

Piracy in the Gulf of Aden



CLIENT ALERT

Piracy in the Gulf of Aden and the Indian Ocean never ceases. Two weeks ago the Bangladesh registered handimax JAHAN MONI was seized by Somalis and some days ago they were narrowly prevented from pirating a large asphalt carrier. This is despite concerted naval action and the convoy system operated by EUNAVFOR.

“Piracy remains a serious danger in the Gulf of Aden “

Piracy raises a number of important issues for commodity traders which are highlighted below.

Risk

The most obvious and dramatic is the seizure of ship and cargo, which invariably means payment of an enormous ransom for its release. There have been few, if any, instances where armed intervention has successfully released the detention and freed the crew. Armed security guards are rare, and are strongly disapproved of by the UK government in case it leads to escalation of violence and bloodshed by the Somali pirates. Cargo interests cannot therefore expect shipowners to provide this protection.

Where you are the buyer, whether CFR or FOB, the risk is all important because it transfers under the Incoterms 2000 generally at the load port as the goods pass over the ship's rail. Thus if the cargo is seized en route it is your problem not the sellers! Conversely where you are the seller, it is generally not significant because the risk at the time of the seizure will have passed to your buyer, but there will be a marked reluctance on his part to pay if the piracy has occurred before the payment process has been initiated.

Apart from the seizure of the cargo it is equally inconvenient for the buyer of cargo if the shipowner carrying the cargo elects to avoid transit through pirate infested waters by a long deviation for instance around the Cape of Good Hope. Not only will there be delay but the shipowner will seek an increase in freight. If you are the buyer FOB you will have arranged the carriage and will



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bear the burden directly. Even if you are receiving cargo CFR the sale contract may provide that the seller can claim indemnity for extra freight costs under the charter he has negotiated.

Insurance protection

It is important therefore that for commodities purchased, or where otherwise at risk, you have adequate cargo insurance. If your insurances are placed using the Institute Cargo Clauses (A) then the all risks cover both for the cargo itself, as well as for freight at risk and general average contributions arising, should provide adequate protection. The exclusions under clause 6.2 against *"capture, seizure, arrest, restraint or detainment"* do not apply to piracy which is specifically included as a risk for which continuing cover is available. The same is not the case of the Institute Cargo Clauses (B) or (C) which have particular risks covered and which do not include piracy, and where the exclusions in 6 do not provide for the same saving for the piracy risk as in (A).

However both with hull and machinery insurance for shipowning interests, and cover for cargo and freight at risk, the wording of the Institute Cargo Clauses specifically exclude loss from *"riots"* or *"any terrorist or any person acting from a political motive"*. The significance of this is that under English law a riot takes place where *"12 or more persons use or threaten violence for a common purpose, such as would cause a person of reasonable firmness present at the scene to fear for his personal safety"*. Thus if the attack causing detention or loss of ship and cargo is undertaken by 12 or more Somali pirates then the ordinary insurances at least arguably do not apply. To cover this eventuality it is important to include in the cover both for ship and cargo, the Institute War and Strikes clauses which specifically cover riots.

The above provision also excludes loss from terrorist activities or from any person acting from a political motive. Since there have been suggestions from time to time that there are links between terrorism and Somali pirates, that would be a further reason for obtaining the war risk extension to cover because that covers the terrorism risks excluded in the Institute Cargo clauses.

Thus, if your cover is on the basis of the Institute Cargo Clauses (A) with the

necessary War and Strike Clause extension, you should have adequate insurance against the total loss of the cargo as a consequence of seizure by pirates and towards any ransom which the shipowner is obliged to pay and which he seeks to recover in general average.

When will the insurers pay out?

But a major problem remains as to when a total loss occurs allowing recovery from the underwriters, where you have cargo at risk. Unfortunately the mere fact of the seizure of the vessel and cargo, under English law, is not sufficient for cargo underwriters to accept an immediate total loss pay out. It is a question of fact and degree when it is possible to claim that the detention has resulted in the assured being “*irretrievably deprived*” of either ship or cargo which is the requisite test. English law is that there can be no irretrievable deprivation when it is merely a question of paying ransom money; in those circumstances it is usually just a question of time before the ransom is paid and the cargo released. If, however, the shipowner absolutely refuses to provide a ransom, and you are not able to advance it for their own account, then the time of irretrievable deprivation may sooner arise. The most recent English legal decision on this subject concerns the detention of the ship BUNGE MELATI DUA¹. In this case the cargo interests argued that their cargo of bio diesel which was on board BUNGE MELATI DUA when seized in August 2008 became an actual total loss under section 57(1) of the Marine Insurance Act 1906 at the moment of seizure or, alternatively, that the cargo was a constructive total loss under section 60(1) of the same Marine Insurance Act 1906 because both the vessel and cargo had been reasonably abandoned since actual total loss appeared to be unavoidable. The court found that this was not the case and both ship and cargo owners had to wait until it could be proved that the cargo had been irretrievably lost.

The case is also of considerable importance because the Court held that the payment of ransom was not illegal as a matter of public policy but was an ordinary commercial eventuality and thus insurable. It has been uncertain up till this decision whether under English law underwriters were able to refuse indemnity because it was generally against public policy to encourage piracy by paying ransom to them.

¹ Reported at [2010] 1 Lloyd's Rep. 509

Moreover, the court also specifically found that the payment of ransom was recoverable as a sue and labour expense under marine insurance policies. This is important because under the Institute Cargo Clauses (A), clause 16, sue and labour expenses incurred to mitigate loss are insured, and assuming you decided it appropriate to pay a ransom to release the cargo, if shipowners were not willing to incur that expense, then that should be recoverable from your underwriters. Otherwise the ransom paid by the shipowners is an expense to which all interests at risk should contribute rateably with their respective values in general average.

Delay and extra voyage expenses for sea transport through piracy areas

Subject to the discretions always given to the master to act prudently and within the limits of obviously grave danger, if the shipowner wishes to divert, they must otherwise seek the protection of special clauses in the voyage or time charter which the owners' brokers may negotiate. The most common clause before those recently specially written to take account of Somali piracy, are the Conwartime published in 2004 and Voywar 1993 clauses. Under Conwartime 2004 the risks specifically for which the owners have protection include acts of piracy. However, following the Somali piracy attacks shipowners felt that they were in need of improvement to protect their interests, because the existing clauses required the judgment of the master, as to whether they could be invoked, to be reasonably taken rather than dependent on the master's own subjective judgment. Furthermore, the risk probably had to be a new one and not what was already prevailing at the date of the charterparty (the PRODUCT STAR NO. 2)². This resulted in the publication of new clauses better to protect the shipowners both by INTERTANKO and BIMCO. These piracy clauses are in common use at the moment.

When chartering a vessel if the purchase is FOB, or if selling CFR the best of the new clauses for cargo interests is the BIMCO Single Voyage Charter piracy clause. The most relevant for one off cargo purchase is probably the Single Voyage Charter BIMCO clause, which happily has the least protection for the shipowner and changes very little the protection given under the

² [1993] 1 Lloyd's rep. 397 (a case which was however not considering CONWARTIME 2004 or VOYWAR 1993).



Conwartime clause or the Voywar clause. If a piracy clause is insisted on by the shipowner, then this BIMCO clause should be the preferred choice. This is less in owners' favour than others, the major difference being that owners are still not entitled to invoke it if the risk existed to the same or a greater degree at the time the charter was concluded, and still follows the principle that it would be inequitable if the owners were able to fix a voyage charterparty on agreed terms knowing the existing level of risk of piracy attack along the intended route only to elect then to take an alternative route once the voyage began. The clause therefore focuses on significant change in risk after conclusion of the charter; and one reasonably deemed by the master to be an unacceptable risk avoiding the subjective test.

Does piracy frustrate the charter?

Of course the liberty to deviate and delay provisions in these clauses do not relieve the shipowner from the ultimate responsibility of carrying the cargo to destination; they merely permit reasonable delay and deviation to avoid the reasonably perceived piracy risks, and some require the charterer to pay extra freight for deviation decided upon by the shipowner to bypass the piracy risk. It should be said, however, that if a vessel is seized then it is possible that eventually the voyage charter is completely frustrated so that both parties are relieved of all further responsibility. In those circumstances it is most likely that the cargo would by then be a total loss with full indemnification from your cargo underwriters (with title passing to the cargo underwriter). The test for frustration is an event *"which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of execution, that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances"*³. Generally the test of frustration is an extremely difficult one for shipowners under English law.

Some recommendations

1. Ensure that cargo insurance (both that arranged by you directly for FOB cargoes purchased or that arranged by sellers if CIF) covers

³ National Carriers -v- Panalpina 1981 AC 675



the piracy risk adequately both for loss of cargo and for any ransom payable, and general average contributions and other expenses in mitigating loss.

2. Consider requiring a clause in insurances permitting you to declare a total loss as from the moment of seizure.
3. Limit the liberty given to shipowners in charterparties to deviate and claim extra freight by special piracy clauses now being inserted by owners in charters for sea transport through piracy waters or by a clause specifically requiring the vessel to proceed via the Gulf of Aden or to bear the cost of proceeding via the Cape of Good Hope. For oil cargoes the standard ASBATANKVOY war wording in clause (vi)(b) does not include piracy, which if you are the charterer is best for you but otherwise, if the owners seek special protection in the charter, insist on the BIMCO Single Voyage Charter piracy clause.
4. Insert in charters and bills of lading for your cargoes, provision requiring the shipowner to liaise closely with you on steps to release ship and cargo, at best not to take any steps without your express agreement, and at least to keep you fully advised of all steps being taken by the shipowner to release the cargo on a regular basis.
5. Require all carrying vessels to join international convoy systems protected by participating navies.
6. Insert provision in your sale contracts exempting you from any liability should a sold cargo not reach its destination due to seizure by pirates.
7. Consider (a) reversing risk for FOB and CFR commodities purchased by you so that risk remains with sellers until safe arrival at destination, or (b) inserting a provision requiring the seller immediately to replace any cargo seized by pirates against payment of the same original contract price or market price if lower, or, in your option, declare the sale void with the return of the sale price if LC encashed.

B. **Action to be taken if your cargo is seized by pirates**



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1. Immediately notify cargo underwriters.
2. Immediately contact the opposing party's sellers or buyers of cargo and request their full co-operation, and advice in writing on a daily basis of any information received from shipowners.
3. Contact operations department of shipowner and request that they keep you advised in writing on a daily basis of position of ship and cargo and steps being taken to release, and request that they do not pay any ransom without your prior agreement.
4. Consider humanitarian risk to crew.

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