

# Piracy

## A growing problem

### Introduction

It is clear that the number of attacks in the Gulf of Aden and Indian Ocean are increasing and the geographical range of the pirates is widening. It also appears that the size of the ransom demands and payments are increasing.

Whilst the naval ships in the region are having an impact, given the size of the area concerned, it is not surprising that they are unable to prevent all attacks and their ability to respond is hampered further by their Rules of Engagement.

So how is the insurance industry handling the arising issues? The answer would appear to be a confused picture with little consistency in approach.

This review provides some guidance on the subject based on the British Institute wordings.



### Ransom payments

#### Hull/War policies

Ransom payments and the cost of negotiating and delivering the ransom are not normally specifically covered in the wording of either the hull or war policies. However, providing the assured exercises 'due diligence', underwriters to date have been paying claims for ransom payments.

Most claims are being settled under the principles of General Average but rarely, if ever, has General Average actually been formally declared.

Although claims have been paid, underwriters disagree about the extent of the cover. Some say that only the ransom payment should be recoverable while others believe the costs of negotiation and delivery of the ransom should also be covered. Marsh is not aware of any court case that has clarified this issue.

Underwriters are reluctant to amend their wordings to refer

specifically to ransom payments and associated costs as they fear this may encourage more attacks and also potentially conflict with Government policy.

It can be expected that most hull/war underwriters will pay for expert claims management assistance and indeed will wish to appoint their own lawyers/consultants to oversee the negotiations.

#### Kidnap and Ransom (K&R) policies

A K&R policy will usually pay, in addition to many other costs, the ransom including ransom lost in transit and a security team that will transport the ransom to the pirates. Care must be taken over limits purchased as many K&R policies have limits lower than current ransom demands. If the hull/war policy tops up the amount or acts as an excess policy there can be major complications over claims handling. It should be noted that these are policies of reimbursement and any ransom has to be paid by the assured in the first instance. It is usual for their K&R policies to contain a confidentiality warranty.

### Cargo policies

As ransom payments are often settled under the principles of General Average hull/war underwriters have been expecting cargo policies to contribute. This, however, does not always happen if the cargo has lost its value as a result of the delay. Not all cargo insurance includes piracy as a peril but that does not change the legal position of the cargo owner or the obligation they may have to contribute to General Average.

### P&I Clubs

P&I Clubs only pay claims where the owner might be found to be legally liable, which clearly is not the case for a ransom payment. There is no legal obligation on the owner to pay ransom although, of course, they have a moral obligation to pay as they are responsible for the crew's safety. Therefore, Clubs do not contribute to ransom payments, although they reportedly did for one or two of the first incidents as claims under the omnibus clause on an 'ex gratia' basis.

### Charterers

Charterers will not be obliged to meet ransom demands unless:

- The Owner can demonstrate some form of 'unsafe berth' claim – in which case a Charterers Liability (Damage to Hull) policy can be expected to respond.
- The Charterers are contractually liable for some or all of the ransom – Contractual Liability will normally need to be specifically added to the Charterers Liability policy or a separate policy taken out.

### Legal issues surrounding the payment of ransoms

Some countries have passed laws prohibiting the payment of ransoms. If a vessel, flagged from one of these countries, makes an illegal payment the underwriters may not reimburse the assured.

There is also the complication of terrorism laws (such as UK or US) where, if the authorities believe the ransom will be used for terrorist purposes, they will block the payment or the Owner/underwriters may find themselves the subject of prosecution if they do go ahead with the payment.

This has been complicated further by the recent change in US regulations where ransom payments to specified individuals and organisations have been made illegal. However, as most of these claims will be settled in cash and payment made via intermediaries, it would be difficult if not impossible to establish who the beneficiary of such payments was.

Some underwriters in the UK are proposing to formally include a new wording in their policies which specifically exclude any payments that are in breach of any of the laws, sanctions or regulations of the UK, US or EU.

In our view this would not change their position because any commercial contract, including insurance contracts, can only be enforced providing the action is legal. Marsh believe the proposed changes are likely to delay the resolution of claims, as the assured may be required to prove that the payment is legal.

In order to avoid conflict with the US regulations, it would be advisable to ensure that ransom payments are not made in US dollars and US citizens should not become involved in any payments or the connected process.

Bearing in mind the majority of war business, directly or indirectly, is placed in the London market the effect if similar restrictions were enforced in the UK would be much more significant.

## Loss of Hire and Detainment

### Hull/war policy

Loss of Hire due to vessel damage is not covered under a standard hull/war policy. Loss of Hire cover, that includes the peril of piracy, can be bought separately which will cover loss as a consequence of damage to the vessel caused by pirates. However, the policy does not always pay for Loss of Hire if no damage has been sustained (e.g. delay following seizure).

Loss of Hire due to non-damage (not restricted to piracy) can be covered either as a stand-alone policy or by specific extension to the existing Loss of Hire policy.

### K&R policy

Assuming the policy has been extended to cover Loss of Hire, these claims are often paid by K&R policies whilst the vessel is seized. This usually ceases as soon as the vessel is released so the policy may not pay for subsequent or consequential loss, e.g. slow steaming and then time taken for examining the vessel and scraping the bottom of the hull.

### Charterers

Charterers may be liable for all or part of the daily hire of the vessel whilst seized by pirates, as the BIMCO Piracy Clause for Time Charter Parties or similar defines. It is possible to insure this exposure but this would need to be a separate policy or an extension of existing cover as Charterers' Liability (Damage to Hull) would not normally extend to such payments.

### Constructive Total Loss

If a vessel is seized the assured may want to tender a Notice of Abandonment to claim for a Constructive Total Loss stating that they have lost the free use and disposal of the vessel and there is no chance of the vessel being freed.

The number of days specified in the Detainment Clause (periods vary but 365 or 180 days are common) determines if a claim for Constructive Total Loss is valid. If the underwriters are not convinced, at the time the Notice of Abandonment is tendered, that the vessel will be detained for more than the number of days specified the assured will have to wait until the defined detainment period is reached before receiving payment.

The normal Loss of Hire wording will exclude payments if the vessel is a Total Loss unless specific provision is made to the contrary.

If the assured's detainment clause states 365 days and their vessel is detained for 364 days then the Loss of Hire cover will pay. If the detainment is 365 days or more, Total Loss cover will pay. This may mean that Loss of Hire payments are made during the Detainment Clause period but then have to be repaid if Total Loss is established.

## Cover

Both the K&R and war policies are ground up policies with, normally, no deductible.

There are potential issues over double-insurance, where a claim could be made against more than one policy. This is true even where the K&R policy waives rights of subrogation over the hull/war policy, thereby promoting itself as the more specific insurance.

Most K&R markets do not subrogate against marine markets, therefore

claims will not affect marine premiums (as long as a sufficient limit is purchased). Some war underwriters will offer significant discounts if the assured purchases a K&R policy from an underwriter that does not subrogate.

Additionally, there can be differences in expectation by the assured and the K&R underwriters regarding what is paid.

## Crew and cargo

### P&I Clubs

P&I Clubs that are members of the International Group Agreement (IGA) exclude liability arising from what they term war risks. However, Piracy and Barratry do not come under their definition of War Risks. As a result, liabilities to crew and cargo as a consequence of acts of piracy would be covered by IGA Clubs.

Their definition of war risks also includes an exclusion for 'weapons of war' which complicates matters further.

This also raises the issue of whether the incident was caused by piracy (i.e. an action for personal gain) or terrorism (i.e. a political act). If caused by terrorism then the vessel owner should look to their war policy assuming that a P&I clause is included.

Such P&I clauses should provide coverage excluded from the cover provided by IGA Club members. This area can prompt disputes under the policies.

### K&R policy

Expenses such as counselling or medical costs for crew are covered under a K&R policy.

The wordings are usually clear that unlimited cover exists for expert assistance from experienced response consultants who will advise the assured in handling all aspects of an incident, including the legal/governmental/financial issues, the media and the families.

## Conclusion

The marine market is paying claims for ransom payments and associated costs, in addition to paying Loss of earnings claims where Loss of Hire cover is purchased. The K&R sector of the market is also paying these claims.

The co-existence of these two markets, their differing approach and use of differing wordings, is causing some difficulties and confusion. Claims have been the subject of dispute and the possibility of gaps in cover or expectation have become apparent.

Marsh's Marine Practice recommends that a rigorous review is carried out to determine:

- Who leads the hull/war policy and what do they believe they are covering
- Where the peril of Piracy rests
- What obligations under Charter Parties exist

- Whether Loss of Hire is purchased and when would payments commence
- Whether K&R is purchased and what are the terms of such cover
- What limits are applied
- What (if any) claims procedures are agreed between the various underwriters and the assured.

As the world's leading insurance broker and risk adviser, Marsh is ideally positioned to help you with this analysis process and has a claims handling team with extensive experience in successfully resolving complex claims. To find out more about how Marsh's Marine team can help your organisation, email us at [marinepractice@marsh.com](mailto:marinepractice@marsh.com).

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