

At war: Working with charterers when trading in an excluded area

When operating in high risk areas owners can sometimes come under pressure to allow charterers to place additional war risk cover on their behalf. We explore some of the pitfalls that can befall the unwary.



Tord Nilson,
Director Underwriting,
Reinsurance & Risk Control



Jakob Osvald,
Senior Manager
Underwriting



Anna Fjaervoll,
Underwriting & Reinsurance
Coordinator

Why war cover?

In an increasingly complex world, for many ship operators, the importance of war insurance has sadly become a fact of life. War perils - with their high risk of cumulative damage, liability and loss of time - are understandably excluded from all Marine and P&I policies. The insurance industry would simply be unable to survive during an armed conflict of some substance, if such an exclusion was not in place. The accumulated risk would be too great. In addition, of course, a key element of the concept of insurance is cover for damages caused by sudden and accidental occurrences, something that cannot be said about acts of war.

War insurance provides cover on a named peril basis, as opposed to all-risk policies which cover every peril unless excluded. The Club's war insurance product provides cover to members for worldwide trading but with certain areas of higher

risk excluded from cover. The current high risk areas are published on the Club's website. The Club, like the majority of insurance companies offering war insurance, follows the decisions taken by the Joint War Committee at Lloyds to introduce, amend or remove areas.

Pressure from charterers

For high risk areas, most of the time war insurance can be reinstated for a time limited call with changed conditions and at an additional war risk premium (AWRP). The AWRP is paid for by the entity that decides that the vessel will trade to the excluded area. There are cases where this will be the owners themselves, but in most cases it will be paid for by the charterers of the vessel.

Problems are sometimes encountered when a charterer, also operating a fleet owned by themselves in the excluded area, rejects the AWRP that the shipowner

has been quoted by his war insurance provider. This will be on the grounds that the cost is higher, or the terms less favorable, than the charterers have seen from other owners or have seen for their own fleet. The charterers will therefore demand that the shipowner achieves a lower AWRP from his war insurance provider.

The attacks against shipping in the Persian/Arabian Gulf which have taken place in recent years have led to higher AWRP being charged for vessels going in and out of the Gulf. With the charterer in many cases bearing the ultimate cost for such voyages, it comes as no surprise that charterers often make efforts to cross-check the level of AWRP charged, or even to seek alternative arrangements to place AWRP war risk cover on behalf of owners, in order to reduce costs for themselves.

The attacks against shipping in the Persian/Arabian Gulf which have taken place in recent years have led to higher for AWRP being charged for vessels going in and out of the Gulf.

For the most part, checking owners' AWRP is sufficient to ensure that the amount that charterers are being asked to pay is competitive in comparison with their own experience and current market levels. In some instances however, the premiums that charterers have been charged differ vastly from the owner's quote. Consequently, the charterers try to force the owners to negotiate certain AWRP levels with their insurer, or even force the owners to place the 'breach voyage' to the high risk area on a separate cover made available by the charterers. Indeed, provisions to this effect are sometimes written into charterparties between owner and charterer. By doing so, charterers will feel in total control of cost and may benefit from returns and commissions.

Into the unknown

For owners of a vessel the situation is reversed as there is a loss of control in relation to the insurance of their vessel. Owners take time and care when choosing the insurers of their vessels, and they work to build up a relationship with them. When owners agree to place cover for their breach voyage on a separate policy they have to 'share' the

policy with other assureds. In addition to the charterer of the vessel, it can also include other owners in the same situation. In the event of a claim, the owners will be dealing with insurers they have not chosen themselves and may know nothing about the security behind.

Further to this there are many issues related to placing breach voyages with charterers or elsewhere, and many arguments for owners to resist or consider before doing so.

Insurable interest

The concept of insurable interest - the financial interest by the insured entity in the object of insurance - is a cornerstone in any insurance. The charterer does not have an insurable interest in the vessel they insure on behalf of the owner. Furthermore, the charterer may have very different objectives - mostly to do with reducing cost - than the owners. Very little emphasis is put on other aspects such as the insurer's claims handling capabilities and willingness and capability to pay in the event of a claim.



Mortgagees

An owner has an obligation under the loan agreement to advise and to obtain approval from mortgagees on each occasion when the underlying war insurance is suspended, cancelled or placed with alternative underwriters. The war insurer, and in some cases the insurance brokers, have obligations to mortgagees under their letter of undertaking to advise mortgagees of the owners intention to suspend cover. This places both a legal obligation and an administrative burden on all parties and increases the possibilities of errors and oversights which may again leave the owner in breach of his loan agreement.

There is also an additional administrative burden when suspending cover for short periods of time in the Persian/Arabian Gulf. The suspension has to be reported to the insurers as well as the mortgagee(s) for approval on every single occasion. If not done or missed, double insurance would be the result and there could be cover issues as well. With insufficient security for their insurance cover, the owners may also be in breach of the loan agreement for the vessel.

Claims disputes

Needless to say, if a claim occurs immediately following reinstatement of the owners cover it will inevitably lead to a dispute regarding what set of underwriters should respond to the claim and no doubt will take months if not years to litigate before settlement is reached. An example could be a limpet mine attached to the vessel, exploding shortly after reinstatement. When was it attached to the vessel? Needless to say the potential for dispute will escalate if the claim occurs during a period of constant suspensions and reinstatements.

For claims purposes a breach is technically looked upon as the period from port prior to breach until the time to first port after breach. Charterers may offer to cover a vessel for the same period, pre-port and post-port breach, however the owner's insurer would usually suspend insurance for the time within the breach area only and will most likely warrant to know that no

known or reported losses have occurred before they agree to reattach cover. If a claim has occurred during the period of suspension, owners may face problems with the re-attachment and may need to seek alternative risk cover or pay an increase in their annual war risk premium to have cover reinstated with their original insurers, a cost that owners will be unable to recover from charterers.

The Swedish Club offers war cover on a 'held covered' provision, which means that if there is an error in reporting the breach it is still covered provided that premium is eventually paid.

No insurance or double insurance

Great care should be taken at all times to avoid the possibilities of operating without insurance or of having double insurance. Often it is not clear when the charterer's cover is deemed to attach and, at the other side of the breach voyage, the owner's war insurance to reattach. This in itself leads to a concerning problem; from what point is the breach cover in place, during what time will the charterers facility insurers be on risk and at which point will the owner's war insurance reattach?

Wherever their insurance is placed, owners require certainty of cover at any given point in time. This includes having a seamless cover between hull policies and war policies to ensure that there are no gaps in the owner's cover. Potential disputes in this respect can occur if the owner's hull and war risk policies are placed on Nordic Plan (NPL) and the cover placed by charterers for the breach is placed on Institute Time Clauses (ITC), and the risk of disputes will of course increase with different

underwriters involved for the various covers.

Errors in administration; insufficient insurance – or no insurance at all

Vessel values change frequently, and an increase in value of a vessel just prior to a breach may not be communicated properly to insurers by charterers, resulting in under insurance during the breach.

Furthermore, the charterer's cover may be prejudiced due to breach of warranty on their behalf (e.g. if charterers have omitted to declare or provide other vital information to insurers). This would result in no cover afforded to owners for an action or inaction that they have no control over. Owners would need to seek re-compensation directly from the charterer, if allowed within the charterparty.

The importance of being 'held covered'

The Swedish Club offers war cover on a 'held covered' provision, which means that if there is an error in reporting the breach it could still be covered provided that it is reported without delay and the additional premium is paid. There may not be such provision in a charterer's cover. This is an important issue, for example over a period when the offices of the various parties are closed, and a fixture within a breach area is arranged at the last minute, meaning that the owners are unable to carry out the numerous administrative tasks that are normally handled with their own insurers.

At the heart of the issue

A charterer does not have an insurable interest in the vessel for which they arrange cover. This means that their main interest is to arrange cover at lowest cost available. It must be remembered that which insurer the cover is provided with, and on what terms, is of less interest to charterers – it is not their property or liability that needs to be insured. The contrary is true for an owner. Certainty of cover, terms, and provider of insurance are the most important things when insuring a vessel. 🇸🇪