

## Trading in piracy-risk areas: issues for commodities traders concerning the piracy threat

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### Introduction

Pirate attacks on merchant vessels are still an increasing problem. The total annual cost to the shipping and trading industries is substantial. Traders have to respond to the reality of the piracy threat by taking appropriate steps to protect themselves and their cargoes, and some suggestions will be made below as to how to do so. Other [Reed Smith Alerts have looked at the piracy issue](#) from a shipping and chartering perspective.

### Background

The numerous incidents of piracy during the past few years have caused headaches for the shipping industry, and also for global trade. Commodity traders doing business in piracy-risk areas, such as the Indian Ocean and the Gulf of Aden, see their cargoes arriving many months late at their intended destination or having deteriorated or even being at risk of loss as a result of the carrying vessel being captured by pirates. The costs of doing business in these areas are becoming exorbitant. The traders should be alerted to a long list of issues when trading in piracy-risk areas - a few examples below:

- **General Average** - The typical piracy incident is followed by a GA ("General Average") declaration by ship owners. This is what triggers liabilities on the cargo owner (via the bill of lading) to contribute substantially to the costs of the ransom and other costs associated with gaining the release of the vessel/cargo. The contribution is in proportion to the value of the cargo compared with the overall value of the "adventure" (vessel, cargo, bunkers etc). Therefore, the trader may not only see his cargo being at risk of deterioration or loss, but must also pay towards the release!
- **Cargo Insurance (1)** - Having adequate insurance in place to cover the risk of piracy and associated costs, such as ransom, negotiation fees etc, has become a key issue for traders and their underwriters. A standard cargo insurance policy may include piracy as an insured risk, (e.g., Institute Cargo Clauses A *does* cover piracy, B and C do not, Bulk Oil SP 13C does not cover piracy), which covers loss and damage to the cargo and indemnity for ransom (under the General Average provision), but not delay to the cargo.
- **Cargo Insurance (2)** - The next issue with insurance is who pays the ever-increasing premiums for piracy cover, and who pays any increase between contract and shipment dates. The standard answer on a CIF contract is the Seller, but the position is increasingly being covered by specially negotiated terms shifting the burden to the Buyer. It is worth checking the express terms of the

contract carefully. For example, the BP 2007 Terms allow *the Seller* to choose between Institute Cargo Clauses A and Bulk Oil SP 13C, one of which does and one does not cover piracy.

- **Cargo Insurance** (3) - A further issue (which links to 'payment' below) is whether the Seller has sufficient insurance to cover his interests pending payment by the Buyer. We have seen a number of piracy incidents where the Seller unexpectedly retains an interest in the cargo throughout the months of the incident, but carries inadequate insurance to cover the problem.
- **Payment of the Purchase Price** - A cargo seized onboard the vessel whilst en route to the discharge port is normally at the Buyer's risk under the usual CIF, C&F or FOB contract. However, even if risk has passed to the Buyer, very few Buyers (in our experience) are in practice willing to pay the purchase price when the goods are known to have been seized by pirates. Buyers therefore look for any suitable contractual excuse not to pay. We have seen Buyers take any and all points available on the shipping documents, particularly in trades where the documents can be extensive and complicated (such as FOSFA). In addition, depending on the requirements of the payment clause in the sale contract, the Seller may not yet even be in a position to demand payment from his Buyer (e.g., if the payment clause is linked to the timing of the vessel's arrival at discharge rather than shipment). Therefore, traders negotiating sales which will involve passage through piracy zones need to pay attention not only to the insurance clauses but also to the payment provisions - in particular timing and security - to ensure that they can force payment from a recalcitrant Buyer.
- **Total Loss?** - On the issue as to whether seizure by pirates amounts to a total loss and whether the payment of ransom is insurable, useful guidance for commodities traders is given in the much anticipated Court of Appeal decision in the *Masefield AG v. Amlin Corporate Member Ltd* ("The Bunga Melati Dua") [2011] EWCA Civ 24, which was delivered earlier in the year (January 2011). The Court of Appeal confirmed that capture by pirates does not render a ship or cargo an actual total loss or a constructive total loss. For a commentary on that decision, please read the [Client Alert we published 28 January 2011](#). Briefly, that case arose out of the capture of the vessel Bunga Melati Dua by Somali pirates in the Gulf of Aden in the course of her voyage from Malaysia to Rotterdam in August 2008. Masefield, the insured/owner of the cargo, served a notice of abandonment to Amlin, the insurer, which Amlin refused to accept. The vessel, her crew and the cargo (bio-diesel) were ultimately released by the pirates upon payment of ransom by the shipowners. (Release occurred six weeks after capture and 11 days after payment of the ransom.) The insured brought a claim against the insurer seeking recovery of the difference between the resale price of the ultimately released cargo and the insured value on the grounds that the cargo had been an actual total loss by capture by pirates, or alternatively a constructive total loss because of the notice of abandonment. The insured's arguments as to total loss (actual or constructive) were not accepted by the Court of Appeal. The key points for commodities traders to note from that judgment are:
  - Seizure by pirates does not automatically render a cargo an actual total loss because there is no irretrievable deprivation of property, since the vessel and cargo would very likely be recovered by payment of a ransom. The seizure is a typical "wait and see" situation. Thus the trader has no

claim on the insurance for many months and may never have a claim if the cargo is ultimately released. All risk of loss in value is on the cargo owner for the months of detention.

- The payment of ransom is not contrary to public policy. There is no legislation against the payment of ransoms, which is therefore not illegal. The payment of ransom is a commercial eventuality and is recoverable either as a General Average or a sue and labour expense under marine insurance policies.

## Recommendations for Traders

We have highlighted above some of the issues raised by piracy which commodities traders and cargo interests should be alerted to. As to how traders should respond to the piracy risk in order to protect their cargo interests, here are some recommendations:

- Of course, it is important to have adequate insurance cover in place which includes the risk of piracy and any associated costs (such as ransom, negotiation fees etc), usually under a war risk policy, and to have such cover even as Seller when you expect all of the 'risk of the voyage' to be with the Buyer.
- It is important to check carefully the insurance clauses of the general conditions incorporated into your contract so that you know whether piracy will be covered.
- Any ransom paid by the shipowners is an expense to which the cargo interests would have to contribute in General Average.
- Traders should be aware that cargo underwriters will not pay the insured for total loss due to the mere fact of the capture of the vessel and cargo by pirates, and may not pay for many months.
- Loss incurred as a result of deterioration of a cargo whilst the vessel is held by pirates will be recoverable under certain cargo insurance policies, where these cover piracy.
- A usual C&F/CIF/FOB Buyer may wish to consider converting to buying on "delivered terms", so that risk of loss or damage remains with the Seller until the safe arrival of the vessel/cargo at the intended destination.
- When chartering a vessel, an FOB Buyer/C&F or CIF Seller should resist the inclusion of any special piracy clauses in the charterparty that may favour the shipowners in the event of an act of piracy (e.g., to claim demurrage/hire whilst the vessel is detained), or at least seek legal advice on any clauses required by the shipowners, to ensure that he does not agree to onerous terms and/or does not agree to terms which will affect his position under the terms of his sale contract and/or the bill of lading.
- Payment clauses should be negotiated with piracy in mind and Sellers should avoid linkage between payment and arrival at destination, at least without a fall back position calculated from B/L date.

- Cargo interests should avoid requests to consent to/approve routing decisions or the placing of armed guards on vessels.

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