurances. This is not the case when Somali pirates hijack your vessel and crew with the intention of extorting money from you in order to safeguard their release. When making a demand for the ransom the implied threat is that if you don’t pay your crew will be killed. It is common practice for the hijackers to focus on the value of the crew rather than the ship or cargo as this is more likely to illicit an emotive response placing the hijacker in a strong negotiating position.

As the crew’s lives are at risk, owners have tried to rely on their P&I insurance. Unfortunately ransom demands are not expressly covered by International Group P&I Clubs and one club goes even further and has an express exclusion of liability for ransom payments. Whilst the P&I Clubs will assist with the liabilities that arise as a consequence of the piracy attack such as personal injury, crew substitution and repatriation, and crew/passenger loss of effects etc they prefer to deal with such matters as “after the event” claims avoiding where possible any involvement during the ransom negotiations.

So what of the hull and war underwriters, well here it depends which policy includes the piracy peril. Some owners have successfully argued that when demands for ransom are received their property is at risk of loss or damage and/or that a voluntary sacrifice will need to be made on behalf of the common maritime adventure i.e. the payment of a ransom, to secure the release of the vessel, cargo and crew, thereby triggering a claim under “General Average”. In recognition of their General Average contribution and/or the need to reimburse sue and labour claims i.e. costs incurred to avoid damage to the vessel, some but by no means all hull and war underwriters recognise the need to engage with the insured. As with the P&I Clubs their involvement may be differed until after the event, as and when the General Average Loss Adjuster has issued his loss adjustment to establish the contributions that need to be made to cover the losses by the various parties to the maritime adventure. Any reimbursement under the hull/war policy will be excess of the owner’s policy deductible and subject to the policy limit which is often aligned to the value of the hull.

An article appearing in Tradewinds dated 21st August 2009 provides details of one very disgruntled Danish ship-owner who was complaining that his traditional marine insurers (War/Hull) had failed to pay a single cent towards his General Average claim some 14 months after the release of the vessel. Moreover, having initially paid a $1m ransom to release the vessel the total costs including ransom delivery costs, intermediary and legal fees had escalated his claim to $5.4m. The owner in question was calling for a single policy, “against piracy that would protect earnings and time lost, ransom and associated costs”.

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Cargo insurers should also contribute to the settlement of a claim in General Average and their contribution will be aligned with the relative value of the cargo to that of the hull. Unfortunately experience shows that General Average negotiations with cargo interests can be almost as torturous as negotiations with the Somali pirates. Once the cargo interests have their cargo they have been known to raise all kinds of spurious lack of seaworthiness defences to avoid their contribution to the General Average settlement. In such cases and to avoid the costs and risks of litigation the parties will often come to a commercial settlement that will leave the ship-owner significantly out of pocket. The leading case on this issue concerns the Malaspina Castle which is currently the subject of arbitration in London.

As you can see in the event of a hijacking, not only does the ship-owner have the mental stress of having his crew held at gunpoint but he also has to contend with the spectre of significant business disruption and financial liabilities, before, during and after the pirates are long gone.

So how can this pain and anguish be reduced? Dedicated marine kidnap for ransom policies of insurance have been and continue to be developed to respond to this very real maritime peril.

This article is aptly named, “Marine K&R an above ‘Average’ Marine Insurance”, for good reason because established market wordings with the leading K&R markets avoid the need for General Average, they sit above and are truly primary to all other traditional marine insurances.

Non-marine K&R wordings have been “marinated” to provide dedicated marine K&R coverage that responds to the special nature of the Somali pirates kidnap for ransom marine risk.

Marine K&R insurance is triggered by a ransom demand. Once triggered the insured is provided with the immediate assistance of a dedicated team of ransom negotiators the costs of which under the established policies are unlimited, meaning the negotiators will assist the insured to achieve the best possible outcome regardless of how long this may take. They are there to protect the lives of the crew, mitigate the period of seizure and the associated financial losses. It is therefore most important to ensure when purchasing marine K&R insurance that you are happy with the response company provided by the insurer whom you will be working closely with in the event of a claim.

These responses costs and all other costs agreed by the response company will be paid first by underwriters up to policy limits.
The only costs which need to be paid first by the insured and indemnified thereafter by the insurer is the ransom itself. As a matter of International Law, K&R insurers are prohibited from paying the ransom in the first instance as it could be construed as funding an illegal act. However, International Human Rights Law allows the insured company to pay the ransom as this is construed in law as an act taken to preserve life. To overcome this potential cash flow problem provision is made in the marine K&R policy for the insured to use the policy as collateral if funds need to be raised by way of a bank loan to pay the ransom, with any interest being indemnified along with the ransom payment usually within 48 hours of the successful delivery of the ransom to the pirates.

In this way the cash flow impact that such an event may have on a company is managed as best as possible by the marine K&R insurers, waiting 48 hours for reimbursement is far more acceptable than the case we highlighted above where the ship owner has paid $5.8m costs and after 14 months is still awaiting reimbursement.

Non-marine K&R wordings recognise the need to indemnify the insured for their “loss of earnings” that follow a K&R incident. This concept has been transferred into the marine policy where owners and their charterers can obtain cover for lost charter hire income during the period of seizure and/or compensation for delay in the event the vessel is on a voyage charter and/or out of charter on a repositioning voyage to be delivered into the vessel’s next scheduled employment.

So, what are the “Key Features” of this evolving marine insurance?

Scope of Cover:

1) Ransom
2) Unlimited Response Costs
3) Loss of Ransom in Transit
4) Additional Expenses
5) Legal Liability

Structural Features:

1) It is primary to other marine insurances.
2) It can be written on a single vessel, multi vessel or fleet wide basis.
3) It can be purchased on an annual, multi-year, voyage, transit or port call basis.
4) It can include threats against the crew, vessel and in some cases the cargo.
5) It is triggered by the demand for money from those who have illegally taken that which is yours.
6) Rights of recovery from other property interests can be preserved or waived.
7) The policy will provide the insured with unlimited preferential access to one of the World’s leading K&R response companies to manage the incident.
8) Subject to policy limits the insurer will pay all of the big ticket expenses first, save for the ransom which will be paid by the owner in first instance and indemnified by the underwriter thereafter often within as little as 48 hours of the payment.
What does the policy avoid?

1) Issues over the definition of what is or isn’t an act of piracy.
2) Concerns over the motivation of the pirates; political/private.
3) Discretionary provisions inherent with traditional marine insurances.

What differentiators are there between the various insurers offering the cover?

1) Marine Experience
2) Price
3) Policy Limits
4) Response Company
5) Terms – the various insurers are willing (or not as the cases may be) to offer optional coverage including, personal accident coverage, legal expenses, vessel/cargo extortion, loss of earnings.
6) Payment versus indemnification.
7) Discounts.

Finally we will end this article with our recommended advice on points to keep in mind when purchasing Marine K&R insurance:

1) Correct market selection is most important.
2) Not all new market entrants have the requisite marine experience.
3) Always check who will provide the response.
4) Check responder’s credentials and previous marine experience.
5) Check the marine K&R claims payment record of the insurer.
6) Check the terms to ensure the policy is primary to other marine insurances.
7) Preserve confidentiality.
8) Work through a specialist broker.

Seacurus is a specialist UK based marine credit and asset protection marine insurance broker regulated by the FSA. It was in 2004 when Seacurus first alerted their clients to the risk of marine piracy and the threat of kidnapping that the crews of their vessels would face when navigating in and around the Horn of Africa.

At this time Seacurus approached certain Lloyd’s underwriters with a view to agreeing upon the wording of the first marine kidnap for ransom policy. The wording was agreed and went by the name, “CrewSEACURE”.

Today Seacurus is one of the World’s leading independent marine K&R insurance brokers.

For further details see www.seacurus.com

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