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Cargo Insurance and General Average

General average is a concept that appears only in maritime law but it crops up surprisingly often. The fact that it exists, is one of the many good reasons for insuring cargo in transit.

Where a ship is in real danger that threatens all of the interests associated with that ship (for example, the vessel owners, the owners of cargo on board, the charterers) and a deliberate sacrifice is made for the common good, all parties whose interests are protected by the sacrifice, share proportionately in the resulting loss. That is what is meant by the term "general average".

For example, if cargo is thrown overboard to lighten a ship to prevent her from running on to a reef, where the ship and the remaining cargo would all be at risk, the jettison of the cargo is treated a general average sacrifice. The financial impact of the loss of the jettisoned cargo is then shared by the parties whose interests were saved, rather than it falling solely onto the owners of the cargo that was lost.

It can often take years after the general average sacrifice has occurred, to determine exactly what the financial losses were and what each party's share of those losses should be. The ship owner needs to be certain that it can collect those shares well after the event. To make sure of it, the ship owner is allowed by law to detain the cargo on board by claiming a lien. The lien (and cargo) are released only when alternative security is provided.

The law allows the ship owner to require security to be provided by way of cash, to be held in trust until such time as the general average contributions have been worked out. This is of course very onerous as the amounts involved can be substantial (they need to be high enough to cover the maximum possible liability, with no way of knowing at an early stage what that might be) and they can be tied up for years. So, the alternative normally adopted is to release cargo on provision of a general average bond – a written guarantee that when the shares have been worked out and each party's contribution is known, payment will be made by the issuer of the bond.

Guarantees are always only as good as the parties who issue them. For that reason, it is normal for there to be strict requirements as to who will be acceptable as an issuer. Invariably the key requirements are that general average bonds must be issued by an insurance company that carries on business in the country where the general average will be assessed.

The insurers of cargo which is insured under any of the standard wordings will always issue general average bonds when needed, without cost to the insured, because policy coverage expressly extends to any general average liability incurred by the cargo. Insurers are accustomed to doing so and the process is straight forward.

Uninsured cargo interests can find the situation virtually impossible to deal with. They must provide cash as described above, if they have it. Sometimes a bank guarantee may be acceptable, but banks are generally very reluctant to issue them. If they do there is an ongoing interest charge, and they have to be backed by counter security. Uninsured interests who simply cannot provide security will have their cargo detained indefinitely by the ship's lien, and ultimately sold by the ship to meet the general average charges. The owners of perishable or time sensitive cargoes run the risk of cargoes being destroyed at an early stage. In any case where the cargo proves to be of insufficient value to meet the general average, the cargo owners will be left with personal liability.

The general average situation is one that is commonly overlooked when a decision is being made to insure or not – but it is one of the very best reasons there is, not to run the risks of being uninsured.

Pauline Barratt