

# Piracy – the insurance implications



Piracy in the Indian Ocean and elsewhere continues to be a major ongoing concern to the shipping industry. Although the human cost to seafarers and the strain on their families is impossible to calculate, Geopolicity, the international management consultancy group, has estimated that the total annual monetary cost of piracy to the international community is between US\$4.9 and US\$8.3 billion.

Ince & Co, the international law firm that monitors developments closely, estimates that ransoms of about US\$75 to US\$85 million were paid in 2010 to secure the release of 21 ships. It understands that average ransom payments by March 2011 had reached about US\$4 million, double the figure in January 2010.

Ince & Co also tracks the length of time that ships are held captive referencing the six most recently released ships. By the end of February 2011 the rolling average had reached 214 days, up from 205 days at the end of 2010 and up from 93 days for the same period in 2010. Since March, and in line with the pirates stated intention to free up space at their anchorages, the average has dropped back to 109 days.

This paper summarises the insurance experience as it relates to piracy. It is intended as a practical guide to shipping companies based on the situation in June 2011. It will consider:

### **Loss of or damage to the ship following an act of piracy – the insurance market position.**

In our view this is best addressed by a properly structured war risks insurance policy covering the ship. We will explain why.

### **Ransom to secure the release of seized ships, crew and cargo – who pays?**

We would normally expect the cost of ransoms for ships to be reimbursable under either the ship's hull and machinery (H&M) marine risks or war risks insurance policy. A marine kidnap and ransom (K&R) insurance policy also covers ransom.

### **Issues relating to the payment of ransoms.**

Ransom payments are prohibited in some jurisdictions. Care must be taken to avoid acting illegally.

### **Issues to consider relating to marine K&R insurance.**

The arguments whether or not to buy marine K&R insurance are not straightforward and if it is purchased other points will need to be addressed. We consider the various issues.

### **The market for war risks insurance and marine K&R insurance**

We briefly consider the insurance market for both war risks and marine K&R at the time of writing and the factors that determine premium levels.

### **Loss of hire following an act of piracy.**

We set out the loss of hire position if the ship is damaged by pirates and separately explore the options available relating to hire payments while the ship is seized.

### **The protection and indemnity (P&I) position.**

The P&I clubs have made it clear that they do not cover ransom payments. However, if a ship owner incurs a legal liability following an act of piracy, the clubs are likely to become involved. The clubs are also very useful sources for advice both when a ship owner considers how to deal with the threat of piracy and after a ship has been seized.

### **The implications of employing guards to protect shipping.**

The employment of an armed security team can result in reduced war risks and marine K&R premium, but it does raise other questions. While we are not qualified to comment on points of law, we are pleased to refer the reader to a paper addressing this issue that has been prepared by Ince & Co.



## Loss of or damage to the ship following an act of piracy - the insurance market position

The insurance industry debate as to whether loss of or damage to a ship as a result of an act of piracy should be covered under the ship's H&M marine risks or war risks policy has been largely resolved. Today the great majority of ships are insured against piracy under their war risks insurance. Marsh considers this to be the desirable outcome for a variety of reasons, not least because it avoids potential disputes in the event of a claim relating to whether the pirates were acting from political or economic motives.

There are other practical advantages to including piracy as a war risk. Deductibles are typically not applied to claims to war risks insurance policies, but are applied to claims on marine risks policies. It also protects the ship owner's marine risks claims record in the event of a claim.

Including piracy as a war risk also introduces a mechanism where insurers can charge an additional premium if a ship trades in pirate infested seas. The war risks additional premium areas are well understood by shipping companies and extending that practice to risks of piracy enables cover to be paid for by those that bring the risk exposure. In practical terms, this enables the cost to be passed on to the charterer or customer.

In the comparatively rare cases where the risk of piracy is still covered under a ship's H&M marine risk insurance policy there will normally be no additional premium charged if the ship operates in waters with a high risk of piracy, because there is no mechanism to set an additional premium. However, a significant piracy claim on the H&M marine risks insurance policy is likely to result in higher premium. The impact of a claim on H&M war risks insurance premium would be much less.

## Ransom to secure the release of seized ships, crew and cargo – who pays?

Both H&M marine risks insurers and war risks insurers have reimbursed ransom payments on policies that include the risk of piracy. Reimbursement has been forthcoming because underwriters accept that payment of ransom to secure the release of a ship seized by pirates is justified as a general average (GA) expense, although in practice, in most if not all cases, claims have been settled without GA having been formally declared.

General average can usually only be declared where parties other than the owner of the ship, such as cargo owner or charterer, have a financial interest in the safe conclusion of the voyage. Therefore it might not be possible to declare GA if the ship was seized while unchartered and on a ballast voyage. In these circumstances we would expect ransom payments to be reimbursed as a "sue and labour" expense. Under policy forms in use today covering both H&M marine risks and war risks, a ship owner that has been deprived of use of the insured ship can ultimately claim a constructive total loss. Payment of a ransom to avoid the prospect of a constructive total loss would certainly appear to be justified as sue and labour, but this is less tested in practice.

While ransom payments have been reimbursed by both H&M marine risks and war risks insurers, the conventional kidnap and ransom insurance market has responded to the escalation of piracy by developing specialist marine K&R products intended to provide certainty of cover. These policies are designed to reimburse ransom payments up to a pre-agreed limit.

Conventional K&R insurance covers ransoms paid to free living persons from kidnap. In the maritime context, a marine K&R policy covers ransoms paid to release crewmembers and others on board the ship.

Recognising that in reality Somali pirates have usually sought payment of a single ransom to release the ship, its crew and the cargo on board, marine K&R policies are typically extended to include ransoms paid to secure the release of seized property.

On occasion, as was seen with the boarding of the m/v Leopard in January 2011, pirates have abducted the crew but abandoned the ship. In these circumstances, because they have no financial interest in the wellbeing of the crew, we believe it unlikely that the ship's H&M marine risks or war risks insurers will readily participate in the reimbursement of a ransom to free crew alone.

It is possible that the underwriters covering a ship owner's liabilities to crew might be asked to contribute to a ransom to secure the release of crew members. This could be the ship owner's P&I insurer or alternatively an underwriter that covers crew P&I war risks. Typically this will be the ship's war risks insurers who customarily also cover P&I war risks on the ship. However, a requirement to reimburse ransom payments follows legal liability and it is unlikely that the ship owner will have a legal liability to pay a ransom. Indeed, the P&I clubs have made it clear that they do not cover ransom payments – a stance considered in greater detail later in this report.

To conclude this section, we expect ransoms paid to free a ship to be reimbursed by the ship's H&M marine risks or war risks underwriter. A marine K&R policy is appropriate cover for ransom to free the crew alone and can also provide an additional layer of protection for the ship.

## Issues relating to the payment of ransoms

Many countries including the United States and the members of the European Union specifically prohibit any payment of funds that could be used to fund terrorism. Any suggestion that ransoms were being diverted to terrorists could result in both ship owners and underwriters finding themselves at risk of prosecution.

Legal advice should be sought and taken into account when formulating a strategy to deal with the piracy risk to ensure that ship owners remain within the law.

## Issues to consider relating to marine K&R insurance

While virtually all ships will be covered for the risk of piracy under either the H&M marine risks or war risks policy, not all ship owners purchase marine K&R coverage. Clearly there is overlap and this has led some ship owners to conclude that K&R coverage is an unnecessary expense. We now address the benefits or otherwise of purchasing a separate marine K&R policy.

Marine K&R underwriters will argue that their product brings certainty of coverage (within the terms of cover and to the policy limits), that it provides additional cover not always given elsewhere, will result in the involvement of the most capable specialist support at the time a crisis is being faced and will bring the speediest settlement of claims.

A marine K&R policy does provide certain benefits that may not automatically be covered under the H&M marine risks or war risks policy. These include insurance for the ransom while in transit and a variety of additional expenses including fees charged by a public relations consultant, interpreter and independent negotiator, medical and psychiatric fees and the travel costs for the insured and the victims' families.

K&R insurers have established close working partnerships with professional response consultants with considerable experience negotiating with pirates and in some cases have retained their services exclusively. While we would expect the ship's H&M marine risks or war risks underwriters to pay for the services of a specialist response consultant, there is finite expertise and these underwriters may find their first choice consultant is exclusively committed elsewhere.

The marine K&R market is evolving and underwriters are looking at how they can achieve a competitive advantage. A number of consultancy organisations (separate from the response consultants) provide pre-voyage audits and generally assist ship owners improve their piracy threat response plans. The services of these consultants are generally available to ship owners, but some K&R underwriters have negotiated with these organisations to provide the service on favourable terms alongside a marine K&R policy.

### Coverage issues to be aware of

Covering ransom payments under either the H&M marine risks or war risks policy and the marine K&R policy opens up the possibility of double insurance, which should be handled carefully at policy inception.

Beyond the risk of double insurance, if a ship owner purchases K&R coverage in addition to the conventional insurances covering the ship, it is essential to ensure that the policies dovetail properly and that in the event of an incident the claims response is coordinated. For example, marine K&R insurance will be subject to a policy limit. H&M marine risks and war risks insurance will also be subject to a limit, but this will be the ship's insured value and is likely to be much higher. If the ransom exceeds the limit under K&R, it is important to make sure the H&M marine risks or war

risks policy (as applicable) will contribute above that limit.

K&R policies include a requirement that they are kept confidential. If a ship is seized by pirates the best outcome will only be achieved if all parties with an interest in the ship, its crew and cargo are able to work together. The K&R insurer's requirement for confidentiality will prevent this, so it is therefore important that the requirement is waived to the extent necessary to achieve full cooperation. Ideally K&R underwriters will agree to waive confidentiality from inception to the extent that it applies to other insurers that may have an interest. At a minimum, confidentiality must be waived as soon as possible after a ship has been seized.

In practice war risks underwriters will often reduce additional premium where the owner has purchased a separate K&R policy, which is a clear benefit. However, in these circumstances the war risks underwriters will need to be made aware of the existence of the K&R policy as a matter of course and the ship owner must obtain the K&R underwriter's agreement to disclosure.

To avoid coverage disputes in the event of a claim, the K&R policy should either name the charterer and the cargo owner as insureds or note that cover has been procured on behalf of all charterers and cargo owners "for their respective rights and interests".



## The market for war risks insurance and marine K&R insurance in June 2011

### War risks market

Most marine insurers underwrite war risks (including piracy), either alongside an H&M marine risks policy or as a separate policy, and can be expected to provide competitive quotations in most circumstances. However, a small number of insurers, primarily Lloyd's syndicates, have targeted war risks business and are likely to be the most consistently competitive. At the time of writing these specialists include the Liberty, O'Farrell, Watkins and XL syndicates.

Outside the London market the leading specialist war risks insurer of international shipping is GAREX, a Paris based agency underwriting on behalf of a pool of, mainly, continental European insurance companies.

Ship owners with close flag, ownership or management ties to certain countries will be able to secure very competitive war risks coverage from organisations established to cover ships from these countries exclusively. These organisations include the Hellenic War Risks Association, Den Norske Krigsforsikring for Skib, the Japanese War Pool, the Arab War Risks Insurance Syndicate and the Combined Group of War Risks Associations, which respectively cover ships with connections to Greece, Norway, Japan, the Arab states in the Arabian Gulf and the United Kingdom.

The London insurance market's Joint War Committee retains a security consultant to provide advice on maritime war risk issues. Based on advice received, the committee compiles a list of areas of perceived high risk for the insurance community. This enables each war risks' insurer to make an informed decision on whether to impose an additional premium to reinstate cover on ships trading into particular zones (known as the "listed areas").

With the growing concentration of naval ships deployed to combat piracy operating in or close to the Gulf of Aden, the pirates have shifted their focus further east and have begun using captured vessels as mother-ships that allow them to operate far from home. This development led the Joint War Committee to extend the listed area east to within 12 nautical miles of India's west coast and south to Latitude 12°S in December 2010.

As a result the operator of any ship in the Indian Ocean as far south as Madagascar and east almost to Sri Lanka's west coast now needs to notify war risks insurers and may be required to pay an additional premium to ensure coverage is uninterrupted.

Details of the current listed areas in the Indian Ocean and its neighbouring seas are set out in the following map.



### Areas of perceived enhanced risk as at 3rd March 2011

- Djibouti excluding transit
- Somalia
- Eritrea but South of 15°N
- Iraq including all Iraqi offshore oil terminal
- Qatar excluding transit
- Bahrain excluding transit
- Saudi Arabia excluding transit
- Yemen
- Iran
- Pakistan

- Indian Ocean, Red Sea and Gulf of Oman area

The waters enclosed by the following boundaries:

- a) On the northwest, by the red sea, south of Latitude 15°N
- b) On the west of the Gulf of Oman by longitude 58°E
- c) On the east, Longitude 78°E
- d) and on the south, Latitude 12°S

.....excepting coastal waters of adjoining territories up to 12 nautical miles offshore unless otherwise provided (shown with █ line on this map for general reference).

War risks insurers will often reduce rates for voyages through the listed areas if they are satisfied with the piracy prevention measures in place and / or if K&R cover is purchased with an appropriate limit.

Marsh has commonly achieved reductions of 50% to the typically quoted war risks additional premium for a ship at risk from Somali pirates provided that it is separately covered for K&R with an appropriate limit (at least US\$5 million) and with a waiver of rights of subrogation from the K&R insurer given to war risks underwriters.

Underwriters assess the ship's characteristics such as its speed and freeboard and whether it is laden or in ballast when calculating additional premium. If an underwriter considers a ship's speed or freeboard might increase the risk of seizure, the additional premium might be loaded unless a separate marine K&R policy is purchased.

The employment of an armed security team on board throughout the at-risk voyage can secure a reduction from war risks underwriters. Small reductions may also be achievable if, for example, razor wire is deployed to protect the ship, if an unarmed security team is on board or if the ship has a fully equipped citadel.

Different underwriters give different weight to the various risk avoidance strategies that are available. A security measure that encourages one underwriter to allow a premium reduction may be an absolute requirement necessary to persuade another underwriter to quote at all.

Compliance with Best Management Practices 3 (BMP3) will normally be expected as standard and may be an underwriting requirement.

## Marine K&R market

At the current time the following underwriters were active in the marine K&R market. Each underwriter has partnered with a response consultant, which is also identified below.

Insurer	Response Consultant
Aspen	AKE Group
Catlin	Security Exchange
Chartis	Clayton Consultants
CV Starr	Neil Young Associates
Griffin	BGN Risk
Hiscox	Control Risks
Travelers	ASI Global

Cover can be obtained from these underwriters covering either individual high risk voyages or annually on a global basis. Marsh has an exclusive arrangement with Chartis in Cyprus for marine K&R insurance and can obtain quotations for international ship owners from them and from other underwriters.

A comparison of the main differences to the various marine K&R policies currently available is set out in Appendix A.





The premium charged for marine K&R depends upon a variety of factors. The underwriter will need to know the route and date of voyage (for individual voyages) or the anticipated number of voyages through high risk waters (for annual cover), the name, speed, size, type and freeboard of the ship, the cargo on board and crew numbers. Underwriters will also ask for details of the security measures in place. Is the ship following BMP3? Does the ship have a fully equipped, secure citadel? Will a security team ride with the ship? Will they be armed or unarmed? Will razor wire be deployed?

In very general terms the current premium for K&R cover with a limit of US\$5 million for a ship capable of 14 knots and with freeboard of at least five metres with standard security including razor wire and a fully equipped citadel would be about US\$12- US\$18,000 for a single voyage through the Gulf Aden. Reductions of up to 25% for a four man unarmed security team on board for the duration of the at-risk voyage, or up to 50% if the security team is armed, are possible.

K&R underwriters may be reluctant to quote unless there is a security team on board if they consider that either the speed or freeboard is inadequate.

These figures should only be considered as a very rough guide. Premiums quoted will depend upon the unique factors of each risk presented and the underwriter appetite at the time of presentation.

## Loss of hire following an act of piracy

### Loss of hire following damage to the ship caused by pirates

Conventional loss of hire insurance only responds if payment of charter hire ceases because a ship has suffered damage or, under English conditions, machinery breakdown covered under the ship's H&M marine risks or war risks insurance policy and has been taken out of service for

the damage to be inspected or repaired.

If risks of piracy are covered under the H&M war risks policy it is necessary for the loss of hire wording to also cover war risks. Ship owners should be aware that some loss of hire insurance policy wordings do not automatically cover off hire following a war risk loss. In these circumstances the wording should be extended to cover loss of hire due to war risk.

### Loss of hire while a ship is seized by pirates

Because the loss of hire policy is linked to the H&M marine risks and war risks policies as outlined above, we would not have expected this type of policy to respond if the ship is detained by pirates, but not damaged. However, a leading average adjuster has recently provided an opinion that off hire as a result of detention by pirates might be recoverable under a loss of hire policy in certain circumstances, even if the ship is not damaged. This has not been tested in practice.

If the charter party includes the BIMCO Piracy Clause 2009 or similar, charterers with a primary obligation to pay hire under the main terms of the charter party will have a requirement to continue paying hire for 90 days while a ship is held by pirates. Charterers have an insurable interest for charter hire payments for the first 90 days following seizure since they have lost the use of the ship. Owners have an insurable interest in lost hire after charterer's obligations cease. Both owners and charterers can normally protect this exposure by extending a marine K&R policy to include loss of hire. Unlike conventional marine loss of hire policies that will normally only respond when a ship has been off hire for 14 days, recovery under a marine K&R policy will usually begin within hours of the illegal seizure.

Loss of hire extensions to marine K&R policies are subject to a limit, usually between US\$3-5 million. They are structured to

help with cash flow and may pay hire amounts as frequently as bi-weekly while the ship is held captive.

Both owners and charterers can be covered for hire payments "for their respective rights and interests" under an owner's marine K&R policy. In these circumstances the policy would respond to the monetary loss as determined by the obligations in the charter party.

However, a loss of hire extension to a marine K&R policy typically has certain limitations. Reimbursement of hire may stop as soon as the ship is released by the pirates. This would mean the policies would not respond if the ship is unable to return to employment until essential maintenance and repairs, such as the restoration of anti-fouling coatings, have been undertaken.

Alternatively, it is possible to purchase a stand-alone war loss of hire insurance covering the risk of piracy based on an extension of a conventional loss of hire policy form. These policies can be taken out for owners for periods in excess of the BIMCO Piracy Clause, as primary policies for charterers, or for both owners and charterers "for their respective rights and interests".

We would recommend that the prospective buyer of piracy loss of hire insurance, either as an extension to marine K&R insurance or as a stand-alone policy, reviews the wording to ensure that the coverage provided is adequate.

## The P&I position

Although a ship owner might have a moral obligation to pay a ransom to secure the release of his employees, there may be no legal requirement to do so. P&I insurance will only respond where the insured ship owner has a legal liability. In the absence of a legal liability, the P&I clubs in the International Group have all made it clear that ransom payments are not covered by them.

There is no specific piracy exclusion in the clubs' rules and the usual heads of claim insured

by the clubs, such as liabilities involving loss of life or personal injury, crew substitution and repatriation and loss of crew's effects, will remain covered. A ship owner's contributory negligence could also result in liabilities arising out of, for example, pollution, wreck removal and cargo liability.

The P&I clubs exclude war risks. This exclusion is triggered in different ways depending upon each club's rules, but typically the use of 'weapons of war' is sufficient to trigger the exclusion. While there is no definition of 'weapons of war' there is an understanding that they are something more than guns, rifles and conventional ammunition. Use of a rocket propelled grenade might be sufficient to trigger the exclusion, but this is untested in practice.

To fill the coverage gap caused by the P&I club exclusion of war risks, a ship owner's war risks' underwriter will typically also provide insurance against P&I war risks. Therefore P&I liabilities arising as a result of piracy that are not covered by the P&I club should be covered under P&I war risks up to policy limits. In these circumstances the P&I club will only become involved on an excess basis, normally excess of the ship's insured value under the war risks policy.

Ship owners should be aware that coverage under P&I war risks is customarily dealt with by non-standard 'brokers clauses'. These clauses should be reviewed to ensure there are no gaps between the cover provided by the P&I club and that provided by the P&I war risks underwriters.

Although the clubs have attempted to distance themselves from any requirement to contribute to the ransom, they have accepted that there are circumstances when they could become involved.

The clubs in the International Group jointly published answers to frequently asked questions relating to piracy in June 2009. This document acknowledged that, while ransom is not expressly covered, "it is possible that ransom

might be recoverable from clubs at the discretion of boards under sue and labour or omnibus provisions if this is not recoverable under any other insurance and cannot be recovered from other sources".

The same document also noted that it is accepted adjusting practice upheld by English courts that a ransom payment made to secure the release of a hijacked ship or cargo is a GA expense for which ship owners are entitled to recover contributions. The P&I clubs accept that they could become liable to reimburse cargo's proportion of GA where this is irrecoverable due to a breach of the contract of carriage by the ship owner.

Even if they are not directly involved, it would be appropriate to notify the ship's P&I club if the ship is seized by pirates. In addition to forming part of a ship owner's support network, the club can provide advice on issues relating to responsibilities under cargo contracts, etc.

The P&I club might also need to be kept informed if a ship owner seeks to avoid the threat of pirates by re-routing through more benign waters. Declining to transit the Gulf of Aden and instead routing around Africa may be deemed to be a breach of the contract of carriage. In these circumstances the ship owner, should refer to their P&I club for greater certainty to determine whether additional ship owners' liability insurance may be needed.

### **The implications of employing guards to protect shipping**

As highlighted above, reductions to both war risks additional premium and marine K&R premium can be achieved if ship owners deploy an armed security team on board during at-risk voyages. This is because they have proved to be an effective deterrent – we understand that no ship with armed guards on board has been successfully taken by pirates.

We are not qualified to comment on the legal implications of ships carrying an armed security team, but Ince & Co have published their own paper addressing this issue and have kindly agreed that we can include it as an appendix to this document.

We would recommend that ship owners inform war risks underwriters of their intention to employ a security company and consult fully with their P&I clubs before entering into contracts to employ guards, armed or not. This will help ensure there are no gaps in cover and that there is no risk of cover being prejudiced.

War risks underwriters may include a warranty to the effect that there are no arms or ammunition on board when quoting additional premium for voyages to war risks listed areas. If there is an intention to carry armed guards, any such warranty must be amended to reflect this.

The maritime security industry has developed quickly as the threat of piracy has grown and today there are a large number of organisations offering security services, often with a very limited track record. The Security Association for the Maritime Industry (SAMI) has been formed as an independent regulatory trade association for maritime security companies. The International Association of Maritime Security Professionals (IAMSP) has been separately established to provide certification for individuals working in maritime security. The primary purpose of both SAMI and IAMSP is to introduce discipline and oversight to the industry to enable ship owners to identify reputable maritime security companies and professionals.

# Appendix A

	Hiscox	Travelers	Catlin	Aspen	CV Starr	Griffin	Chartis
<b>INSURED LOSSES</b>							
Ransom	✓	✓	✓	✓	✓	✓	✓
Ransom in transit	✓	✓	✓	✓	✓	✓	✓
Consultant fees & expenses	✓	✓	✓	✓	✓	✓	✓
Legal Liability	✓	✓	✓	✓	Optional	✓	✓
Personal Accident	x	✓	✓	x	x	✓	x
<b>ADDITIONAL EXPENSES</b>							
Independent negotiator's fees	✓	✓	✓	✓	Silent	✓	✓
Independent PR consultant fees	✓	✓	✓	✓	Silent	✓	✓
Independent interpreter's fees	✓	✓	✓	✓	✓	✓	✓
Assured's travel and accommodation costs	✓	✓	✓	✓	✓	✓	✓
Travel costs of victim's family	✓	✓	Silent	✓	✓	Silent	Silent
Medical/psychiatric fees	✓	✓	✓	✓	✓	✓	✓
Legal advice	✓	Silent	Silent	Silent	✓	✓	Silent
Reward	✓	✓	Silent	✓	✓	✓	✓
Costs of fuel oil used by seized vessel as a result of the event	USD 250,000	USD 250,000	✓	USD 250,000	USD 150,000	✓	USD 100,000
Reasonable costs paid to port authorities for seized vessel(s)	Included in above	Included in above	✓	Included in above	USD 150,000	✓	Included in above
Negotiator's fees - carried out on pirates' side	USD 50,000	Included in ransom limit	Silent	x	Silent	Silent	Silent
<b>PERSONAL FINANCIAL LOSS</b>							
100% of insured person's gross salary	✓	✓	✓	✓	✓	✓	✓
Costs for salaries of negotiating employees	✓	Silent	Silent	✓	Silent	✓	Silent
Sums payable by way of interest on loans	✓	✓	✓	✓	✓	✓	✓
Costs, fees and expenses of temporary security measures	✓	✓	Silent	✓	Silent	✓	Silent
Costs of communication/recording equipment and advertising	✓	✓	✓	✓	✓	✓	✓
Reasonable fees and expenses of independent forensic analysts	✓	✓	✓	✓	✓	Silent	✓
Reasonable rest and rehabilitation expenses of assured and family	USD 25,000	USD 25,000	✓	USD 10,000	USD 150,000	✓	Max 25% of main limit
Reasonable costs of cosmetic or plastic surgery	✓	✓	✓	✓	✓	✓	✓
Job retraining costs	✓	✓	Silent	Silent	Silent	Silent	Silent
Reasonable costs of transporting any ransom to perpetrators	✓	✓	✓	Silent	✓	Silent	✓
Costs of inability to attend to personal financial matters	✓	✓	Silent	Silent	Silent	✓	✓
Costs of repatriation & burial/cremation of the body of kidnap victim(s)	Silent	✓	✓	Silent	✓	Silent	✓
All other reasonable expenses incurred during and after insured event	✓	✓	✓	✓	✓	✓	✓

	Hiscox	Travelers	Catlin	Aspen	C V Starr	Griffin	Chartis
<b>EXCLUSIONS</b>							
Loss or damage to the property of the assured (vessel, cargo & other)	✓	Silent	✓	✓	Silent	Silent	Silent
Surrender of a ransom in a face to face encounter	✓	✓	✓	✓	✓	✓	✓
Surrender of a ransom at location kidnap occurs or extortion is made	✓	✓	✓	✓	✓	✓	✓
Fraudulent or criminal act of an Insured person	✓	✓	✓	✓	✓	✓	✓
Surrender of cargo, goods and/or cash in transit for use as ransom	✓	✓	✓	✓	✓	✓	✓
Surrender of the vessel(s) for use as a ransom	✓	✓	✓	✓	✓	✓	✓
Use of pathogenic or poisonous biological or chemical materials	x	✓	x	✓	✓	x	✓
Nuclear reaction, nuclear radiation or radioactive contamination	x	✓	x	x	✓	x	✓
Insured persons taking part in armed forces, police or security organisation	x	x	✓	x	x	✓	x
Legal advice obtained without the insurer's consent	x				✓	x	✓
				✓			
<b>SUBROGATION CONDITION</b>							
Waive all rights of subrogation against assureds' hull & machinery insurers and/or assureds' marine war risks insurers.	✓	✓	✓	✓	x	✓	✓
Above Subrogation Waiver include Cargo	x	x	✓	✓	x	✓	✓
<b>OTHER</b>							
Automatic termination of policy if vessel changes flag state - unless agreed by underwriters	x	x	x	x	x	✓	x
Losses which would normally be insured under hull policies whether purchased or not are excluded	x	x	x	x	x	✓	x

Wordings can be tailored and the above comparison is taken from the standard wordings of the named insurers. This comparison may not however accurately reflect terms and conditions in a tailored wording.

This comparison is provided as a guide only and the individual policy wordings should be reviewed for details of all policy terms and conditions.

# Appendix B



INTERNATIONAL  
LAW FIRM

# Piracy

## Issues arising from the use of armed guards



AVIATION | BUSINESS & FINANCE | COMMERCIAL DISPUTES  
ENERGY & OFFSHORE | INSURANCE & REINSURANCE  
INTERNATIONAL TRADE | SHIPPING

By March 2011 the average duration of the hijacking of the most recent six ships released reached 214 days. The corresponding average for the amounts paid in ransom is difficult to calculate from open sources, but is estimated to be approximately US\$4 million. These figures are an increase of almost 100% on those of January 2010.

The levels of piracy activity in December 2010 and January 2011 have far exceeded those for the corresponding periods last year. Despite the best efforts of the limited military resources, the pirates seem unstoppable and, notwithstanding a greater use of citadels, vessels continue to be hijacked. The use of armed guards remains a controversial policy but more owners are being pushed in that direction as they compete for business in a difficult market. The recent shocking events on the *Beluga Nomination* and the yacht *Quest* have again highlighted the ruthlessness of the Somali pirates, particularly when threatened by military action.

Those in favour of the use of weapons were given a significant boost on 15 February 2011 when the International Chamber of Shipping (“ICS”) announced a change of stance on armed guards, recognising that they were being used off Somalia. The ICS also called on the military to do more to disable hijacked “mother ships” being used by the pirates. It is not clear whether the ICS will be followed by other industry bodies. Whilst the guidance in Best Management Practice 3 (BMP3) remains to discourage the use of armed security, the UK and German governments are understood to be reviewing their own position on the use of armed guards on ships flagged in their respective registries. Both governments have been firmly against the use of armed guards.

The debate on armed guards on board vessels and the role of private security companies is ongoing. The unique selling point for the security companies is that to date no ship with armed guards has been hijacked. However the potential escalation of the use of force remains one of the bedrocks of the argument raised against the use of armed guards on ships. By employing armed guards on board a vessel an owner is making a calculated trade-off: a perceived decrease in the risk of the vessel being hijacked and the subsequent exposure to the losses this brings, against a possible increase in the chance of the crew being harmed or the vessel damaged should pirates attack or invade the ship.

### How is the maritime security industry responding?

The attempts by the maritime security industry to regulate itself is a welcome initiative. In particular the efforts of the Security Association for the Maritime Industry (SAMI) who are seeking members to join and to set minimum standards of conduct and procedures. All companies are being encouraged to adopt the new International Code of Conduct for Private Security Companies. Though this is primarily aimed at land based security companies, a maritime annex is being drafted. It is likely that those companies prepared to separate themselves from the pack in this way will find themselves preferred to those who don't. The danger to owners and insurers is that an increase in demand for armed guards will lead to a decrease in quality.

### Who is in charge of the ship?

If armed guards are onboard, a fundamental question arises as to who authorises the use of force. Security companies still seek to insert clauses which appear to provide that the master

may not have overall control or the final decision in whether weapons will be deployed and used. That decision may rest with the security team, on terms that the master only need be consulted “if there is time”. The justification is that, if faced with a lethal threat, the right to self defence outweighs the master's overall responsibility to his crew and the environment.

In other words, the master may not have full control of a key area of the vessel's security, something which impacts directly on the safety of the crew and the vessel. Indeed there may be a contractual obligation for him to obey “security” instructions from the guards which extend to the routing of the vessel, possibly without regard to any contractual obligations to charterers and/or cargo interests.

The use of armed force on a vessel must relate to the safety of the crew and the protection of the environment and yet, by employing armed guards, owners may be forcing masters to give up that discretion in breach of SOLAS Regulations. This could lead to issues arising under SOLAS, which at Article 34-1 provides:

*“The Owner, Charterer, the Company operating the ship as defined in Regulation 1X/1 or any other person shall not prevent or restrict the Master of the ship from taking or executing any decision which, in the Master's professional judgment, is necessary for the safety of life at sea and protection of the marine environment”.*

This message is reinforced in the ISPS Code which states:

*“At all times the master of a ship has the ultimate responsibility for the safety and security of the ship....”*

This was reinforced graphically after the *Maersk Alabama* case in 2009, where Captain Phillips before the hearing of the Senate Foreign Relations Committee said:

*“I am not comfortable giving command authority to others. In the heat of an attack, there can be only one final decision maker.”*

His comments seem to support the belief that masters will not be happy to give up any of their overall authority on board. Owners, charterers and others should therefore give serious thought as to how they would deal with the issue of authority on board the vessel when considering employing armed guards.



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## Armed escort ships

Using an armed escort in a high risk area may seem easy in theory. However the practicalities are causing real problems as the status of these companies and therefore their vessels is not defined. Interesting questions have been raised both in terms of responsibility to the master of the ship under escort and under international law as, under Article 107 of UNCLOS, power is given only to military vessels to seize ships involved in piracy. Questions have been raised as to the legitimacy for these private gun boats. Some arguments have even arisen as to whether the armed intervention of a gun boat is in itself piracy.

Article 19 of UNCLOS provides the definition of Innocent Passage, stating:

*“Passage of a foreign ship shall be considered prejudicial to the peace, good order or security of the coastal state if in the territorial sea it engages in any of the following activities: .....any exercise or practice with weapons of any kind.”*

The provisions on the rights of transit and the regime of local laws in middle eastern countries make the use of these vessels difficult and controversial. Those considering providing such a service as an agent of a commercial ship owner should pause for thought.

Various approaches being considered at present, such as the recently announced initiative from one insurance broker to set up a small flotilla of private escort vessels to run a Convoy Escort Programme, mean that the issues set out above will need to be addressed.

## Can armed guards or escort boats use lethal force?

Any use of arms must be governed by clear Rules for the Use of Force (“RUF”). There are as many RUFs as there are security companies and there must be some merit in trying to develop a uniform system which all companies and operators agree to follow. In our view, RUF should be attached to the contract and discussed in detail with the master and crew. Furthermore, they should be endorsed by the Flag State, whose laws we would expect to govern the use of force in deterring or preventing what is a criminal act. In the UK for example, lethal force is normally only allowed where there is serious and imminent threat to life. The decision to use lethal force must be reasonable and the force used proportionate.

Distinguishing between fishermen armed to protect themselves and pirates intent on hijacking a vessel should be possible but perhaps only at the last moment. There has undoubtedly been at least one incident where an armed security team have engaged a fishing boat with devastating effect.

Where the Flag State authorises or directs the presence on board of military personnel, these issues may well be more straightforward.

There is some movement in this area in the United States, where proposals have been made that immunisation against prosecution should be given to those who injure or kill a pirate whilst protecting a ship from attack.

## Who needs to know?

### i) Insurers

Clearly prudence dictates that the use of armed guards should be discussed and agreed with all underwriters. Although not a question of “disclosure” for existing policies which are not being extended or varied, there are many other possible implications. We can envisage arguments that the practice may affect the validity of a policy, and/or the recoverability of a claim under a valid policy. Arguably, this could be the case even if the security providers were on board with underwriters’ full agreement. Where a voyage through pirate-infested waters requires a variation of a policy (for example because it involves a change of trading limits), then disclosure considerations also apply.

### ii) Cargo interests

For the reasons given above, damage arising from or caused by the use of armed forces, particularly if the use of that force was negligent or illegal, may give rise to an argument under the bill of lading contract that the vessel was unseaworthy. Informing cargo interests of the intention to arm the vessel should therefore be considered.

### iii) Charterers

The security providers are likely to want to agree a route prior to transit of a high risk area. That route may not be the normal or quickest route and may represent a deviation or a failure to use utmost despatch under the relevant charterparty. An unauthorised deviation may mean a breach of the charter and/or contract of carriage which could then jeopardise the P&I cover. There

may also be off-hire implications. Interesting questions could arise, for example, if the vessel was taken by pirates whilst deviating.

### What happens if someone is killed or the ship/cargo is damaged during a hijack as a result of the actions of the guards?

The security contracts may have a “knock for knock” type provision, which means that in the event that a guard or crew member is killed without negligence occurring, then the loss falls where it lies and there is no recourse between owner and the security company. The security company may have some kind of “Public Liability Insurance” to cover them in cases where there has been negligence. That may not prevent owners being sued by dependants or cargo interests if they think there is fault or some other breach (such as the duty of care under an employment contract) on the part of owners. Anecdotal evidence suggests that there have been attempts to persuade P&I Clubs to agree to treat guards as supernumeraries and therefore be covered as if they were crew.

### Licensing of weapons

The licensing regime, particularly in the UK in respect of controlled weapons, casts a wide net and applies to UK companies and nationals (wherever they are) and to foreign companies set up by UK nationals, where the foreign company is set up for the sole purpose of acquiring and moving weapons. Given the identity of the littoral states, the myriad of export and import regulations and the requirement to arrange bonded stores of weapons, it is unsurprising that many grey areas exist. It is a legal minefield through which the private security companies must tread. Indeed on 28th February David Cameron said in Parliament that the UK had one of the strictest export regime’s in the world. There are worrying

signs that they many may simply be ignoring these regulations. Sometimes, oblivious to the source and provenance of the weapons, Flag States approval is then given and their lead is then followed by the underwriters. The result is that they may simply be approving unlicensed weapons on board. With recent events in the Middle East and Africa, the whole issue of exported equipment has become serious. The industry wants the option of arming their ships, but the licensing system, certainly in the UK, is cumbersome and needs streamlining. We continue to work with companies advising on these issues.

### Conclusion

The issue of using armed guards on board vessels will continue to be debated. The key concern for owners is to ensure the safety of their crew and their vessels. In doing so it is vital for owners, charterers and underwriters to review all provisions in their charters and policies and ensure adequate attention is paid to the questions raised. Shipping companies will need to address the authority of the master and crew once armed guards are onboard. The international law-making fraternity is currently dealing with jurisdictional issues, but it will soon need to address more formally the status of private security companies and their role in support of legitimate operations. Focus will continue to be put on the legalities and licensing regimes and we continue to review and advise on the relevant contracts.

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