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Dire straits for commercial shipping

Understanding insurance coverage in potential choke points

With over 90% of international trade being carried by sea, the safety of commercial maritime shipping is essential to the global economy. Much of the world's trade travels along maritime highways between Asia, Europe, and North America. Most of these routes are sailed through wide open waters, but there are a few places where narrows, straits, or other restricting features must be navigated.

Should safe navigation through these vital waters become dangerous, they could prove to be the Achilles heel of global economic growth and prosperity. It is therefore not surprising that the potential closing of two of those essential waterways in the Middle East — the Bab el-Mandeb Strait and the Strait of Hormuz — raises questions about insurance coverage for delay, voyage frustration, and possible deterioration losses.

Concerns with the Bab el-Mandeb Strait and the Strait of Hormuz

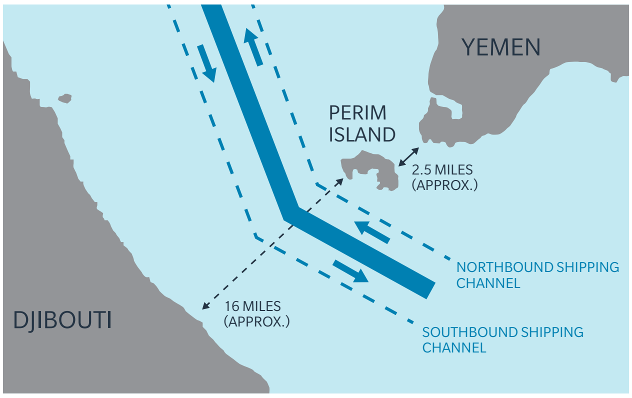
The Bab el-Mandeb Strait (or "Gate of Tears") is at the southern entrance to the Red Sea. This narrow waterway must be navigated by all commercial vessels trading between Europe and Asia in order to avoid the far longer, time-consuming, and thus more costly routes around southern Africa or through the Panama Canal. Perim Island is situated close to the Yemeni side of the strait, which means that most international shipping, both north and southbound, keeps to designated shipping lanes to the west, or Djibouti side, of this island. The water there is much deeper, but the channel is only about 16 miles (25 kilometers) wide at its narrowest point. However, the entire strait is easily within range of land-based missiles and of small, attacking boats.

Although complete closure of the strait is considered unlikely, threats on commercial vessels using it may be enough to quickly produce far-reaching economic effects that could have serious implications for continued insurance cover. For example, on July 25, 2018, Saudi Arabia announced that it was ceasing to sail its Saudi-flagged oil tankers through the Bab el-Mandeb Strait following targeted attacks on their vessels by the Houthi rebels in Yemen (against whom, Saudi Arabia is taking military action)[1].

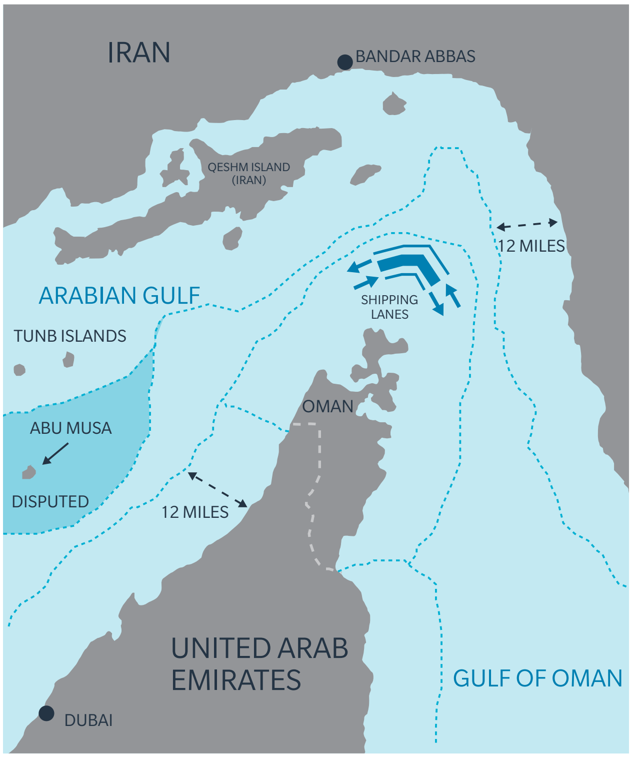
However, Saudi Arabia soon recommended using the Bab el-Mandeb Strait. Although Saudi Arabia has an oil pipeline from the eastern part of the country that can be used for its own oil loadings, the warning for the wider shipping community of the strait's closure is evident.

The Strait of Hormuz is another narrow waterway in the region through which great quantities of oil and natural gas are shipped. Situated between Iran and Oman, this is the only maritime passageway between the Arabian/Persian Gulf and the outside world. Approximately 34 nautical miles wide at its narrowest point, the strait has a small island in the middle, Abu Musa, which is currently claimed and occupied by Iran, thereby considerably restricting commercial shipping lanes. As with the Bab el-Mandeb, the Strait of Hormuz could be threatened with blockage at any time.

Bab el-Mandeb Strait



Strait of Hormuz



Insurance considerations in the straits

So often, it is innocent commercial vessels, their cargoes, and their crews that are put at grave risk when conflicts spill over into international waterways. Operators of vessels, charterers, cargo owners, and their financiers need to be aware of the limitations of insurance cover should waterway closure frustrate voyages or charter parties.

Yemen has suffered political unrest and civil war for many years. It is therefore not surprising that Yemen — and its claimable territorial waters of up to 12 miles offshore under the United Nations Convention on the Law of the Sea (UNCLOS) — has long been on the Joint Hull War Committee's list of areas of perceived enhanced risk[2]. Vessel operators should already be aware that permission from underwriters should be sought before entering any listed area if insurance cover is not to be prejudiced. Yemen and Iran are both on that list, and concerns about the Bab el-Mandeb are echoed by similar concerns over the Strait of Hormuz.

Unlike marine hull war insurance coverage, there are no market-wide cargo insurance exclusions concerning Yemen, but the Joint Cargo Committee's Cargo Watch List[3] continues to note Yemen as a severe risk. This list, updated monthly, is a risk advisory notification, meaning the decision whether to provide cover for cargo shipments in or through these waters is left to individual insurers. With the re-imposing of sanctions against Iran, it is doubtful that most hull or cargo insurers will provide any cover while in Iran or its national waters. Similarly, most insurance brokers will be unable to provide insurance services for goods located in Iran.

In a wider context, it should be remembered that losses to goods caused by delay without physical damage — such as seasonal goods whose value will reduce substantially if not timely delivered to intended markets — are usually excluded under the terms of the standard Institute Cargo Clauses 2009. Therefore, if the goods are of a time-sensitive nature, additional cover should typically be sought, if possible. The insurance cover for perishable goods should also be carefully considered if waterways along the transit route are threatened with blockage.

The consequences of enforced discharge at locations other than those originally intended need to be assessed; it cannot be assumed that coverage will automatically continue, or that resulting additional expenses would be covered.

Vessel charterers and operators also need to be clear about the respective obligations within their charter party agreements and the potential contractual liabilities each could incur should the chartered vessel be unable to complete the originally agreed voyage, or worse, suffer damage by warring parties along the route.

It is important for our clients to ensure that they are aware how their insurance coverages may be affected by conflicts in these two important geographical choke points, and elsewhere. If unsure, we recommend you seek advice from your Marsh contact.

Sanctions threat

With the re-imposition of sanctions on Iran by the US and others, great care should be exercised in the navigation routes adopted by commercial vessels near Iran. Having transited through the Strait of Hormuz, heading north into the Arabian/Persian Gulf, it is now unlikely that many vessels intend to stop at any Iranian ports along the way, as most are likely heading north toward ports in Iraq, Saudi Arabia, Kuwait, or Qatar. However, we must warn that a seemingly common practice of sailing close to — or, even worse, inside — Iranian waters along that route may present considerable legal challenges now that sanctions have been re-imposed.

According to the UN Convention on the Law of the Sea (UNCLOS), all nations may claim up to 12 nautical miles offshore to be their sovereign, national waters. But it must be remembered that Iran has claimed far more of the southern Arabian/Persian Gulf as their national waters than most other countries accept, due to Iran's occupation of some small, but strategically important islands of Abu Musa and the Tunb Islands. Sailing through such disputed waters may expose ship operators to serious consequences regarding their marine insurances, which invariably contain a sanctions limitations and exclusion clause. This clause is usually far-reaching — even sailing through Iranian sovereign waters might be considered a breach, even if there is no intention to call in Iran. Wanting to optimise their sailing efficiencies, many operators choose to route their vessels close to Iranian waters. However, this carries a danger that the vessel may inadvertently stray into Iranian national waters, potentially putting their continued marine insurance cover at risk.

Even if a vessel prudently stays out of Iranian waters, dangers remain. Should a vessel suffer a breakdown, fire, or other accident while in international waters near Iran, the nearest salvage services or rescue services required may well be those in Iran. The vessel may need to seek refuge at the nearest port, which again, could be in Iran, or may be taken there by Iranian authorities, possibly while under arrest following a collision or pollution accident.

Any salvage or repair services provided by Iranian companies will have to be paid for, but doing so might breach the sanctions limitations and exclusion clause terms.

Not only is there a danger that insurance contracts could fail to respond to claims that breach international sanctions, in this regard, insurance brokers, such as Marsh, would be unable to assist in such circumstances. Also, the use of the US dollar in any such transactions might be restricted or prohibited, further complicating the issue. Iranian companies could potentially refuse to release the vessel until their bills are paid.

While these sanctions against Iran exist, ship operators should ensure that their vessels, when sailing in the Arabian/Persian Gulf, stay far enough away from Iran that salvage or other services can be obtained from other nations in the region where international sanctions do not apply. We would further advise that, to avoid any potential loss of insurance cover, even the disputed waters that Iran claims in the Arabian/Persian Gulf be avoided. Remember that if any action is deemed to be a breach of the Sanctions Limitations and Exclusion Clause, Marsh would be unable to assist with the consequences. Ship operators should be sure to read, understand, and adhere to the terms of this important clause within their marine insurance contracts.

Sources

[1] Lee. J. "Bab el-Mandeb, an Emerging Chokepoint for Middle East Oil Flows.", available at https://www.bloomberg.com/news/articles/2018-07-26/bab-el-mandeb-an-emerging-chokepoint-for-middle-east-oil-flows, accessed on August 31, 2018.

[2] Lloyd's Market Association. "Joint Hull War Committee JWLA023 14", available at http://www.lmalloyds.com/lma/Underwriting/Marine/JWC/JW_Bulletins/JWLA023.aspx, accessed on August 31, 2018.

[3] IHS Markit. "The Joint Cargo Committee monthly Watch List (August 2018 Edition) published 6 August 2018", available at http://watch.exclusive-analysis.com/jccwatchlist.html, accessed on August 31, 2018.

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