



Loss of hire insurance – back to basics

Challenging markets across almost all sectors of the shipping community provide a useful backdrop for going over some of the basic elements of loss of hire cover under the Nordic Plan

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Introduction

Loss of hire insurance is broader than its name suggests, it encompasses *hire* in the traditional sense, loss of freight and any other form of income that is lost as a direct consequence of loss of time. Its principal role as a risk management tool is to protect cash flow, and it is often demanded by banks to ensure owners will be able to meet loan repayments in the event of an incident that deprives the vessel of income.

Two key premises

- The loss of time must be due to damage that is in principle covered under the relevant hull & machinery (H&M) policy, or one of four special circumstances mentioned in [clause 16-1](#) of the Nordic Plan (the Plan).
- The assured must show that the loss of time resulted in an actual loss of income.

Relationship to the hull & machinery policy

The basic principle is that if damage arises which is recoverable under the conditions of the Plan, the loss of hire policy will respond. If the H&M insurance is written on conditions other than the Plan, and these have been accepted in writing by the loss of hire insurer, then those conditions will determine the recoverability of the underlying hull damage and so the loss of hire.

It is important to note that in all other aspects, it will be the conditions in the Plan that govern the cover. One example is the timing of loss. The loss of hire insurers are not bound by the H&M adjustment as to which policy the claim falls under. If, for example, an H&M adjustment under English conditions apportions the claim over all the policies in force since last dry-docking, it may be that the loss of hire claim is deemed to fall 100 per cent on the last policy pursuant to the Plan's provisions dealing with the timing of the loss. If the assured wishes to have consistency across its policies with respect to timing, this must be specifically agreed in the wording of the loss of hire policy.

Protecting actual loss of income

As for all property insurance, the basic premise is that the assured has an economic interest in the subject-matter insured. Shipowners clearly have an economic interest in their vessels both in terms of capital and *usually* as a source of income. However, weak shipping markets and correspondingly high levels of layups and scrapping can prove a challenge for assureds seeking to recover under a loss of hire policy in the event of damage.

Scrapping voyages

At one end of the spectrum, a vessel en route to a breakers yard clearly has no value as a source of regular income. The only economic interest is its scrap value minus costs. If the vessel is damaged before reaching the yard and requires temporary repairs in order to complete the journey, the time lost will not deprive the assured of any loss of income. In fact, any loss of hire policy should be cancelled once the scrapping voyage has been fixed and no future earnings will accrue.

Awaiting orders

At the other end of the spectrum, a vessel awaiting orders off port in a weak but otherwise active market where vessels of a similar size and specification are being fixed on a regular basis, clearly has value as a source of income. Should the vessel sustain damage resulting in being taken out of the market for a period to perform repairs, the assured will have a valid claim under its loss of hire policy.

The threshold of proof in such cases is very low. The commentary to the Plan describes it as *a reasonable chance of obtaining employment*. In practice, this means that as long as the vessel is in an active market, no further *proof* of loss is necessary.

Layups

Vessels in layup are a challenge from a risk management perspective. The primary objective of any layup is to save running costs, including insurance premiums. Many owners will choose to reduce the daily amount under the loss to hire policy to zero, avoiding premium payments but keeping the policy active on paper. This is generally a sensible option if there are no foreseeable prospects for the vessel. Should damage occur that requires removal and repair, no income will be lost. However, once it becomes clear that the market is picking up and there may be a chance of re-activating the vessel within the next few months, the owner should increase the daily amount under its loss of hire policy to protect potential future income. If left until the day the vessel is due to start a new charter, the owner risks being without cover should an incident occur the week before, which, in a worst case scenario, causes cancellation of the charterparty.

Fixed and agreed

Additional clauses in loss of hire policies to the effect that the daily amount is *fixed and agreed whether chartered or unchartered* often create confusion, and in reality do not alter the cover provided by the standard wording of the Plan. One common misconception is that such clauses remove the requirement of showing a reasonable chance of employment - they do not. Even where such a clause is incorporated into the policy, a vessel en route to a scrap yard for example, will not have a valid loss of hire claim. Interestingly, the origins of the *chartered or unchartered* term is the English AB Stewart conditions, where the policy would be automatically cancelled upon termination of the charter in the absence of such a clause.

The second common misconception is that such clauses set aside the second paragraph of clause 16-14 of the Plan regarding repairs carried out after the expiry of the insurance period. The basic principle is that loss of hire, which accrues after the expiry of the insurance period, is compensated by a daily amount that is equivalent to the vessel's actual earnings, up to a maximum of the agreed daily amount. This is essentially because after the insurance period has expired, there is no mechanism by which the insurer or the assured can demand a change in the daily amount if the market rates have changed significantly. Nevertheless, the total sum insured will still be applicable, and in cases where the market rate has fallen compared to the agreed daily amount, the duration of the cover will of course be proportionately longer.

Concluding remarks

Depressed markets can pose a challenge for owners looking to manage their income risk. If you are unsure of your position under your current policies, please get in touch with your usual Gard contact to discuss your options.

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