GEORG DUNCKER
MARINE INSURANCE BROKERS

BRIDGE LOOK-OUT

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MIND YOUR LIQUIDITY IN CASUALTY SITUATIONS

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Since the financial crisis of 2008 and the subsequent crisis in the shipping market, shipowning companies are still suffering from low liquidity or in worse cases, slipping into liquidation.

It is therefore essential to follow annual budgets closely, to ensure the economical operation of the vessel and in turn to maintain control of costs and earnings. In this regard, insurance plays a major role. Whilst premiums account for a considerable portion of the vessel's annual budget, they provide financial security in event of a casualty, which otherwise would lead to major unbudgeted costs. In an event of a major casualty, it is prudent to mention that the Shipowner may still face considerable outgoings, even with coverage for the main insurance products such as P&I, Hull and Machinery and Loss of Hire in place.

In several emergency casualty situations, the Shipowner is required to declare General Average to benefit from the solidarity principle by having Cargo Interests contributing to expenses like salvage, emergency port call, discharging and storage of cargo or even disposal of firefighting water. For the most part, the Shipowner has to pay out the aforementioned costs and is required to understand emergency procedures which need to be executed to resolve the dangerous situation.

The reimbursement principle of the Shipowner's disbursements in General Average is quite simple, however very time consuming. The Hull and Machinery Insurer will usually grant a payment on account for the Shipowner's disbursements which are limited to the ship's proportion of the disbursements only. For the remaining costs, there is no obligation for the Cargo Interests to effect a payment on account. As a result, the Shipowner will have to front the cargo's contribution to costs and usually need to wait a considerable amount of time before the General Average adjustment can be finalized and the cargo contribution is collected. The waiting time for the collection of the cargo contribution can even be extended if the allegation of a breach of contract is brought up by the party with Cargo Interests. From experience, we have seen that the reimbursement of the Shipowner's disbursements can last even several years.

In our bridge look-out edition 1/19, we described the advantages of the financial mechanism for emergency services rendered under the Lloyd's Open Form of Salvage Agreement (LOF) in General Average situations which avoids the Shipowner having to advance the cargo's contribution. In this current edition of bridge look-out, it is our aim to describe the insurance solutions available on the market to limit the Shipowner's financial burden of disbursing the cargo's contribution.

The international insurance market effectively offers two different major models to fill the gap of the cargo's contribution in General Average situations.

The first insurance model, the so called „Cargo Contribution Protect", prefinances in first instance the cargo's contribution to General Average up to a limit of EUR 7.500.000 in different layers. The ship's contribution remains recoverable under the H&M cover up to the insured value of the ship. The Shipowner will therefore receive a prompt reimbursement. It should be highlighted that the Cargo Contribution Protect cover can still be placed after the incident occurred but prior to official General Average declaration, however on a much higher premium level.

The General Average process will remain unaffected by this insurance and it is in fact a condition for the Shipowner to declare General Average to trigger the Cargo Contribution Protect cover. Following the completion of the General Average Adjustment, the cargo's contribution will be collected in the usual way and the Cargo Contribution Protect cover will be reimbursed accordingly.

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In the event the Cargo Interests claim for breach of contract and subsequently do not pay their contribution, the insurance will also cover the legal fees to recover the cargo's contribution. In summary, one could say that the Cargo Contribution Protect cover is in principle a prefinancing model to protect liquidity.

The second insurance model, the so called „Extended General Average Absorption" is of different nature and is linked to the Absorption Clause under the H&M policy. The insurance cover for the Extended General Average Absorption will be triggered once the vessel is in an emergency situation which fulfils the conditions of General Average. However, Shipowners do not need to declare General Average, but instead the Absorption Clause under the H&M cover and in excess the Extended General Average Absorption will cover the General Average related costs up to a maximum limit of USD 5.000.000. For all General Average costs in excess of that limit, Shipowners need to consider declaring General Average at a certain time or to find a commercial solution with Charterers in order to ensure that the extended absorption limit will not be exhausted.

Which of the above described models suit best to a Shipowner's fleet depends on various factors.
For example, the Cargo Contribution Protect cover provides financial security for a Shipowner in casualty situations on a rather low premium level and a higher available limit. However, the long lasting and expensive General Average process is still to be conducted and business partners such as Cargo interests and Charterers are still expected to contribute to the casualty related General Average costs.

On the other hand, the Extended General Average Absorption cover provides financial security on a higher premium level, but the Shipowner will benefit from not being obliged to declare General Average of up to USD 5.000.000. This is certainly an advantage in terms of the business relation with Charterers and Cargo Interests and it might be expected that an increased hire can be negotiable if the Extended General Average Absorption limit is incorporated into a Charter Party and hence may be a selling point when offering the vessel in the market.

In summary, the aforementioned models could be of great assistance to a Shipowner in covering financial risks in casualty situations, namely due to the long lasting adjustment and reimbursement process and through securing the relationship with business partners such as Charterers and Cargo Interests in difficult shipping times. Additionally and by ensuring liquidity, it may also protect Shipowners from potential arrests for unpaid General Average expenses.

Your Brokers at Georg Duncker will be happy to assist Clients individually on which model is best suited to their respective fleet.

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