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## *Fishing Vessel Insurance— How Much Is Enough?*

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A factory trawler rolls over and sinks in the stormy Bering Sea. Nine crew members die, and 22 are rescued but suffer injuries and emotional trauma. Total liability awards come to \$6 million.

But what does that have to do with you, owner/operator of a small seiner or longliner? After all, with only a couple of crew aboard, the risk can't be that great, right? Wrong. Not long ago one deckhand was hit on the head by a loose piece of deck tackle—his spinal cord was crushed and he was rendered paraplegic. The court award was \$6.6 million.

It could happen to anyone. If you put to sea in a vessel, you could be involved in a maritime accident that would jeopardize your boat, your savings, your home, and your entire financial future. In fact, you don't even have to go to sea—since owners are liable for injuries sustained by crew "in the service of the vessel" even if the vessel is up on blocks in the boatyard!

The reasons for carrying insurance are clear enough, but how much do you need? What should the policy cover? Can you avoid liability by incorporating your fishing business? Will the policy really pay off in the case of a legitimate claim, or will the insurer weasel out through a loophole in the contract? Who pays for your legal defense while liability and award are being determined? What are the key features to look for in a marine policy, and how do you know that you're buying a good one?

### **Insurance Terminology**

It is important to know a little about the different kinds of insurance, about maritime law, and a few marine insurance terms. An insurance policy is a contract between the insured (you) and the underwriter, which is the company or companies who agree to pay if you have a loss, in exchange for the premiums that you pay on a regular basis. The broker or agent is the person or company who sells you the policy. Brokers may be affiliated with underwriting companies, but they work for you and their job is to shop around and get you the best policy for your needs.

There are four basic types of insurance that pertain to both commercial and recreational vessels: hull and machinery, breach of warranty, cargo, and protection and indemnity (P&I).

## Hull and Machinery

A hull and machinery policy pays for the repair or replacement of the vessel itself, including engine, deck machinery, and most contents, in the event of sinking, collision, fire, or other damage.

Some policies pay for repairs or replacement of the engine and other fixed equipment in the case of major breakdown, if the damage results from a “latent defect” in the equipment and not from normal wear or operator neglect. Some policies, called “all risk,” cover all kinds of losses except those specifically exempted (such as those caused by acts of war). Most fishing vessel policies, however, cover only “named hazards” and are not valid for any other kind of loss. Lenders, such as banks, prefer all-risk policies, but may be content with a named-hazard policy if an adequate breach of warranty policy (see below) is in effect.

Both fishing vessel and recreational vessel policies may have a mandatory lay-up period each year, during which the vessel is out of the water or at least tied to the pier. During lay-up the owner should be sure that there is a port risk policy in effect, with P&I provisions, to cover the vessel while it is not in use.

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Hull policy coverage usually is based on market value of the vessel as determined by a recent survey, not on replacement value. Lenders require mortgaged vessels to be insured at least to the amount owed to the lender, although underwriters usually prefer to insure for the entire market value, plus or minus 10%. It might seem logical that companies would want to write policies for sums lower than the actual market value to create a disincentive to owners who might be tempted to sink their vessels in poor years or times of declining vessel values. But the companies’ incomes are based on the premiums paid, and premiums are a percentage of the insured value. The higher the amount of the policy, the greater the premiums the insurer collects.

## Breach of Warranty

Lenders know that vessel owners sometimes fail to do all that they are supposed to do, so they usually require that policies on vessels for which they hold the mortgage also carry breach of warranty coverage. This policy pays off the lender what is owed, even if the operator violates terms of the hull and machinery policy. Usually only the bank will be paid; the vessel owner will not collect on a loss even if most of the equity in the vessel is his.

Of course, breach of warranty coverage is void if the premium is not paid. But the insurance agreements specify that the lender is notified if premium payment lapses, and the bank will pay at least the breach of warranty premium, and then tack that charge onto other payments it is collecting from the vessel owner. Often, breach of warranty premiums are a lot more expensive than premiums for the original policy.

## Cargo Insurance

Machinery permanently affixed to your boat is covered by your hull and machinery policy, but nets and other portable fishing gear, and other equipment and supplies you are carrying, are not covered. Cargo insurance is the means of protecting yourself from loss of these items due to sinking, fire, or theft. Tendering vessels can even get cargo insurance to cover fish in their holds. Cargo insurance won’t cover nets or gear in the water or being set or retrieved.

## **P&I**

Protection and indemnity insurance is to vessels what liability insurance is to homes or cars. P&I coverage will indemnify, or pay back, the owner if he suffers financial loss because of accidents involving, or loss caused by, his vessel.

P&I is separate from a hull and machinery policy, with a separate premium. For commercial vessels, P&I may be a significant cost, because of the inherent danger to crew and the favorable treatment the courts afford to crew members who are injured.

### **Maintenance and Cure**

A crew member doesn't have to prove negligence in order to collect money from you, the vessel owner. Regardless of whether you were in any way to blame, a crew member who is injured, or even becomes ill, while in the service of your boat is automatically entitled to maintenance and cure. This means that you are obliged to pay medical costs and living expenses until either he recovers or is determined to be permanently disabled, and you will probably have to pay him the crew share or wage he would have earned for the remainder of his expected employment.

This may seem like an outrageous burden to place on a vessel owner, but for historical reasons it has been part of American statute and case law since 1823. For centuries, British and American seamen, many of whom were "pressed" or "shanghaied" into duty at sea, were treated badly by ship owners. In earlier days most sailors were illiterate, poorly paid, and scarcely able to take care of themselves. In the United States a body of legal tradition, much of it codified in the 1920 Jones Act, developed to protect seamen and to require that ship owners provide minimal care for their employees. Probably at one time the requirement was a reasonable demand on shipping companies, but it has become a financial millstone around the neck of a small-boat fisherman. P&I insurance is the fisherman's only protection.

What does P&I do for you? A normal policy will, within the limits prescribed in the contract:

1. Pay maintenance and cure for sick or injured crew.
2. Pay your defense costs in a personal injury lawsuit.
3. Pay to repair damages caused by your vessel to another vessel, equipment, or facility, and pay for death or injury to people caused by your boat.
4. Pay for removal of the wreck and abatement of pollution caused by the wreckage of your vessel, if required by authorities.

P&I will not cover sickness or injury of the owner or owners of the boat, however, and it will not pay fines or penalties that result from deliberate illegal acts. As with hull insurance, a deductible applies to P&I payouts.

### **Negligence and Unseaworthiness**

Probably the most important function of P&I insurance is to provide payment in settlement of negligence lawsuits. Injured crew will, as a minimum, demand full compensation for their expenses. Often they demand additional sums for "pain and suffering" or punitive damages. And in the case of permanent disability, their lawyers usually seek a sum equivalent to lifetime income. The sums are calculated with the knowledge that the attorneys will get 30 to 40% of the settlement.

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The courts have defined operator negligence and vessel unseaworthiness very broadly. If anyone gets hurt on, or in association with, a vessel, that fact serves as evidence that the owner was negligent in failing to take adequate steps to prevent the injury from occurring. Never mind that the crew member may have done something that showed poor judgment or was even contrary to instructions.

“Contributory negligence” on the part of the injured crew member may reduce the eventual award somewhat, but the owner of a vessel found “unseaworthy” by a court is liable regardless of what the crew member did to get injured.

Owners have been held negligent when crew members were injured in traffic accidents while on shore leave in the middle of a fishing trip, and when intoxicated crew members have fallen while attempting to reboard the vessel at the dock. If a crew member gets angry at another and beats him up, the victim can successfully sue the owner on the grounds that a “defective” crew member renders the vessel “unseaworthy.”

Only if you can convince a jury that the victim intentionally injured himself do you stand much of a chance of avoiding a negligence determination. “There’s a tremendous volume of fraud on the claimants’ side,” is the assessment of Craig Nodvedt, a maritime defense attorney who represents vessel owners in personal injury cases. But even if the claim is bogus, the owner can go broke defending himself in court. P&I insurance shoulders the financial burden of mounting a defense. Often, the insurance company will settle out of court by simply paying off the plaintiff in a nuisance suit with a small sum to save the much larger cost of a defense.

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## **Crew Contracts**

Owners can reduce the chance of having to pay a personal injury claim, and can reduce the amount of any settlement, by requiring crew members to sign a contract with a medical history disclosure. Since pre-existing conditions are excluded from maintenance and cure provisions, and a plaintiff has less chance of making a successful personal injury case if the problem has occurred before, the medical disclosure gives the owner some protection in court. Plus, it allows the owner to screen prospective crew members and avoid those with recurrent back or wrist problems, for example. Crew contracts should be detailed, should include a medical disclosure page, and should be signed by crew and employer. Your Sea Grant Marine Advisory office is likely to have an example of a crew contract.

## **Adjusters**

Don’t make the mistake of thinking that the amount of your hull and machinery policy is what you will collect in the event of an accident. First, the insurer may commission a surveyor or adjuster to determine the amount of damage. If the cost of repairing the vessel is less than the insured value, the company will probably pay the lesser amount. If the vessel was surveyed and insured when it was new, but was operated for a season, the insurer might pay off at a depreciated value.

Also, a deductible will have to be paid out of your pocket before the insurance company will pay. The exact amount is specified in the policy, and the higher the deductible, generally the lower the premium. In the case of minor damage, your deductible may cover the entire bill and the insurance company won’t pay anything.

## Voiding a Policy

There are many ways you can void your policy. Most policies impose a set of conditions on the owner called expressed warranties, and violating any of them can invalidate your policy. For example, operating outside geographic limits named in your contract, or during times of the year when the agreement specifies the vessel is to be in lay-up, is a breach of your agreement. Another breach is operating without the licenses or safety equipment required by law for your kind of operation, or in any other way operating illegally. Your policy may be voided if anyone other than the named insured operates the vessel. Misrepresentation of a material fact, which means concealing information or providing incorrect information to your agent or on your application, will invalidate your policy. And, of course, your policy is void if you forget to pay your premiums on time.

In many cases, it is possible to avoid problems concerning seasonal or geographic limits simply by informing your agent of your intent to operate outside those limits, and requesting an extension or rider that will cover you while you are temporarily out of compliance. The underwriter will consider your request and probably will give you a rider, for a modest additional charge.

## Weighing the Factors

Considering that the entire onus is on the vessel operator, it is prudent to be sure that P&I coverage is adequate to cover all the likely possibilities. Some skippers consider their crew member a friend and neighbor, who depends on the skipper to operate a safe working place and to produce income, a share of which will support the crew member's family. These skippers believe it is their moral obligation to provide adequate insurance coverage to protect the crew member and family in case anything goes wrong. Other skippers are less concerned about their crew than they are about protecting themselves. A fisherman who has a lot of equity in a valuable boat, a house, and other property, and who has kids headed for college, has a lot more to lose in a lawsuit than someone running a shoestring operation.

While partners in ownership of the vessel don't have to be covered, hired or relief skippers should be. And don't think that family members can be overlooked; many injured crew don't hesitate to sue their own relatives if they feel they stand to collect a big settlement.

Industry observers say that awards shot up dramatically in the 1970s and 1980s but have leveled off a bit since then. Because of the very sophisticated and expensive medical technology now in use, awards in injury cases tend to be higher than in fatalities. The most costly awards are still those that involve a permanent disability, since the injured party will probably seek a lifetime income. "If a boat goes down with several people aboard you're likely looking at a settlement of one to one-and-a-half million dollars," says Fred Richard, a loan officer with National Bank of Alaska. "But if there are partial injuries—the sky's the limit." And injured parties are almost sure to sue, whereas sometimes the deceased have no relatives, or their survivors don't bother. Maritime law professor Dennis Nixon, of the University of Rhode Island, has investigated casualty records which suggest that some skippers, aware that it can be far more expensive to bring in a severely injured crew member, may have failed to take heroic measures to recover a victim.

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## Incorporation

Some experts, and Nixon is one, advise vessel owners to incorporate their fishing businesses as a way of avoiding liability. “Take advantage of the Sub-Chapter S corporation,” Professor Nixon advises. “You never want to own a boat personally.” He says you can make yourself “judgment-proof” by getting adequate “preventive legal care.” Others contradict this advice. Seattle maritime attorney Val Tollefson points out that even though a vessel is owned by a corporation, it still can be seized to pay a judgment. And the skipper, in a small closely held corporation, is probably the main owner of the corporation, and can be sued individually.

Incorporation does provide another layer of legal protection, Tollefson says, but attorneys have become quite adept at “piercing the corporate veil” to get at the assets of the corporation’s owners. It is essential, he says, to rigorously follow all the rules of incorporation if you want to gain any protection from corporate status.

## Self-insurance and Pools

What about self-insurance as a way to avoid the high cost of insurance? Many vessel owners self-insure their boats by setting aside money regularly to replace their vessel, gambling that they won’t have a major loss until their fund is big enough to cover it. But self-insuring for P&I is difficult to do unless you’re as big as the federal government.

Some self-insurance programs are really cooperatives, or mutuals, in which members of an organized insurance group pool their money in a fund to pay claims in case of a loss. Several of these insurance pools operate successfully around the country, but they usually have to buy some insurance on the commercial market to lower their risk, and that is expensive. Self-insurance pools can be a way to save money but they require organization, commitment, and good management, just like a successful fisheries marketing cooperative. And again, since P&I claims tend to be much higher than vessel values, it is difficult to pool sufficient cash to protect members against P&I claims, and owners usually have to buy P&I coverage from a broker.

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## How Much Is Enough?

How much insurance do you need? “How much can you afford to lose?” is the answer from Sue Petek, a claims adjuster for Reilly Associates Maritime Adjusters in Seattle, Washington, and her response is similar to that offered by many adjusters, agents, attorneys, and bankers. “A fisherman should think about his boat, the value of the vessel, how safe the boat is, does he put his crew through training?—and then ask himself, how much does he have invested, and how much can he afford to lose.”

Insurance industry insiders say that P&I settlements are usually under \$200,000 and most are considerably less. They say that a few years ago small boat owners commonly bought policies for \$100,000 per occurrence, \$300,000 maximum. Now they say that \$250,000 is the standard, \$300,000-\$500,000 is more common, and many skippers are opting for a million dollars.

The standard upper limit on many policies is \$500,000 but prudent owners don’t always stop there. They buy “excess” coverage from another underwriter, usually through the same agent. For example, \$1 million coverage is not unusual

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for gillnetters in Bristol Bay, Alaska. Excess coverage is usually less expensive than the standard policy, in part because it is less likely to be used.

Sizing a hull and machinery policy is a little simpler than P&I, since the vessel's survey will determine the amount the underwriters will cover. Since owners tend to add equipment and upgrade their vessels throughout their ownership, they should be sure to update surveys and avoid undervaluing their vessels when it comes time to insure.

## Price Shopping

How expensive is a good insurance policy? The answer varies with the age and condition of the vessel, the type of the operation, the skipper's experience and loss history, and the current state of the insurance industry. Typically, hull and machinery coverage on vessels in good condition runs 1.5 to 2.5% of survey value.

P&I premiums may be charged on a seasonal basis for the whole operation, or on a per-person, per-month basis. The seasonal policies may cost a little more but give the owner more flexibility to adjust to changes in the fishery. The P&I policies on individual crew members usually require payment of an additional month's premium if the fishing periods extend even a day past the designated period, and those periods may be calendar months instead of 30-day blocks of time. In relatively safe inshore fisheries, per-person monthly P&I premiums are typically in the \$250-\$350 range for \$200,000 coverage.

Some vessel owners buy P&I for one crew member although they have two or more, reasoning that it is unlikely that more than one will get hurt at a time. That is false economy because if anyone gets hurt the adjuster will ask questions and when it is revealed that more than one crew member was on the boat, the company may void the policy.

P&I policies are usually sold in conjunction with hull and machinery, but it is possible to get P&I without the other. However, stand-alone P&I policies tend to be more expensive because the hull policy may partially subsidize the accompanying P&I policy. Setnetters can get P&I-only policies through some agents.

Both P&I and hull rates depend in part on qualifications and operating history, and in most cases brokers make remarkably little effort to verify the information you provide. Some owners may see that as an invitation to fudge on the facts a little, but the fact remains that "misrepresentation of a material fact" is grounds for voiding a policy.

There is no precise system for determining rates, and each quote represents an individual decision by a particular underwriter. So it pays to shop around; some companies simply charge less than others.

## The Fine Print

Be sure to read the fine print, since the specifics vary from one company to the next.

Because marine policies are actually two, three, or more separate agreements covering different kinds of coverage—sometimes provided by different underwriters—agents usually combine them and offer you a single quote for the whole package. Experienced agencies can mix and match coverage from several underwriters to give you the package with the best fit.

Take a copy of the policy home and study it before making your decision, and if you don't understand any of the language, ask the broker to explain it to you or

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take it to your own lawyer before you sign anything. While the companies are in business to protect you, they also make it their business to protect themselves. With a careful reading you may find terms or exclusions in the contract that are very much contrary to your interest. Often those terms are negotiable, and the broker should be willing to go to bat for you to get a policy that fits your needs.

Keep in mind that if your boat is financed, the lender will have its own insurance requirements, which may be different from yours. For example, one major bank specifies a \$500 deductible, which is practically unheard of in the marine insurance industry, and would be extra expensive if it were available. But this is the kind of thing you can negotiate if you learn of it in time, so be sure to get insurance specifications from your banker before shopping around.

As with every other product you buy, it pays to be an informed consumer and learn all you can about your insurance policy before you sign on the dotted line.

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