

PIRACY AND INSURABLE RISKS IN MARINE INSURANCE

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Piracy

It is one of the maritime perils and insurable risks. Pirates are robbers at sea who steal the vessel and her cargo by force. They can use captured vessel for trading. At the other extreme are pirates who simply retain possession of the vessel and her crew to extort a ransom which they know from past experience will be (albeit reluctantly) paid.¹

For a piracy to take place, it contains the presence of force or a threat of force, a purpose of personal gain and the occurrence of such act within the territorial waters or high seas. A national court can prosecute the captured pirates for criminal offences if they are caught within the territorial waters of the country.²

The Straits of Malacca is an important waterway for international navigation and an average of eight hundred ships use it every day. It used to have its share of piracy activities. Such pirates stormed the vessels at night and escaped with cash from the masters' cabin security boxes and electronic goods.

Compared to the pirates from Somalia, these pirates in the Straits of Malacca are amateurs. *Modus Operandi* of Somali piracy is notorious among ship-owners and shipping companies throughout the entire world. They capture vessels several hundred nautical miles from the Somali coastline in order to ransom them. They negotiate with the owner and other interested parties through intermediaries for the release of the vessel, cargo and crew, in exchange for a payment which represents an economic proportion of the value of the property. Each ransom may run into a couple of millions. The Somali pattern of piracy has also spread to other parts of Africa and there was a major instance of piracy off the coast of Lagos in Nigeria in August 2012.

Pirates were described as "the enemies of mankind and would have no right to the possession".³ A ship and her cargo captured by pirates do give rise to legal claims and problems in the law and practice of Marine Insurance.

Insurable peril

Piracy as a maritime risk is as old if not older than the Marine Insurance Act 1906.

The old SG policy includes piracy in archaic language:

Touching the adventures and perils....of the seas, men of war, fire, enemies, pirates, rovers, thieves

¹See *Cory v Burr* (1883) LR 8 App Cas 393.

²See *Bayswater Carriers Pte Ltd v. QBE Insurance (International) Pte Ltd* [2006] 1 SLR 69.

³See *Dean v Hornby* (1854) 3 E & B 180, per Lord Campbell at p 190-192.

Piracy is also included as one of the maritime perils in the Institute Cargo All Risks since its introduction in 1983. The all risks policy covers piracy under clause 6.2 in the following manner:

6.2 capture, seizure, arrest restraint or detainment (piracy excepted) and the consequences thereof or any attempt hereat.

Total loss

There are two kinds of total loss – actual total loss and constructive total loss. One is dictated by physical deprivation and the second one is based on economic factors.

When there is a total loss, the assured is entitled to claim for the full insured value stated in the policy. This is the measure of indemnity for the assured.

Actual total loss

The assured can have a claim for actual total loss if the insured subject matter is physically destroyed or damaged to the extent that it no longer resembles the subject matter. The obvious examples include a sinking of the vessel or an explosion of a tanker.⁴

There can also be a claim for an actual total loss if the subject matter is beyond recovery. The key words are “irretrievably deprived”. To succeed, the assured has to establish that he is irretrievably deprived of the insured vessel or goods.

S 57(1) of the Marine Insurance Act 1906 stipulates:

Where the subject-matter insured is destroyed, so damaged as to cease to be a thing of the kind insured, or where the assured is irretrievably deprived thereof, there is an actual total loss.

Where a vessel is sunk or physically, it is a clear total loss. However, a total loss can take place in the event of capture by pirates as decided by an English case more than 100 years ago:

*....captured by the enemy in time of war or seized by pirates, although she continues to exist, the vessel is no longer available to the parties interested.*⁵

“Irretrievably deprived” under s 57 (1) is an objective test. There has to be an assessment based on true facts either apparent or known to the assured. No “irretrievably deprived ” if recovery could only be achieved by disproportionate effort and expense. For the purposes of establishing irretrievable deprivation the assured must establish that the recovery is impossible.⁶

In *Fraser Shipping Ltd v Colton* [1997] 1 Lloyd’s Rep 586

⁴*McPhee v. Phoenix Insurance Co* (1890) SCR 61.

⁵*Cambridge v. Anderton* (1924) 2 B & C 691.

⁶*Masefield AG v. Amlin Corporate Member Ltd* [2009] 2 CLC 318, per David Steel J at p 330:

A vessel was insured only for actual total loss. She was stranded on a Chinese island whilst under towage. On a balance of probabilities, the cost of a successful salvage would outweigh the insured value of the ship. Potter LJ aptly provided the legal basis for an actual total loss:

*As to the definition of actual total loss, whether the plaintiffs were “irretrievably deprived” of the vessel prima facie depends upon whether, by reason of the vessel’s situation, it was wholly out of the power of the plaintiffs or the underwriters to procure its arrival. It seems to me that this, in turn, depends upon whether the vessel could have been physically salvaged or not. The undisputed evidence in this respect was to the effect that it was feasible to salvage the vessel subject to accessibility and cost.*⁷

Inevitably, most judges in dealing with complex issues of the law and practice of marine insurance will turn to the primer, Arnould on *Marine Insurance and Average*. The present editors enunciate the following principle:

*The great principle, therefore, on which all the cases of actual total loss depend appears to be this – the impossibility owing to the perils insured against, of ever procuring the arrival of the thing insured. If, by reason of those perils, the assured is permanently and irretrievably deprived not only of all present possession and control over it, but of all hope or possibility of ever ultimately recovering possession of, or further prosecuting the adventure upon it, that is a case of ACT, independently of the election of the assured to treat it as such*⁸

In *Masefield AG v Amlin Corporate Member Ltd* [2011] EWCA Civ 24:

The ship and her cargo of bio-diesel oil were seized by Somali pirates. The insured was notified of the seizure and the ship-owner was negotiating with the pirates for a release in exchange for a ransom sum. The cargo owner served a notice of abandonment on the insurers which was rejected. The cardinal issue here would be whether the seizure amounting to an actual total loss irrespective of prospect of recovery.

The appeal of the cargo owner was unanimously dismissed by the Court of Appeal. Rix LJ said as follows:

There was no rule of law that capture by pirates, whatever the prospects of recovery might be, created an immediate actual total loss.....where there was not only a chance, but a strong likelihood, that payment of a ransom of a comparatively small sum, relative to the value of the vessel and her cargo, would secure the recovery of both, piratical seizure did not give rise to an immediate actual total loss and that, accordingly, in the circumstances, the insured had not made out its claim for an actual total loss of the cargoes.

Constructive total loss

An insurer is keen to pay his assured the insured value if the cost of recovering the subject matter is going to be higher than the insured value. A constructive total loss arises purely out of economic considerations.

A good example is where a vessel has been stranded in a disputed area in the South China sea. She has to be salvaged, her cargo needs to be transferred to another vessel and she has to

⁷ [1997] 1 Lloyd’s Rep 586,

⁸ 17th Edition, para 28-03, note 9.

undergo extensive repairs in the nearest port city with a ship-yard. It may be cheaper for the underwriters to pay the assured the insured value than to face the daunting cost of all these expenses.

S 60 (2) of the Marine Insurance Act 1906 provides the legal framework for a constructive loss in respect of the ship and her cargoes:

(i) Where the assured is deprived of the possession of his ship or goods by a peril insured against and (a) it is unlikely that he can recover the ship or the goods as the case may be, or (b) the cost of recovering the ship or goods as the case may be, would exceed their value when recovered;

An assured has the election either to treat his loss as a partial loss or to give notice of abandonment to the insurer and claim for a total loss. It is a condition precedent for a claim of total loss to give notice of abandonment under s 62 of the Marine Insurance Act. As a consequence of the notice of abandonment, the underwriter may be entitled to take the benefit of what may still be of any value, and he may, if he pleases, take measures, at his own cost, for realizing or increasing that value.

The relevant criteria for a claim under a constructive total loss other than a notice of abandonment are deprivation of possession and uncertainty of recovery.⁹

In *Dean v Hornby* (1854) 3 E & B 180

The vessel was captured by pirates in the Straits of Magellan in December 1851, but was recaptured by an English warship within two months. The assured gave notice of abandonment when he learned that the prize master sailed her to Valparaiso to be condemned as a prize. The same prize master sailed her to England but deviated to Fayal due to bad weather. She was sold on as a prize in Fayal based on erroneous advice by a surveyor that she was unfit for a voyage back to Liverpool. The new owner bought her for a song, carried out the necessary repairs and sailed her to Liverpool.

The assured and his underwriters instituted proceedings to recover possession and the Admiralty court awarded possession to the assured. She was subsequently sold and the proceeds of the sale were subjected to the determination of the court on the following legal issues:

- (1) Whether the assured was to be paid on the basis of a total loss or constructive total loss.*
- (2) Whether the assured was to be paid for partial loss on the basis of the notice of abandonment.*

The assured's contention was for a total loss since he did not take possession of the ship at all until the commencement of the admiralty court proceedings. Counsel for the insurers said that the notice of abandonment was given under a mistake of either facts or law as the vessel was re-captured by the English war ship at the time of the notice.

⁹Rix LJ in *Masefield AG v Amlin Corporate Ltd* [2011] EWCA Civ 24, at para 32.

The court held that this was unquestionably a total loss as the assured never had an opportunity of taking possession.

In this case, there was both a deprivation of possession coupled with uncertainty of recovery.

In *Polurrian Steamship Co Ltd v. Young*, Kennedy LJ said that test under S 60 of the Act was no longer that of uncertainty of recovery, but whether “it is unlikely that he can recover the ship” and this court could not say that recovery was unlikely and therefore the claim failed.¹⁰

Another case of constructive total loss surfaced in Asia is the *Panamanian Oriental Steamship Corp v Wright*.¹¹ In this case, the vessel was seized by the Vietnamese customs and was sold pursuant to an order of the military tribunal of Vietnam. The confiscation and subsequent sale was not judicial but an executive or political one. The assured could probably obtain her release on payment of a hefty fine coupled with payment of bribes to the officials. It was decided by Mocatta J that this would be a constructive total loss on the ground that the test for “irretrievable deprivation is clearly far more severe than the test of unlikelihood of recovery of possession”.

Partial Loss

The Marine Insurance Act 1906 provides only for total loss or partial loss.¹² A claim for a total loss can also be converted into a claim for partial due to subsequent evidence and facts. This is specified under s 56 (4):

*Where the assured brings an action for a total loss and the evidence proves only a partial loss, he may, unless the policy otherwise provides, recover for a partial loss.*¹³

A vessel could be captured by pirates. It could *prima facie* be a total loss, followed by a recapture, which would revert the property in the assured. Under such circumstances, the ship owner could only claim for a partial loss for damage to the vessel.¹⁴

In *Dean v. Hornby*, Lord Blackburn advised a “wait and see” approach:

*It is therefore dangerous to treat deprivation of possession simpliciter as a cause of total loss subject only to being turned into a partial loss by subsequent recovery. Secondly, even in the Act of 1906, this concept is only a prima facie basis for a case of total loss. ...”Wait and see” is therefore to some extent always an essential ingredient of a claim for total loss in circumstances involving deprivation of possession unless...clear intention at the time of the dispossession permanently to deprive the owner of possession and ownership.*¹⁵

Sue and Labour

¹⁰[1915] 1 KB 922 per Kennedy LJ on p 937-938. Also see *Roux v Salvador* (1836) 3 Bing NC 266.

¹¹[1070] 2 Lloyd’s Rep 365.

¹²S 56 (1).

¹³Marine Insurance Act 1906.

¹⁴*Roux v Salvador* (1836) 3 Bing NC 266 , per Lord Abinger CB at 285-286.

¹⁵(1854) 3 E & B 180 at p 190.

The Somali pirates do not keep the vessel and her cargoes. They capture the vessel only for the purpose of extracting a ransom through intermediaries.

Compared to the insured value of the ship and her cargoes, the ransom amount is only a small fraction. Ransom amount is often less than 3 percent of the combined insured value of both vessel and goods.

The logic of making ransom payments to secure the release of the captured vessels and their cargoes was given by David Steel J:

*Equally any concept of military intervention involves legal and technical difficulties, leaving aside the risk to captured crews. In short, the only realistic and effective manner of obtaining the release of a vessel is the negotiation and payment of a ransom.*¹⁶

The actual payment sum plus the expense of engaging intermediaries to secure the release of the ship are part of sue and labour expenses. Payment of ransom to the pirates is not illegal and contrary to public policy.

S 78(1) of the Marine Insurance Act 1906 states:

Where the policy contains a suing and labouring clause, the engagement thereby entered is deemed to be supplementary to the contract of insurance, and the assured may recover from the insurer any expenses properly occurred....

Hence, the expenses incurred can even be higher than the insured value as they form part of an independent contract supplementary to the contract of insurance. The only limitation is “reasonableness” of the claims.

Also, sue and labour expenses have to be incurred for the purpose of minimizing or averting an insurance risk covered by the contract of insurance. S 78(3) provides of the same Act provides:

Expenses incurred for the purpose of averting or diminishing any loss not covered by the policy are not recoverable under the suing and labouring clause.

The present editors of Arnould on *Marine Insurance and Average* clarify:

*There appears to be little doubt that a payment which is not illegal itself under any relevant law is made to secure the release of the property, this can be recovered even though the persons demanding the payment are not acting lawfully in so doing. Thus, for example, payment to recover property from pirates or hijackers must, it is submitted, in general be recoverable.*¹⁷

The learned editors’ view was given judicial support by Phillips LJ (as he then was) in *Royal Boskalis’ case*:

¹⁶*Masefield AG v. Amlin Corporate Member* [2009] 2 CLC 318, at p 323.

¹⁷ At para 25-21 of the 17th Edition (2008).

*In my judgment, the assumption of the editors of Arnould that payment of ransom, if not itself illegal, is recoverable as an expense of suing and laboring is well founded.*¹⁸

Conclusion

Payment of a ransom of a comparatively small sum to the Somali pirates, relative to the value of the cargo and ship would secure their recovery cannot be an actual total loss as there is no irretrievable deprivation of property. Also, payment of ransom cannot support any claim for constructive total loss as it fails the current test of unlikelihood of uncertainty.

The *modus operandi* of these African pirates is simply to capture the vessel and her cargo for a quick ransom and release. They are different from the pirates cited by the old English cases more than 100 years where their purpose was to capture the ship for their own use.

In the *Masefield's* case, the underwriters rightly rejected the cargo claimants' claim for a constructive total loss as there was no unlikely recovery under s 60(2) of the Marine Insurance Act 1906.¹⁹ There may be a claim for partial loss due to piracy if the cargo claimant can establish *causa proxima*. The underwriters will use delay as one of the excepted perils to reject such a claim. Often there is a diminution in the value of the cargo due to detention caused by the pirates and the cause of this delay.

For the ship-owner, he may claim back the cost of providing the ransom as part of "sue and labour". It will be a win-win formula for both the insurer and the assured. The insurer may only have to pay a small fraction of the insured value.

¹⁸ [1999] QB 674 at p 720.

¹⁹ [2011] EWCA Civ 24.