

MARINE INSURANCE AND SALVAGE
LEGAL FRAMEWORK AND PRACTICAL SOLUTIONS



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1 Introduction

1.1 Presentation of subject and issues to be addressed

Marine salvage is a fascinating area of the maritime industry and involves aspects that are unique compared to similar undertakings ashore. It is different because ashore there are rescue services available at any time, such as the local fire department. At sea there is no guarantee that help will reach a vessel in distress. Weather conditions can be extreme with no possibility for shelter. Professional salvage is highly specialized and can be a very hazardous undertaking. The salvage award paid out to the salvor is often very generous and much more than normal pay for work performed. A salvage reward is based on the salvaged values and other criteria such as the skill and efforts of the salvor. The reward is meant as an incentive for a salvor, and for the existence of professional salvage companies. The rules regulating salvage are also unique and reflect the specialized nature of marine salvage. Several parties are involved in a salvage operation, mainly the shipowner, the salvage company and the insurers. There are of course others, such as the national government of the country where the operation takes place, environmental organizations or providers of equipment.

Vessels today are equipped with modern navigational aids such as radar, electronic charts and communication that allow the ship's officers to receive updated weather forecasts and hurricane tracking. Thus it is easier to plan the voyage and avoid dangerous weather conditions. This is a huge improvement compared to earlier times when sailors could not anticipate what weather conditions to expect or even be certain of their true position. Despite all the modern technology available on a ship today a number of accidents occur regularly that necessitate salvage. Most shipowners do not have the expertise to handle a casualty as it is relatively seldom that one specific shipping company's ships need salvage. The expertise can be found among those who relatively often have to deal with casualties and salvage, mainly the insurers and the

salvage companies. The shipowners often do not even know where to start when an unfamiliar situation like a casualty occurs, so they rely on the assistance of experts. The expenses of salvage are mainly paid by the marine insurers, and the marine industry relies on them for support in difficult situations. Questions like which salvage company to contact, what terms should be agreed with a salvor and how to handle the media are common.

The aim of this thesis is to investigate the marine insurers' involvement in a salvage operation and what kind of cooperation there is between the insurers and the other parties, mainly the shipowner and the salvage company. At the same time this thesis aims to find out whether the marine insurers involvement in salvage is described by the law. I.e. the objective is to compare information in the legal sources of marine salvage and insurance with the practical work undertaken by the insurers, including the cooperation taking place between the insurers and other parties. What information is possible to derive from the law? What do the parties actually do? What goes on “behind the scenes”? What does the law tell us and how are things actually done in the practical world? One main research question: Is the cooperation taking place between the insurer and the salvor described by the law?

The reason for choosing this topic is first and foremost my interest in marine insurance and salvage. Marine insurance was an elective course at the Scandinavian Institute of Maritime Law which was very interesting. Salvage is a topic that has interested me from earlier: as a yacht skipper in Greece, during my maritime education at Vestfold University College and also in my position as skipper on the NSSR Rescue vessel “Simrad Færder”.

1.2 Demarcation of thesis

This thesis will focus on the marine insurers involvement in salvage, first and foremost the hull insurer and the P&I insurer, even though others are also mentioned. The shipowner, the salvor and other parties are not discussed as in-depth as the insurers, but are mostly referred to from the insurers' point of view as their counterpart, contractual or in practical terms. Some other parties, such as the broker and the government, are also discussed to give a holistic picture of how things are connected. As there is a maximum limit of 18000 words for this thesis it is not possible to discuss all issues concerning marine insurance and salvage. Therefore the issues chosen are the ones that I find most interesting and those that attracted the most interest during the interviews. Many different objects may be in need of salvage at sea, such as a ship, an oil rig, a floating crane, a barge or a lost container. In this thesis the focus is on the salvage of vessels.

Salvage is an international business and operations take place all over the world. Marine insurance is also international, but the rules are more specialized for each country. With some exceptions there are no common international rules on marine insurance. Therefore it is the Norwegian insurance rules that will be discussed in this thesis. Even if the salvage company may be foreign and perform salvage outside of Norway it is the Norwegian perspective that is in focus.

1.3 Structure of thesis

In chapter 3 background information on marine insurance and salvage will be presented, including a presentation of the most important parties. In chapter 4 the legal aspects and the insurers' involvement in the many processes of salvage is discussed, including how the main parties relate to each other when a casualty occurs. The practical work of the insurers and their cooperation with the other parties is discussed in the light of legal instruments that apply. Chapter 5 contains a summary of the major findings, followed by a short summary of topics discussed. There is also an outlook on the future and suggestions for future research.

2 Legal sources and method

2.1 Legal sources

The most important legal sources in this thesis are the rules applicable to marine insurance and the rules regulating salvage, as well as the salvage contract. Salvage is regulated internationally by the Salvage Convention 1989, which has been incorporated into Norwegian national law in the Norwegian Maritime Code chapter 16. Both SALVAGE 1989 and NMC is referred to in this thesis. Lloyd's Standard Form of Salvage Agreement and the scopic clause are thoroughly discussed. As the hull insurer and the P&I insurer are the most important in relation to salvage, the rules applicable to these are central. Although marine insurance is of international importance, the rules are specialized for each country. With the exception of rules for P&I insurers party to the Pooling Agreement of the International Group of P&I Clubs, there are no common international rules on marine insurance.

Each country has developed their own set of rules. Therefore it is the Norwegian insurance rules that will be in focus. In Norway marine insurance, e.g. hull and loss of hire insurance, is regulated by the Norwegian Marine Insurance Plan of 1996. This, however, is not the case with cargo insurance and P&I insurance. The rules of the different P&I clubs must adhere to the common rules under the Pooling Agreement. Therefore P&I rules are kept out of NMIP. Skuld Statutes and Rules 2011 is referred to in this thesis. It should be noted that NMIP is an agreed document that is normally referred to in the insurance contract, incorporating the rules of NMIP into the contract. Books and articles, as well as laws, conventions and other legal sources are listed in the bibliography.

2.2 Strategy and Method

My strategy for this thesis has been to conduct a qualitative survey in order to compare the legal rules of salvage and marine insurance to the marine insurers' practical involvement in salvage operations. The sources I have used are written sources, such as the legal literature described above, and interviews. Ordinary legal method is used when discussing legal issues in my thesis. The legal literature has been discussed in relation to the information from the interviews, to see if the relationships between the parties are covered by the legal sources, and to link the information from the interviews with the legal sources. To find out how things are actually done when a salvage situation occurs, my interviews with the marine insurers are the main sources. For my interviews with Anders Hovelsrud from Norwegian Hull Club and Paul Lange from Skuld P&I Club I prepared interview guides. The interview guide is an overview of main research questions and helps the interviewer keep on track through the interview. The questions were based on legal texts concerning salvage and marine insurance, and what I have learned during the maritime law program. The aim was to find out how the insurers work when they are involved in salvage. The guide is not a list of questions that is gone through methodically. The interviews were more like conversations where one topic led to the next, not a controlled "question-and answer session". The interview guides were used to make sure that all issues were covered during the conversations. This conversational style of interview even resulted in discussion of some issues that I had not originally thought about, and this added to the material I have used in my thesis. The interviews were recorded so that I could carefully listen to every detail later. Follow-up questions were sent by email to clear up any uncertainties. I have then proceeded by discussing this practical material in relation to important legal instruments that apply to salvage and marine insurance.

3 Background on Marine Insurance and Salvage

3.1 The main parties

3.1.1 The shipowner

The shipowning company (or "shipowner"/reder) is the legal owner of one or several vessels, and has the responsibility for keeping the vessel seaworthy in all respects. This means in a technical state that is acceptable according to the rules and manned by crew with the appropriate education, training and skills required for their position. The vessel must also be properly equipped for the voyage/ trade. The shipowner is responsible for any damage caused by his ship to another party, and also damage to the environment. If the ship is grounded or sinks in shallow water, and thereby becomes an obstacle and a danger to other shipping, the shipowner is responsible for removing it by salvage or wreck removal. The shipowner is the contractual counterpart in a salvage contract or a towage/ assistance contract with a salvage/tugboat company.

3.1.2 The salvage company

The salvage companies are experts in handling casualties and performing salvage operations. They have manpower and equipment available for salvage, and their existence is very important to the marine industry. To encourage them to stay in business, and maintain a high degree of readiness with necessary equipment, the salvage rewards available to a successful salvor may be very high. Still, a salvage company must have an income in periods where no salvage is required, so a salvage company also takes on other assignments, e.g. regular towage. The salvage company is the contractual counterpart in a salvage contract or a towage/ assistance contract with a shipowner.

3.1.3 The marine insurer

The marine insurer provides financial backing for the shipowner, but is also an advisor to the shipowner when a casualty occurs. As will be further discussed in this thesis, the insurer even performs practical work on behalf of the shipowner in relation to other parties. Marine insurance is a cover for loss of or damage to a ship, the cargo and cover for claims against the shipowner from third parties. One example is cleanup costs for pollution from the ship. On certain terms it is also possible for a shipowner to obtain cover for loss of the ship's income. The different types of marine insurances each provide cover in their respective area, but in some circumstances they also overlap to a certain degree. An example of this is the hull insurers cover of collision liability (limited) and the P&I insurer's cover for the same. In this thesis the focus is on Hull and P&I insurance. The marine insurer is the contractual counterpart of the shipowner, and the insurance policy is the contract between them.

3.2 Marine insurance

3.2.1 Norwegian Hull Club

As much of my thesis is based on interviews with NHC and Skuld presentations of these and how they work is appropriate. They are mentioned throughout the main part of my thesis. Norwegian Hull Club (NHC) is the leading hull underwriter in Norway and will be referred to when hull insurance is discussed. NHC offers a range of insurance types and covers more than 7000 ships worldwide¹. As hull & machinery insurers NHC covers more than 3000 ships and is claims leader for 1500 of these². With all these ships in their portfolio there are many casualties to deal with, including salvage situations. This experience is what makes the insurer an expert in handling salvage situations on behalf of and in cooperation with the shipowner.

¹ Norwegian Hull Club (2011). [internet].

² Hovelsrud (2011).

3.2.2 Insurance syndicates with claims leader

The economic implications of a major casualty are significant, so one insurer cannot bear the entire risk alone. The hull risk is normally covered through cooperation between many insurance companies or underwriters in a syndicate. In this syndicate one insurance company acts as claims leader with the responsibility and authority to make certain decisions on behalf of all the co-insurers, binding for all³. Each co-insurer is liable for the portion of a claim that corresponds to the sum they have insured in relation to the total sum insured. NHC is claims leader in half of the hull & machinery insurances they are involved with⁴.

3.2.3 Skuld P&I Club⁵

Skuld P&I club handles about 4000 cases a year and 10-15 of those are defined as casualties. When major incidents happen it is important for the insurer to have personnel that are ready. Therefore Skuld has one casualty coordinator in every one of the 10 offices worldwide. These are given extra training to handle major casualties, and Paul Lange in Oslo functions as their coordinator with an operational overview of the situation. The claims director in Oslo keeps overall track of any cover issues or legal issues that must be taken care of. Skuld also has a casualty reference group that is involved in every major Skuld case worldwide. This group consists of the claims director in Oslo, the director of the Copenhagen office and the technical manager in Oslo, Paul Lange. Skuld usually send personnel onsite when something happens in order to secure firsthand information from the scene of the incident and to keep close track of what happens. As NHC, Skuld also has media personnel to help handle the shipowner's contact with the media. Skuld is active in getting involved as fast as possible if a ship they insure suffers a casualty. The P&I insurer has limited influence in

³ NMIP section 9-2.

⁴ Norwegian Hull Club (2011). [internet].

⁵ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

the planning process of a salvage operation. Therefore it is better to seek information early and evaluate the insurance company's exposure rather than wait for information. It is important to establish contact with key persons immediately. Typically phone-meetings will be arranged two times a day in the initial phase of a casualty, where the P&I insurer, the hull insurer and shipowner discuss the situation.

3.2.4 The International Group of P&I Clubs

Most of the world's merchant ships are covered by P&I clubs belonging to the International Group of P&I Clubs. Contrary to most hull insurance companies these are mutual insurers who cover each other in case of major liability expenses. The P&I clubs cooperation is regulated by the Pooling Agreement, and claims in excess of 8 million USD is covered by the pool. The maximum pool coverage is about 6,9 billion USD⁶. In other words the individual club has to cover claims less than 8 million USD themselves. There are 13 underwriting member clubs in the International Group of P&I clubs and together they cover about 90% of the world's fleet⁷. Both Skuld and Gard P&I Clubs are members of the International Group. In order for the P&I clubs to function as a group, all the clubs in the International Group have very similar rules. This is why, in Norway, the Gard Rules are almost identical to Skuld Statutes & Rules.

3.2.5 Mutual insurance and commercial companies – P&I and hull⁸

P&I clubs work as mutual insurance associations where the shipowners (the insured) may have to make extra payments in case of high casualty costs, while hull insurance is not normally organized like that. Hull insurers in general are commercial companies, but NHC specifically is a mutual insurance company. NHC has the right (like P&I) to

⁶ International Group Of P&I Clubs (2011 A). [Internet].

⁷ International Group Of P&I Clubs (2011 B). [Internet].

⁸ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

claim a supplementary call (extra premium) if the outpayments are too high. However, since NHC is the only mutual association in a commercial market they must act like a commercial company to stay in business.

3.2.6 Hull and P&I – different liabilities⁹

Simply put, the hull insurer basically has the vessel to take care of. He is liable for the shipowner's part of a salvage reward, towage costs, damage to or loss of a vessel etc. As will be discussed in this thesis he is heavily involved in the processes of a salvage operation. The P&I insurer on the other hand has a lot more varied tasks to keep track of; Personal injury or loss of lives in relation to crew, passengers and also 3rd parties. Damage to or loss of property or cargo in connection with the initial casualty, or in connection with the salvage operation. Scopic remuneration is also the P&I insurer's liability. The tasks of a P&I insurer can vary a lot. If for instance there is cargo involved which may be saved with special cleaning treatments, the P&I insurer must employ experts in that area. P&I must take liability statements from and assist the crew. If there is a criminal investigation from the authorities P&I must support and help those involved. One example is criminal charges against the shipowner or captain/officers for the pollution of coast/ beaches (e.g. "Full City"). Another is claims from fishermen or from fish farms and claims from the tourist industry (pollution of hotel beaches). There are numerous responsibilities for the P&I insurer and the tasks can differ a great deal compared to the somewhat more predictable tasks of the hull insurer.

⁹ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

3.2.7 Hull, hull interest and freight interest – how it works¹⁰

As all of these insurances may be triggered following salvage or salvage attempt a short description is included here. Usually 80% of the ship's value is covered with hull insurance, while the remaining 20% is covered by hull interest insurance. This is because a total loss is an unlikely event, and the premium for hull interest is lower than for hull insurance. Because of this the vessel's sum insured is lowered in the hull insurance, and then compensated for with hull interest insurance. In case of a total loss these two insurances together cover the total insured value of the ship. In addition freight interest insurance will give the shipowner extra cover to compensate somewhat for the loss of income during the time it takes to replace a lost vessel. In reality there are always extra expenses connected to replace a lost ship, so a prudent shipowner should have all these insurances in order. It is interesting to note that the hull interest insurer is not responsible for a salvage reward, but has a great interest in successful salvage. If a salvage operation fails and results in a total loss of the vessel, or the vessel has so much damage that it is considered a total constructive loss, all three of these insurances may be triggered.

3.2.8 Loss of hire¹¹

Loss of hire insurance (LOH) can also be activated in case of salvage. The loss of income while a ship is not performing can be a heavy burden for the shipowner. LOH will cover the shipowner's daily expenses and, depending on the current freight rates, some or all of the lost income. The assured will receive a pre-agreed daily rate for the time lost regardless of the actual loss. The daily rate is not dynamic as the market is because the assured pays premium depending on the daily rate agreed. In a poor market the agreed daily rate may therefore be more than what the vessel earns, and the shipowner may hypothetically be happy to have his ship off-hire. The insurer will

¹⁰ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

¹¹ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

monitor the off-hire situation to take care of their interests, possibly more so in a poor market? In a good market, on the other hand, the shipowner will lose money if the ship is not in business. In this case the shipowner, as well as the insurer, will benefit from speeding up the process of having his ship repaired after salvage. NHC offers LOH insurance, and may be both LOH insurer and hull insurer for the assured.

3.2.9 Co-insurance and re-insurance¹²

According to NMC¹³ the shipowner and owners of other salvaged interests bear the liability for a salvage reward, and the reward is payable by them. The insurers are not mentioned. However, the liability is transferred to the insurers under the insurance agreement, which is the contract between the insurer and the assured. The hull insurer's liability, i.e. what they cover, is described in the contract between the insurer and the assured in each separate insurance agreement. NHC's standard cover is also described in Charterer's Rules List of Correspondents for Norwegian Hull Club¹⁴. NHC's cover in case of salvage is described in paragraph 19.1. None of these legal sources give any information on how the insurer is able to cover a large salvage reward. A salvage reward can be a heavy economic burden for one insurer alone. Therefore a system is in place to distribute this burden. The hull insurer is usually both co-insured and re-insured. In a co-insurance syndicate with NHC as claims leader, NHC represents all the co-insurers. However, NHC is only bound to their share of the risk and is not liable for the other co-insurers parts of the risk. If they have 15% of the risk, they get 15% of the premium and must pay 15% of any claim. If a salvage company demands security the claims leader often sets up a salvage guarantee to a salvor, but in that case they require a counter guarantee from the other co-insurers. This means that the claims leader issues a guarantee, but the other insurers must endorse this guarantee. This is documentation that all the co-insurers know about the situation and that they have to pay their part. It is

¹² Note: information in this section is from the interview with Anders Hovelsrud, NHC.

¹³ NMC section 447 (cf. SALVAGE 1989 article 13.2).

¹⁴ Charterer's Rules List of Correspondents for Norwegian Hull Club 2012, Part 2.

usually the broker who collects all the co-insurers parts of a salvage reward and then channels the reward to the salvage company. However, it is not uncommon that a hull insurer like NHC covers a sum of e.g. 5 million USD, and then recovers from the other co-insurers afterwards.

The claims leader is usually also re-insured for his part of the total sum insured. For the sake of argument let's assume the total sum insured is 100 million USD, and the claims leader is responsible for 15% in the co-insurance agreement. Even this is a large sum, 15% of 100 million USD is 15.000.000, so the claims leader may also choose to re-insure parts of the 15% risk. If he wants to cap his liability risk at 5 million USD, then he can re-insure 10 million USD with other insurers. The re-insurers are not liable towards the shipowner directly, only towards the insurer who has re-insured parts of his risk with them. NHC is part of several co-insurance syndicates as well as being re-insured.

3.2.10 Insurance broker¹⁵

Even the insurance broker may be involved in a salvage claim. The broker has an important role in the system. It is not the claims leader who chooses the co-insurers in a co-insurance agreement. Formally it is the shipowner, but he leans on the broker to carry out this job even though the shipowner may have some preferences. The banks and other investors also have requirements in the choice of insurers. They require good financial security for their investments and cannot accept a small insurer with a poor credit rating. The banks often require A- rating¹⁶ as a minimum. When a shipowning company wants to insure a vessel he will usually contact a broker. The owner may ask the broker to find the best possible cover for the ship, and may instruct on the choice of

¹⁵ Note: information in this section is from the interview with Anders Hovelsrud, NHC. Information on brokers also confirmed by Tone Scøyen, Marsh.

¹⁶ Note: Standard & Poor rating.

claims leader, e.g. NHC. Then the broker contacts the insurers in the market and gets offers from them. He then decides on which offers to accept and builds a package that in total constitutes 100% cover, and a new syndicate is created. There can be various insurers all over the world in this syndicate, but the claims leader binds them all together. The broker acts as a middle man between the assured and the insurers, so he is important also in relation to a large salvage claim. The broker can coordinate and collect insurance premiums, and in case of an insurance claim he can also collect the co-insurers contributions. In case of a large salvage reward, the insurance broker collects the co-insurers parts of the reward and arranges for the reward to be paid to the salvage company. So he is a service provider for both the shipowner and the insurer, as well as the salvor.

4 Legal Framework and Practical Solutions

4.1 The salvage convention 1989 and chapter 16 of NMC

The most important piece of legislation internationally concerning salvage is the Salvage Convention 1989. This convention was a reaction to the Amoco Cadiz shipwreck in 1978¹⁷. At the time it was the largest tanker oil spill ever registered and 227.000 tonnes of crude oil was spilled¹⁸. The older salvage convention of 1910 proved inadequate in the face of the large scale pollution following this accident. There was a need for an incentive to salvage the environment and not just the property, so the changes made in 1989 was first and foremost connected to environmental protection. The special compensation for environmental salvage was introduced in the Salvage Convention 1989¹⁹. The Salvage Convention 1989 has been incorporated into Norwegian law in the Norwegian Maritime Code chapter 16. Both the Salvage Convention and NMC have been used when working with this thesis, and will both be referred to; either NMC or SALVAGE 1989, and sometimes both. The rules, although differently worded, are mostly the same in NMC and the Convention.

4.2 Defining marine salvage

To determine whether or not an operation can be defined as salvage, and give rise to a salvage reward, one must look to the rules in chapter 16 (cf. SALVAGE 1989). NMC 441 defines salvage as assistance to “a ship or other object which has been wrecked or is in danger”. So both ships and objects can be salvaged. “Ship” is defined in NMC 441b as “any ship or vessel and also any other construction capable of navigation”.

¹⁷ Falkanger (2004), p 447.

¹⁸ Centre of Documentation, Research and Experimentation on Accidental Water Pollution (2008).

¹⁹ Falkanger (2004), p 447.

Thus it may be possible to “salvage” a floating crane or even a floating oil rig. “Object” is also defined in NMC 441c as “any object not permanently attached to the coastline”. Therefore it may also be possible to salvage a lost container or equipment lost from a ship. From the definition it seems possible to salvage almost anything from the sea, but it is reasonable to assume that the object must have a connection to a ship and maritime activities to fall under the definition. It is important to note that the rescue of human life does not in itself give rise to a reward. If, however, human life is rescued in connection with a salvage operation where property is also salvaged, then the rescuer of life is entitled to a share of any salvage reward or special compensation²⁰.

As laid out in NMC 441(a) an object of salvage must be “wrecked” or “in danger” for the operation to be considered “salvage”. It should in most cases be fairly simple to determine whether or not a ship has been "wrecked", but the evaluation of "danger" is not always obvious. “Danger” is not defined in the salvage convention or in NMC chapter 16. As the term “danger” is discretionary, the presence of danger must be evaluated for each separate case, and it is not always obvious that a ship is in such a grave danger that salvage services are required. So the degree of danger is important when evaluating what kind of assistance the situation requires. It may come as a surprise for some to learn that it is usually the insurer and not the shipowner who decides what assistance is needed, and negotiate with the salvage or towage company²¹. According to Hovelsrud hull insurers like NHC place great emphasis on the degree of danger as a guide in choosing the correct measures.

²⁰ NMC 445, 2nd paragraph.

²¹ Hovelsrud (2011). Interview.

4.3 The insurers view - 3 categories of danger²²

The Norwegian hull insurers are active in negotiating better deals for the shipowners, which is also to the benefit of the insurers. If there is any possibility to negotiate a commercial contract instead of a LOF, e.g. when time is not that important and several salvors are available, then the hull insurer will always try to do this. The number of salvage companies has increased in the last 10 years, so there are more providers of salvage services and they are more willing to sign a commercial contract instead of LOF than in previous years. Determining whether or not there is a salvage situation or merely a need for other assistance is essential to the insurers as this makes a huge financial difference. In this connection evaluating the degree of danger is very important. The insurer often has the possibility to negotiate with the salvage company but agreeing on the terms and what contract to use can be difficult. Therefore, through good contact with the salvage industry NHC has contributed in preparing and defining three categories of danger. These are helpful when negotiating the type of help and assistance required for different situations: category 1, 2 and 3. The following descriptions of these categories are based on the booklet *Salvage Response & Crisis Management*²³, which was lent to me by one of the authors, Anders Hovelsrud.

Category 1:

A typical example would be a vessel which has lost engine power and is drifting, but there is no imminent danger. The weather may be calm and there is no coastline or reef in the path of the drifting vessel. Therefore there is no immediate threat to the ship or to the environment and there is time to consider what measures should be used. The only service needed may be a tow to a harbour with the appropriate repair facilities. In such a situation the preferred contract is "Towhire".

Category 2:

A typical example would be a vessel which has run aground, though not very heavily.

²² Note: information in this section is from the interview with Anders Hovelsrud, NHC.

²³ Hovelsrud and Egeland (2008) p.8–10.

The grounded ship is situated in sheltered waters so that the risk of further damage being caused by waves or a shift in the weather or wind direction is very low. Consequently the risk to the environment is also very low. The hull is not breached, at least not by other than small holes which can easily be temporarily patched by the salvor. Refloating of the vessel may be done by shifting of ballast water and bunkers between tanks. Alternatively clean ballast water may be discharged into the sea and some cargo or bunkers may be removed to lighten the vessel before refloating it at high tide. This kind of situation does not call for desperate or hasty measures and the preferred contract is “Wreckhire”.

Category 3:

A typical example would be a vessel in a distress situation. A ship drifting helplessly towards shore or reefs in strong wind and/ or heavy swell is certainly in need of immediate salvage assistance. Or the ship could already be aground, but this time exposed to heavy swell. In open waters where weather changes or wind could pose a serious threat there is usually no opportunity to negotiate with the salvage company. The ship must be refloated and removed fast, and the risk is higher both for the ship and the salvor performing the job. A typical example is an oil tanker drifting towards the Cliffs of Dover threatening to spill its cargo along the English coast. This is a clear category 3 salvage situation with no time to negotiate, and the closest available salvor will get the contract.

Fire on a ship is a sailor's worst nightmare and is certainly a category 3 situation. A vessel in danger of sinking due to water flooding the hull is also category 3. Time is of the essence as the crew is in great danger, and the ship along with its cargo might be lost. If the vessel constitutes a threat to the environment, as covered by the Salvage Convention Article 14, reducing or hindering pollution has priority over salvaging the ship and cargo. Only life and health has higher priority in a salvage situation. In a category 3 situation, the vessel is in imminent danger and the preferred contract is Lloyd's Standard Form of Salvage Agreement, also called Lloyd's Open Form or LOF.

4.4 Salvage as supply and demand – need for salvage or merely assistance²⁴

When the insurer is involved in negotiations on whether there is a salvage situation or not, the danger requirement in NMC 441a is important. The ship must be in danger if the assistance rendered is to be considered as salvage, but the degree of danger is also evaluated. The 3 categories of danger may seem clear enough as they are written but it is not always easy to agree on which category the situation falls under. Especially category 2 or 3 can be hard to distinguish. Often there is a borderline situation where several factors contribute to define the situation as category 2 or 3 depending on how the parties choose to see things or how they argue. In such a situation it is easy to recognise salvage as a typical example of supply and demand. If both category 2 and 3 can be argued for, and several salvage companies have available resources nearby, then there might be room for the insurer to negotiate terms more beneficial for the shipowner and themselves. This could be a ship drifting in the middle of the Atlantic with tugs available both from Europe and USA. Unless there are other perils making the situation critical, the ship needs towage and can bargain with the salvage and tug companies. Both Wreckhire and Towhire are commercial contracts and will be a lot less expensive than a salvage reward. I.e. several providers of salvage services with vessels and equipment available nearby means the shipowner can get a better deal. This also depends on the time factor. If the shipowner is not forced to accept the first offer of salvage assistance, then the chances are he might avoid a pure LOF salvage. If on the other hand there is only one supplier of salvage services available in the area or within reasonable time, then the salvage company has a better chance of negotiating the terms they want.

²⁴ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

4.5 Salvage reward

The salvor is entitled to a salvage reward, given that the salvage operation produced a useful result²⁵. The requirement of success has long traditions and is a very practical solution. If no value is salvaged there will be no reward, “no cure – no pay”. As the salvor will only be compensated if some property of value is successfully salvaged, the salvor has a very strong incentive to do his utmost in achieving a result. A salvage operation can be costly, and if the salvor is not successful he may have invested time and money without any remuneration at all, leaving him with a loss. Because of this, if the situation seems too difficult or too risky for a salvor to attempt salvage on “no cure – no pay” basis, then the salvor may demand an alternative contract ensuring a fair compensation regardless of the result of his efforts. However, as long as the risk is manageable and the property is of substantial value, a salvor will prefer to have the possibility of a salvage reward. Such a reward will usually be much higher than normal salary or remuneration for work performed. In Norway it has been normal that a salvage reward amounts to 4-5% of the salvaged values, while in England a reward of 15-20% of the salvaged value is not unusual²⁶. In any case this can be a substantial amount of money for a salvor, and a strong incentive. So how is the insurer involved? According to NMC 447 “the salvage award is payable by the shipowner and the owners of other objects in proportion to the values salvaged for each of them”. A typical hull insurance policy will transfer this liability from the shipowner to the hull insurer, and this is also stated in Norwegian Hull Club's own rules²⁷. I.e. for the part of a salvage reward due by the shipowner, it is the hull insurer that covers the shipowner's part²⁸. The salvage reward is fixed on the basis of criteria set out in NMC 446. These criteria reflect several factors that come into play when a salvage operation is conducted. From NMC 446 one might believe that these criteria have a certain order of priority, the order in which they are written. However, according to the Salvage Convention, Article 13, the order in which these criteria are presented has no relevance to their priority. Therefore this should also

²⁵ NMC section 445, 1st paragraph.

²⁶ Haaland (2009), page 6.

²⁷ NMIP section 4-8, 1st paragraph.

²⁸ Charterer's Rules List of Correspondents for Norwegian Hull Club 2012, Part 2, paragraph 19.1.

be the case in NMC 446. As a starting point these criteria should all be given equal weight²⁹, but in practice it depends on the situation³⁰. The situation in the time leading up to the salvage operation, and the conditions during the operation, influences which criteria in article 13 are given most weight in practice. E.g. if a ship has grounded and is stuck on a reef with the hurricane season closing in fast, there is no time to lose. This increases the need for fast action, which makes "Time used..."³¹, more important. The increased risk of a hurricane also increases the risks for the salvor, which through LOF has taken responsibility and must use their best endeavors in salvaging the vessel³². In that case "the risk of liability and other risks run by the salvors or their equipment"³³, will kick in more strongly. In general, however, the insurers³⁴ have experienced that there is generally a lot of focus on "the salvaged value of the vessel and other property"³⁵. This seems reasonable as the reward should reflect the economic loss which has been prevented by the salvor.

4.6 Liability for salvage rewards

"All interests which have benefited from salvage services are in principle liable to contribute to the payment of the salvage reward"³⁶. This is regardless of whether the owner of the interest is party to the salvage contract or not, e.g. the cargo owner. This is in line with NMC which states that the salvage reward "is payable by the shipowner and the owners of other objects in proportion to the values salvaged for each of them"³⁷. In other words each party pays a part which corresponds to the percentage of their values in relation to the total salvaged value. There are exceptions, e.g. crew's and passenger's

²⁹ SALVAGE 1989, article 13, 1.

³⁰ Lange (2011). Interview.

³¹ SALVAGE 1989, article 13, 1.f.

³² LOF 2011, A.

³³ SALVAGE 1989, article 13, 1.g.

³⁴ Lange (2011). Interview.

³⁵ SALVAGE 1989, article 13, 1.a.

³⁶ Rose (2010) chapter 4, 4.001.

³⁷ NMC section 447 (cf SALVAGE 1989, article 13.2).

personal belongings³⁸. A salvage reward is usually paid by the owners of the ship, the cargo and the remaining bunkers. So it is basically the shipowner and the cargo owner who must contribute. E.g. if the salvaged cargo value is 40% of the total salvaged value (the salvaged fund), then the cargo owner is liable for 40% of the salvage reward. If the ship is bareboat chartered, the bareboat charterer may own the bunkers onboard and must contribute for the salvage of this. If the salvor is successful he may demand security for a salvage reward from the owners of the salvaged property³⁹. The salvage contract does not mention the insurer, but in practice it is the hull insurer that provides security or a guarantee for a salvage reward⁴⁰. It should be noted that if security is not provided a salvage reward is secured by a maritime lien⁴¹, but if security has been provided the salvor may not enforce such a maritime lien⁴².

4.7 Salvage Contract

There are a number of alternative contracts out there, e.g. Scandinavian Salvage Contract, French Salvage Agreement, USSR Salvage Contract, Japanese, Chinese and Turkish Salvage Agreements and several others. Nevertheless, Lloyd's Open Form (LOF) is the contract which is used for most of the salvage agreements anywhere in the world, so the other contracts will not be discussed in this thesis. LOF is recognised as the world leading salvage contract and has been in use for more than 100 years. The first modern Lloyd's Form of Salvage Agreement was adopted in 1892⁴³. Since then the contract has been revised and adapted to fit today's challenges, and the most recent form is LOF 2011. In fact, one reason for the success of LOF has been the ability to adapt to changes in the maritime sector that has taken place through history, and stay

³⁸ Rose (2010) chapter 4, 4.001.

³⁹ NMC section 452 (cf. LOF 2011, article 1 Salvage Security).

⁴⁰ Hovelsrud (2011). Interview.

⁴¹ NMC section 51, paragraph 5.

⁴² NMC section 452.

⁴³ International Salvage Union (2011 A).

updated⁴⁴. It is interesting to note some of the changes in the most recent version, LOF 2011; e.g. clause 13: notification of arbitration proceedings through the cargo insurers, clause 14: agreement by 75% binds all cargo interests (practical for container vessels with many cargo owners) and clause 15: low value cargoes may be excused from contributing to salvage costs⁴⁵. These are 3 examples of how LOF is adapted to be practical, functional and up to date.

The most common choice is to use LOF with or without the scopic clause. However, any contract may be agreed as long as there is no limitation in protecting the environment⁴⁶. The freedom of the parties to enter into any agreement they want means that it is possible to agree on other terms than those laid out in NMC chapter 16 (cf. Salvage 1989). E.g. the parties may deviate from “no cure-no pay” and agree on a lump sum as compensation instead of a salvage reward. The exception is the obligation to prevent or limit environmental damage⁴⁷, from which there can be no contractual deviation. Environmental damage will be paid by the P&I insurer⁴⁸, and in the interview Lange emphasized the importance of the obligation to protect the environment during salvage. This obligation is set out in SALVAGE 1989⁴⁹ and consequently also in NMC⁵⁰. In addition it is integrated into the salvage contract LOF 2011⁵¹. The costs of a cleanup operation following pollution may be huge and the insurers monitor environmental protection carefully during a salvage operation to ensure that this is taken care of.

Salvage may also be performed without the existence of a contract, in which case the terms and remuneration or reward may be agreed later. Of course, if the parties involved in an incident do not agree as to whether salvage or other assistance was conducted, and do not agree on the amount of compensation to be paid, the matter will be decided in

⁴⁴ Darling and Smith (1991) p.10.

⁴⁵ Tatham (2011).

⁴⁶ NMC section 443, 1st paragraph.

⁴⁷ NMC section 443, 1st paragraph.

⁴⁸ Skuld Statutes and Rules 2012, Part II P&I Cover, paragraph 14.1 – 14.5.

⁴⁹ SALVAGE 1989, Article 8, 1b.

⁵⁰ NMC section 444b.

⁵¹ LOF 2011, B Environmental Protection.

the court of law. In such a case the rules in SALVAGE 1989 applies, and NMC chapter 16 applies to court proceedings or arbitration in Norway⁵². In most cases, however, a contract is entered into prior to any salvage operation⁵³. A salvage reward or special compensation under a LOF contract is decided by arbitration in London⁵⁴. In the case of a disagreement between the parties under a LOF salvage agreement, this will also be decided by an arbitration tribunal⁵⁵.

4.8 Insurers view on LOF and the size of the reward⁵⁶

As hull insurer NHC applauds LOF and hopes this contract will continue to be the leading salvage contract. It is a good solution in critical situations where there is no time to negotiate all the details of a salvage agreement, and it is very functional. Still the insurers are sometimes accused of being against LOF. It is of course easy to imagine how a salvor is very eager to work under LOF terms as the salvage reward could be very profitable in the end. The insurers, however, do not like the use of LOF if the situation could be solved without it. The insurers view is that LOF should only be agreed for category 3 salvage situations.

In some cases the insurer is sceptical to the size of the salvage reward. When a LOF has been agreed there are examples of salvors being extremely generously rewarded, too generous from the insurers' point of view. This is especially the case in English arbitration or courts, which are seen as very "salvor friendly". In a situation where there is a lot of pressure on the captain and the shipowner, a salvor may hypothetically be successful in pressuring the captain or even the shipping company into signing a LOF, even though a tow or some other form of assistance might have been sufficient to solve

⁵² NMC section 442, 1st paragraph.

⁵³ Falkanger (2004), p 454.

⁵⁴ LOF 2011i.

⁵⁵ LOF 2011i.

⁵⁶ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

the problem. An example would be engine failure in the middle of the Atlantic and no real danger to life, property or the environment, and the ship is just drifting and losing precious time. A tow on a daily rate to a shore based repair facility may be sufficient in many cases. If the salvage company is then very generously rewarded following LOF arbitration in London, with a good lawyer arguing the ship was in grave danger, this is not positive for the insurer. Too many cases like this will give the insurers a negative view of LOF. The insurers are in favour of salvage rewards, but reasonable in relation to the situation at hand. If salvors are too greedy then the insurer will not recommend LOF in the future. However, when the salvor has actually done a good job, in a category 3 salvage situation, he should be very well rewarded and generously so. After all, a salvage reward is much less than the total sum insured following the total loss of a vessel, so the insurers definitely want to maintain the current system with the strong incentive of salvage rewards.

4.9 The different alternatives with a LOF contract

Here is a short overview of the different alternatives that are possible with a LOF.

4.9.1 LOF without scopic clause incorporated

This is a pure “no cure - no pay” salvage contract where the salvor is only compensated if the salvage operation has some degree of success in salvaging property of value. The salvage reward is set according to criteria in the Salvage Convention article 13. When the contract has been signed without incorporating the scopic clause, an article 14 special compensation for efforts to reduce or avoid environmental damage is also available to the salvor. No party can demand that scopic be incorporated or invoked later.

4.9.2 LOF with the scopic clause incorporated, but not invoked

In this scenario the scopic clause has been incorporated in the contract. The salvor did

not invoke the scopic clause, so the contract remains a pure “no cure - no pay” agreement. The possibility for an article 14 special compensation is eliminated when the scopic clause is incorporated in the contract, regardless of whether it has been invoked or not⁵⁷. Therefore, if the salvor fails to invoke scopic he will not be covered by the scopic clause or by article 14 for “environmental salvage”. It should be mentioned that article 14 becomes available to the salvor in any case if the owners of the vessel fails to provide the initial security for the scopic remuneration⁵⁸.

The advantage of incorporating scopic in the salvage contract is that the salvor has a safety net in case the salvage operation proves more difficult than he had initially thought, or if the property value turns out to be lower. He will then invoke the scopic clause. It is interesting to note that incorporating but not invoking scopic may hypothetically place a salvor in a situation where he will not be compensated for environmental salvage. Let's assume the salvor has used a lot of time and resources in cleaning up pollution and protecting the environment in connection with a salvage operation, but the vessel is lost. As article 14 is not available when scopic is incorporated, and scopic has not been invoked, the salvor gets no compensation. As the salvage failed there is no salvaged value on which to base a reward. Without success there is no reward and the salvor is left with nothing.

4.9.3 LOF with scopic clause incorporated and invoked by the salvor

Same as above regarding article 14, which is not available when scopic is incorporated into the contract. The scopic clause, when invoked, guarantees cover of the salvor's expenses in the operation regardless of whether or not the operation is successful. This is because the "no cure – no pay" provision in the main LOF salvage agreement is overridden by SCOPIC 2011⁵⁹. In addition he will receive either 10% surplus on his actual costs, or 25% surplus on the tariff rates⁶⁰, whichever is greatest⁶¹. Only expenses

⁵⁷ SCOPIC 2011, sub-clause 1. Confirmed by International Salvage Union (2011 B).

⁵⁸ SCOPIC 2011, sub-clause 4.

⁵⁹ SCOPIC 2011, sub-clause 1.

⁶⁰ Note: see SCOPIC 2011 APPENDIX A for the rates.

⁶¹ SCOPIC 2011, sub-clause 5.

incurred after the scopic clause has been invoked are covered⁶². It is important to be aware that if the salvage reward ends up exceeding the scopic remuneration in the end, the reward will be deducted by 25% of the difference between the salvage reward and the amount of scopic remuneration that would have been assessed if scopic had been invoked on the first day of services⁶³. In SCOPIC 2011, article 7, this is referred to as “discount”, but it is also sometimes referred to as “25% penalty”⁶⁴. The reward is discounted because the salvor has invoked scopic unnecessarily. If, on the other hand, the scopic remuneration ends up exceeding the salvage reward, then the salvor has been right in invoking scopic and no deduction is made from the reward.

4.10 Who may enter into a salvage contract and how is the hull insurer involved⁶⁵

According to NMC⁶⁶ the master can enter into a salvage agreement on behalf of the shipowner. The authority to conclude a salvage agreement is held by both the owner, the reder (e.g. a bareboat charterer) and the master independently of each other. The agreement is made on behalf of all those with interests onboard⁶⁷, also the cargo owners and their insurers. In those cases where the master enters into a contract this is usually the result of a critical situation where there is no time to make arrangements for the owner to get involved and sign the contract. If, however, there is no such haste to begin the salvage operation immediately, the owner and the insurer will be involved first, and the owner will sign a contract with the salvage company when the insurer has negotiated the terms with the salvor. The rules on salvage agreements do not mention the insurer, and one might get the impression that the insurer has no role in this stage of a salvage operation. One might think that the insurer merely provides financial resources. This, however, is incorrect. The insurer is deeply involved in a salvage

⁶² SCOPIC 2011, sub-clause 2.

⁶³ SCOPIC 2011, sub-clause 7.

⁶⁴ Lange (2011). Interview.

⁶⁵ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

⁶⁶ NMC section 443.2 (cf. SALVAGE 1989, article 6.2).

⁶⁷ NMC section 443 (cf. SALVAGE 1989 article 6.2).

situation, preferably from the very start. When a situation arises one of the very first tasks of crucial importance is to choose a salvage company for the job, and the hull insurer can be of great help in this respect. A typical shipowner may not have a very good overview of the salvage industry, or even know where to start looking for a salvor. An insurer like NHC has a network of salvage companies and knows where the different providers of salvage services have their resources. Because of their size as insurer of much tonnage and the need for salvage services for their customers on a regular basis, they have a better bargaining position towards the salvage companies than the individual shipowner. Therefore it is normal that the insurer chooses the salvage company and negotiates directly with them on behalf of the shipowner. As a “big customer” the insurer has the advantage of volume. So hull insurers like NHC not only provide funds but are heavily involved if a salvage situation arises. As the hull insurer will ultimately have to pay for the services rendered they have much at stake in a salvage operation. Because of their regular involvement in salvage they have the expertise to handle the salvage situation in cooperation with and on behalf of the shipowner. The P&I insurer is not involved in choosing the salvage company⁶⁸.

4.11 Entering into an agreement under time pressure⁶⁹

The shipowner may face a situation where a salvor demands a LOF contract before rendering any assistance, and the shipowner may be unsure whether or not he should agree on this. If time allows he may ask the insurer for advice. Such cases may be borderline cases regarding haste, and the insurer's advice will then usually be that if uncertain whether or not an LOF is necessary then the owner should sign the LOF. If there is no time for the insurer to get involved in this decision it is the captain who must make the decision on the spot, and sign the contract on behalf of the owner⁷⁰. In such a situation there is no room to negotiate and the closest salvor will get the contract

⁶⁸ Lange (2011). Interview.

⁶⁹ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

⁷⁰ NMC section 443.2 (cf. SALVAGE 1989, article 6.2).

without discussion. A typical example would be an oil tanker drifting towards the Cliffs of Dover threatening to spill its cargo along the English coast. The risk of grounding and sinking, and not least the risk of pollution, is high and imminent. This is a typical “category 3 situation” where, in my understanding, the insurer would have recommended a LOF anyway, so the captain cannot do much wrong. A LOF may even be agreed verbally via VHF radio to save time. Both the ships and any VTS station record VHF communication, so documentation of the agreement is not a problem.

Sometimes the contract with the salvor can be signed after the operation has started because the salvage company knows and trusts the insurer and has a good contact with the shipowner. In these cases the terms have been discussed on the phone and emails have been exchanged confirming the terms. “We will sign the contract on Monday” may be agreed. The salvage companies are very important to the shipowners and the insurers because they are the operational contingency on the sea. Shipowners and insurers want them to exist and be ready to help with specialized salvage equipment, vessels and expert crew, so cooperation and trust is vital in this business. It is good not to have to discuss the small details of a contract when a situation has arisen and time is of the essence. Rather the parties will have an understanding between them, i.e. solve the problem now according to the terms agreed and sign the contract later. Such agreements are not possible for the shipowners alone, they depend on the insurer.

4.12 Scopic and P&I⁷¹

The P&I insurer may become involved in a salvage situation through various events resulting from the initial casualty and the resulting salvage operation. This can be personal injury or death, damage to or loss of crew's belongings, passenger's luggage or cargo, shipowners or crew/captains liability in tort etc. Special compensation for "environmental salvage" through article 14 is also covered by the P&I insurer⁷².

⁷¹ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

⁷² Skuld Statutes and Rules 2012, paragraph 22.1.3.

However, it is now relatively seldom that the scopic clause is not incorporated in the contract, and therefore article 14 is not often an issue today. According to Lange most salvors today include the scopic clause in the salvage agreement even if they do not initially intend to use it. They see it as a kind of “safety net”. So in practice it is first and foremost the scopic clause that determines the P&I insurer's involvement in a salvage operation. Even though it is the P&I insurer that have to pay the scopic costs, the incorporation of the scopic clause in the contract is a discussion between the hull insurer and the salvor. The P&I insurer do not have any influence on this matter, but the P&I insurer wants to be involved as much as possible. Of major importance to the P&I insurer is assessing what the chances are that the scopic clause will be invoked by the salvor. When it has been invoked it is important for them to evaluate the chances that the scopic remuneration will exceed a possible salvage reward. It is only this exceeding sum that will be claimed from the P&I insurer. Any salvage reward will be paid by the hull insurer. So if the salvage reward exceeds the scopic remuneration there will be no scopic claim against the P&I insurer at all. This is the best case scenario for P&I when scopic has been invoked. In the worst case (for the P&I insurer) the operation fails, or there are no values left, and there is no salvage reward. In this case the scopic remuneration will be paid in full by the P&I insurer.

To the P&I insurer's dismay, when scopic has been invoked, the P&I insurer may have to pay a lot of money without having had any influence on the choice of salvage company or on the terms of the salvage agreement. The same is the case for the cargo insurer, who must also contribute to a salvage reward without having any influence. It is the hull insurer, the shipowner and salvage company that have real influence and negotiate up front of a salvage operation. It is they who agree on any details, such as the incorporation of a scopic clause in the contract. The P&I insurer would of course prefer that a shipowner signs a LOF without any scopic clause, because this leaves out the possibility for P&I to become liable for a scopic remuneration. When the salvor invokes the scopic clause he may claim security for the scopic remuneration from the shipowner⁷³. The wording in the clause does not mention the insurer but in reality it is

⁷³ SCOPIC 2011, sub-paragraph 3.

usually the P&I insurer that provides security directly. The salvor may also accept a Salvage Guarantee Form, I.S.U.2, which is a guarantee from the insurer that scopic remuneration will be paid.

The hull insurer on the other hand will always recommend incorporating the scopic clause as they have nothing to lose. If scopic is invoked and the salvage reward exceeds the scopic remuneration they even profit by it as the reward is discounted. Another argument is that with the scopic clause the salvor may be willing to attempt salvage even in very difficult situations where the outcome is very uncertain. If the alternative to a reward following successful salvage is total loss compensation from the hull insurer, then the hull insurer prefers that the salvor attempts salvage even if the chances are slim.

4.13 Article 14 special compensation and scopic remuneration

As explained above, the P&I insurer places a lot of emphasis on the scopic clause and the economic consequences it may have. Even though the P&I insurer is also responsible for an article 14 special compensation⁷⁴, they do not put as much emphasis on it because the chances for such a compensation to come into play are much more slim. This is because most salvors prefer to include the scopic clause in the contract⁷⁵, which excludes an article 14 special compensation⁷⁶. It is also important to bear in mind that article 14 is only activated if the salvor has protected the environment, while the scopic clause may be invoked regardless of any threat to the environment⁷⁷. The risk of financial liability for the insurer is therefore much greater with the scopic clause.

⁷⁴ SALVAGE 1989, article 14.

⁷⁵ Lange (2011). Interview.

⁷⁶ SCOPIC 2011, sub-clause 1. Confirmed by International Salvage Union (2011 B).

⁷⁷ SCOPIC 2011, sub-clause 2.

It is important to understand the difference between the scopic clause and Salvage Convention article 14. The Salvage Convention article 14 regulates the possibility of a special compensation to the salvor in respect of a vessel or cargo which threatens the environment⁷⁸. This is often referred to as “environmental salvage”. The starting point for such special compensation is that only the expenses are covered⁷⁹. So at least the salvor will not go home with a loss. The salvor's expenses are defined as “out-of-pocket expenses ... and a fair rate for equipment and personnel ...”⁸⁰. If the salvor has succeeded in minimizing or preventing pollution, then the special compensation “may be increased up to a maximum of 30% of the expenses”⁸¹, securing a surplus on the salvor's investment of time and resources. If the salvor's efforts are deemed to have been exceptional and the job very well done, then his expenses may be increased up to a maximum of 100%⁸², further increasing the salvor's profit. It is important to note that special compensation is only payable if it exceeds the salvage reward⁸³. This means that if in a salvage operation, the salvor has both succeeded in salvaging property and succeeded in environmental salvage, he may only receive the part of a special compensation which exceeds the reward. So the special compensation is there to ensure that the salvor has an incentive to reduce or prevent pollution even if the property is lost or has a reduced value. The problem with article 14 has been determining whether or not environmental salvage has actually taken place and then to agree on the size of the special compensation. Assessing the size of an article 14 special compensation is difficult and has often led to expensive legal costs. As article 14 may be difficult and expensive to use it does not always have the intended effect as incentive, but may even have the opposite effect⁸⁴. It should be mentioned that article 14 is very seldom in use today, as scopic is usually incorporated in the salvage contract⁸⁵.

⁷⁸ SALVAGE 1989, article 14 (cf. NMC section 449).

⁷⁹ SALVAGE 1989, article 14.1.

⁸⁰ SALVAGE 1989, article 14.3.

⁸¹ SALVAGE 1989, article 14.2.

⁸² SALVAGE 1989, article 14.2.

⁸³ SALVAGE 1989, article 14.4.

⁸⁴ International Salvage Union (2011 B).

⁸⁵ Lange (2011). Interview.

As a response to these problems the scopic clause was introduced in 1999⁸⁶, and the P&I insurers were burdened with expenses on which they have very little influence. An invoked scopic clause gives the salvor a right to have his expenses covered according to fixed tariff rates⁸⁷. In addition he will receive either 10% surplus on his actual costs, or 25% surplus on the tariff rates, whichever is greatest⁸⁸. The tariffs make it easy to calculate the size of a scopic remuneration, and one avoids the uncertainty connected to the assessment of special compensation under article 14. A scopic remuneration is paid regardless of any threat to the environment, even though the clause was originally intended as a simplification of article 14. The scopic clause is an optional contractual addendum to LOF, contrary to article 14 which is part of the Salvage Convention. Today scopic and special compensation exist side by side and are two different possibilities. As explained earlier it is not possible to have both at the same time. If scopic is included in LOF, then the possibility of an article 14 special compensation is lost, regardless of whether scopic is invoked or not⁸⁹.

My understanding of this is that, in principle, if scopic is included in the contract but is not invoked, and the salvage operation fails, then the salvor gets no salvage reward, no scopic remuneration and, even if he has succeeded in preventing pollution, no special compensation under article 14. In reality, however, the salvor will not put himself in such a situation. If there is indication that the object of salvage will be lost, or that its value is decreasing due to damage, then he will safeguard his interests by invoking the scopic clause. In any case, what the salvor really aims for is a large salvage reward following a successful "no cure - no pay" salvage operation. The salvor may therefore also choose to take his chances without invoking scopic. The scopic alternative, as well as the article 14 special compensation, are just safety nets to keep the salvor working even after the much more profitable possibility of salvage reward is lost.

⁸⁶ International Salvage Union (2011 C).

⁸⁷ Note: see SCOPIC 2011 Appendix A for the rates.

⁸⁸ SCOPIC 2011, sub-clause 5.

⁸⁹ SCOPIC 2011, sub-clause 1. Confirmed by International Salvage Union (2011 B).

4.14 The salvaged fund, the salvage reward and the scopic remuneration

If any property of value has been salvaged the salvaged fund is calculated. The salvaged fund is the total of the salvaged value of the vessel and other property, which is one of the criteria used to assess the size of a reward⁹⁰. It is important to bear in mind that it is the value of the property after the salvage has been completed that counts. Any reduction in value because of damage before or during the salvage operation will lower the salvaged fund. The size of the salvage reward depends on how one argues using article 13 of the Salvage Convention, and the parties may not always agree with each other when this is evaluated. The scopic remuneration, on the other hand, is calculated based on fixed tariffs. Only the part of a scopic remuneration which exceeds the reward is actually paid. Therefore, if scopic is invoked and the salvage succeeds, a higher reward means less, if anything, paid in scopic remuneration. For the P&I insurer a high salvage reward is better, and a high salvaged fund is a criteria which will increase the chance of a high salvage reward. The process of assessing the size of the salvaged fund is explained in the following example. Then an example of how the scopic clause may influence a salvage reward will be presented.

4.14.1 Example 1: How is the salvaged fund calculated

This example will illustrate how the salvaged fund is calculated and how it affects the size of a salvage reward.

1. The vessel is redelivered in a safe harbour following LOF salvage. The ship has been damaged in the initial casualty.
2. A sales and purchase broker will help assess the current market value of the vessel by comparing with similar vessels in the market. In perfect condition (which it is not) the second hand vessel would have cost 8 million USD.

⁹⁰ SALVAGE 1989, article 13, 1.a.

3. The vessel is then towed to a repair yard. The towage cost is 0,5 million USD which must also be subtracted from the salvaged values.
4. Then the repair is conducted and ends up costing 3 million USD, which must be subtracted from the salvaged values.

So in total 8 mill– 0,5 mill– 3 mill USD = 4,5 million USD, which is the salvaged value of the ship.

5. The salvaged value of the cargo is added to the value of the ship. If there is any damage to the cargo, or any cargo is lost, this must be subtracted from the salvaged cargo value. Some types of cargo can lose a lot of value. A classic example is a shipment of Christmas trees which is redelivered after salvage in January, too late for Christmas. In our example, however, we will say the cargo is worth 5 million USD after salvage.
6. The value of the remaining bunker must also be included in salvaged fund, e.g. 0,5 million USD.

The entire salvaged fund is:

Ship 4,5 mill + cargo 5 mill + bunkers 0,5 mill = total salvaged fund 10 million USD. This sum is used in connection with Salvage Convention, article 13, 1 a (cf. NMC 446 a) when assessing the size of the reward.

4.14.2 Example 2: Salvage reward and scopic remuneration

This example will illustrate how the scopic clause affects the economic outcome for the insurers and for the salvor. Let's say the salvaged fund is 10 million USD and the salvage reward is decided to be 20% based on the criteria in article 13⁹¹. This means a salvage reward of 2 million USD. Involving the scopic clause in the calculations can have a lot of influence on the outcome. If scopic has been invoked and the scopic costs end up as 3 million USD, then the hull insurer must pay the 2 million and P&I must pay the exceeding 1 million USD⁹². So both insurers become liable in such a case, and the salvor was right in invoking the scopic clause. Had the salvor not done this he would only have been paid the reward of 2 million USD, instead of 3 million USD in total.

If, in the previous example, the scopic remuneration ended up at only 1 million USD, then only the hull insurer becomes liable because the salvage reward of 2 million USD is higher than the scopic costs. The P&I insurer pays nothing and one can say that in this case the salvor was wrong in invoking the scopic clause. As a "penalty" a deduction is made from the full salvage reward, 25% of the difference between the full reward (2 mill) and the scopic remuneration (1 mill). The difference is 1 million, and 25% of 1 million = 250.000 USD deduction. So the salvage reward ends up at 1.750.000 USD payable to the salvor. If he had not invoked the scopic clause he would have received the full 2 million USD reward. So it is easy to see how invoking the scopic clause or not can make a lot of difference for the salvor financially. In our example 2 mill or 3 mill USD and 1.750.000 or 2 mill USD. To both the insurers and the salvage company this makes a big difference financially.

⁹¹ SALVAGE 1989, article 13.

⁹² SCOPIC 2011, sub-clause 6.

4.15 Salvor's assessment - invoking scopic or not

Low-value vessels carrying low-value cargo also generate a reward, though relatively low. Also a ship which is considered a total constructive loss will generate a reward if salvaged. Ships in the range of 7-8000 tons tend to have a scrap value of about 3 - 3,5 million USD⁹³. Even this generates a salvage reward of a certain amount. In such cases the salvor will usually invoke the scopic clause immediately, because it is probable that scopic will be higher than the reward. If on the other hand the ship and cargo has a very high value the salvor might be willing to risk working on "no cure - no pay" terms because the possible economic gain of a full reward is so much higher. The following two examples illustrate this:

4.15.1 Example 1: High property value

3000 TEU container vessel with 1500 containers on board. Vessel built 2008. A relatively new vessel with a lot of value in containers and a lot of value in the ship itself. Each container is worth approximately 50.000 USD, and the total value of vessel and cargo is enormous. If we imagine a scenario where this ship runs aground and LOF is agreed, the possible scopic expenses may be high, which put the P&I insurer on high alert, but the potential for an enormous salvage reward is also present. If the salvage is successful, and the scopic clause has been invoked, there is no chance that the scopic remuneration will exceed the salvage reward for such a valuable ship and cargo. Therefore the salvor knows that invoking scopic will most probably result in the 25% penalty deducted from the reward, which is a substantial loss for the salvor. The scopic clause is usually incorporated in the contract as a backup, but with such high values the salvor would not invoke scopic unless the risk of failure is considered high.

⁹³ Lange (2011). Interview.

4.15.2 Example 2: Low property value

Old vessel with low-value cargo, e.g. iron ore. Even without an oil spill and very low risk of pollution the salvors will invoke scopic immediately if it is probable that the scopic expenses will exceed a possible salvage reward. Even with no risk of a failed operation the salvors will invoke scopic to secure the 25% surplus on their expenses. One may look at invoking the scopic clause as an insurance policy. If all goes well and the salvage reward still end up exceeding the scopic remuneration, the salvor has invoked unnecessarily, and pays for the safety net provided by scopic by a reduction in the reward, 25% of the difference between the salvage reward or settlement and the scopic remuneration that would have been assessed if scopic had been invoked on the first day of the services⁹⁴. This may be an expensive "premium", but if the operation is too risky or the values in question are very low, the salvor may prefer the safety of invoking the scopic clause. In other words he pays to be safe. For a salvor, assessing whether to invoke scopic or not, is a question of experience⁹⁵. It is a question of evaluating the situation as soon as possible, and be able to assess/ calculate the values they may salvage vs. the expenses they will have in the operation. The P&I insurer also monitors a salvage operation closely to see if scopic may be invoked, and whether or not the scopic remuneration will exceed the reward.

4.16 Hull insurer and P&I insurer – conflict of economic interests⁹⁶

Sometimes there are disputes regarding the size of the salvage reward. Previous assessments of salvage rewards in similar cases do not necessarily give precedent for subsequent cases. The hull insurer wants the reward to be as low as possible because they are liable for the reward. The P&I insurer wants the reward to be as high as possible because they pay only the part of the scopic remuneration exceeding the

⁹⁴ SCOPIC 2011, sub-clause 7.

⁹⁵ Lange (2011). Interview.

⁹⁶ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

salvage reward. Because deciding the size of the reward in accordance with the Salvage Convention⁹⁷ is a subjective task it is easy to see how there may be much discussion on this matter. To the salvor it makes no difference who pays as long as he is paid, but for each of the insurers it does. In theory one could see it as a "struggle" between them to minimize their expenses at the cost of the other insurer. When there is a chance that scopic will kick in because salvaged values are low relative to the scopic remuneration, there is a clear motive for the P&I insurer to get the salvage reward as high as possible. The higher the reward, the less of the scopic remuneration must be paid by the P&I insurer. The hull insurer on the other hand always has a clear motive for getting the salvage reward as low as possible. However, there may sometimes be an advantage in a higher salvage reward in relation to the scopic remuneration. If the reward is higher than the scopic remuneration than the 25% penalty⁹⁸ reduces the reward payable by the hull insurer. These considerations can in theory make the relationship between the insurers more complicated, as each insurer works to further their own interests.

4.17 Termination of the scopic clause

If the scopic clause has been invoked this is not irreversible. According to SCOPIC 2011 both the salvage company (contractor) and the shipowner may terminate scopic⁹⁹. The salvor may terminate the scopic agreement and the main agreement if it becomes apparent that the costs to finish the salvage operation will exceed the value of the property capable of being salvaged and the scopic remuneration¹⁰⁰. The owners do not need a specific reason but can terminate the scopic agreement at their own discretion, with 5 days notification to the salvage company¹⁰¹. It should be noted that according to LOF both the owner and the salvor may terminate the main salvage agreement if there

⁹⁷ SALVAGE 1989, article 13.

⁹⁸ SCOPIC 2011, sub-clause 7.

⁹⁹ SCOPIC 2011, sub-clause 9.

¹⁰⁰ SCOPIC 2011, sub-clause 9 (i).

¹⁰¹ SCOPIC 2011, sub-clause 9 (ii).

is no longer a prospect of a useful result¹⁰². Again, the LOF contract does not mention the insurer. Still, according to Paul Lange, in practice, it is the P&I insurer that decides whether the owner should terminate scopic or not. This is totally in the P&I insurers control¹⁰³. This is why the insurer monitors the situation closely, continuously comparing the scopic costs versus the possible salvage reward. As seen in the previous examples a lot of money is at stake, so this is very important to them. It is also in their interest to assess whether scopic is unnecessarily invoked, and if it is possible to terminate the scopic agreement. A decision to do so could be considered because the risk of pollution is not there anymore. E.g. all oil has been removed from a stranded ship, pumped onto another vessel, and the salvors are now working on a lightering operation to refloat the vessel. At this stage there is no risk of pollution and the P&I insurer might consider scopic to be unnecessary¹⁰⁴.

It is obvious that if the P&I insurer can justify termination, then it will be sensible for the P&I insurer to terminate scopic. By doing so further operations are not considered work under scopic tariffs, and thereby the P&I insurer decrease the chances of scopic exceeding the reward. As mentioned before, it is only the part of a scopic remuneration exceeding the salvage reward that must be paid. If the reward is higher than the final scopic remuneration, then the P&I insurer will not be liable for any scopic expenses.

If the scopic clause has been invoked by the salvor and then later terminated, the salvors may continue the operation on "no cure - no pay" terms under the main LOF agreement. However, termination is not always easy because it requires the permission of the local authorities to do so. SCOPIC 2011 states: "The termination provisions ... shall only apply if the Contractor is not restrained from demobilising his equipment by Government, Local or Port Authorities or any other officially recognised body having jurisdiction over the area where the services are being rendered"¹⁰⁵. The reason for this sub-clause is obvious as it ensures that those responsible for a cleanup operation cannot

¹⁰² LOF 2011, G.

¹⁰³ Lange (2011). Interview.

¹⁰⁴ Lange (2011). Interview.

¹⁰⁵ SCOPIC 2011, sub-clause 9 (iii).

pull out of a situation where the initial casualty or the salvage operation has caused or may cause pollution. In reality the local authorities are usually very reluctant to allow the P&I insurer to terminate scopic¹⁰⁶. They may regard the P&I insurer as security that the salvor will be paid to stop pollution. If there is even the slightest hint of pollution or that something may go wrong, the local authorities may not allow termination. Skuld has terminated scopic in some cases but it is not something they can count on as a possibility in all cases¹⁰⁷.

4.18 The government's role in the salvage operation¹⁰⁸

As explained above the authorities may hinder termination of the scopic clause, but there are also other ways in which the local authorities may become involved in salvage. If the government does not understand the importance of the salvor's and insurer's involvement, they may not be cooperative. Because of this the insurers also work with national governments to ensure a good relationship with them and maintain contacts that are useful. According to Paul Lange, the local government can often delay an operation and create trouble. A typical example is a salvage company which needs specialized equipment to handle a crisis. The gear arrives at the airport but customs will not release the gear because they do not know what it is and wants documentation that it is safe etc. This is a big problem when time really matters. While the equipment is stuck in customs the situation deteriorates and the risk of pollution increases. The problem is that the authorities do not always understand who the different stakeholders in a salvage operation are or why they are involved, and may also have doubts about their motives. Paul Lange and Skuld is currently involved in a project with the International Salvage Union and the Nautical Institute to improve this situation. The objective is to write a book with Casualty Management Guidelines. Such guidelines will help all the stakeholders understand each other's roles in a casualty situation. The main target group, however, is the national government where the operation takes place.

¹⁰⁶ Lange (2011). Interview.

¹⁰⁷ Lange (2011). Interview.

¹⁰⁸ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

4.19 The salvor's risks¹⁰⁹

LOF is a best endeavour contract and this is also true for environmental protection. The salvor has undertaken to do everything in his power to be successful, and with all available resources bring the ship to safety¹¹⁰. At the same time the salvor has also committed to do his utmost to protect the environment, and make sure that the salvage operation itself does not harm the environment¹¹¹. If an oil spill has occurred a rule of thumb is that any oil outside the oil spill booms surrounding the vessel, e.g. washing up on beaches, is a P&I liability. The shipowner's P&I club works with the local authorities in a cleanup operation. The damage following a major oil spill can be an enormous task with large expenses in cleanup costs and compensations. This is the P&I insurer's liability. The salvage company on the other hand takes care of oil they have managed to detain inside the oil spill booms surrounding the vessel. This is a responsibility they have undertaken when signing a LOF. If the salvage is successful the salvage reward will normally be more than adequate to compensate the salvor for this and any other work they have done. It is important to note that such cleanup may increase the reward in accordance with the Salvage Convention, article 13 b; "the skill and efforts of the salvors in preventing or minimizing damage to the environment". If the reward is not high enough, or there is no reward, the salvor's expenses in cleaning up this oil will be paid by the owner's P&I insurer. Either in accordance with the scopic tariffs¹¹², or in accordance with article 14¹¹³ if scopic is not incorporated in the contract. What if the oil spill has been caused by the salvor during the operation? The salvor may have made a mistake or failed to anticipate all the risks of their actions. Will the shipowner's insurer still have to pay the expenses? The shipowner is strictly liable for oil pollution damage. This means that the shipowner will be held responsible for any oil spill from his ship regardless of fault¹¹⁴. What of the salvor's responsibility? An important question is whether the shipowner's P&I insurer can claim recourse from the salvor if the oil spill

¹⁰⁹ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

¹¹⁰ LOF 2011 A.

¹¹¹ LOF 2011 B.

¹¹² Note: see SCOPIC 2011 Appendix A for the rates.

¹¹³ SALVAGE 1989, ARTICLE 14.

¹¹⁴ NMC section 191.

resulted from a mistake made by the salvor.

Oil spills are not uncommon in a salvage situation. To impose liability on the salvor would require gross negligence on the part of the salvor. If the salvor has acted with due diligence a mistake is not likely to make him liable. After all, the salvor is trying to save the vessel and avoid pollution in a difficult situation, where the vessel may already pose a serious threat before the salvage contract is agreed. It is important not to scare the salvage companies from making an effort to solve situations where the risk of pollution is high. Therefore there is good political reason to set the bar very high for the salvor to become liable for pollution. Even if the salvor's efforts are not always enough he may not be blamed as long as his actions are considered reasonable, acting with due diligence. If, on the other hand, it could be proven that the salvor has acted with gross negligence, then the owner's P&I insurer may have a claim against the salvor? It should be noted, however, that the salvor is protected from claims for compensation for oil pollution damage by the International Convention on Civil Liability for Oil Pollution Damage¹¹⁵. So there may be a difference depending on the type of pollution. My conclusion on this matter is that it would take a lot for the salvor to become liable. (Note also that the salvor may limit his liability for maritime claims under the Convention on Limitation of Liability for Maritime Claims¹¹⁶). What is certain, however, is that if the salvor fails to prevent or limit pollution as a result of negligence, the salvor may be deprived of all or part of a special compensation¹¹⁷. If the salvage operation has become necessary or more difficult because of the salvor's fault or neglect, the salvor may be deprived of all or part of a salvage reward¹¹⁸.

There are many risks involved in salvage and the salvor should be well compensated for taking these risks. There is the risk of personal injury and death of salvage workers, damage to or loss of the salvage vessel or salvage equipment, and possibly the risk of

¹¹⁵ International Convention on Civil Liability for Oil Pollution Damage, article III, paragraph 4 d.

¹¹⁶ Convention on Limitation of Liability for Maritime Claims, article 1.1.

Note: the claims subject to limitation are set out in article 2.

¹¹⁷ SALVAGE 1989, ARTICLE 14 (cf. NMC section 449).

¹¹⁸ SALVAGE 1989, ARTICLE 18 (cf. NMC section 450).

liability towards third parties. To manage the risks the towage and salvage companies have their own insurance, both regular P&I and a so called "salvor's liability insurance". As a starting point they have a standard P&I insurance covering them in non-salvage work. When they are involved in a salvage operation this is regarded as a "special operation" and require a specialized salvor's liability insurance. What happens is that the towage or salvage company contacts their P&I insurer and pays an extra premium for the vessel, equipment and personnel they are planning to use in the salvage operation, a "special operations cover". Skuld offers this kind of insurance and have the Norwegian company Bukser og Bergning as a customer. It is interesting to note that Skuld may find themselves in a situation where they insure the liability of both the ship in need of salvage and the salvage company at the same time.

4.20 General average and the salvage reward

According to the York Antwerp Rules a salvage reward may be accepted in general average only if the reward has been paid by one of the parties on behalf of the other parties¹¹⁹. The salvor will usually not release the ship and cargo until the insurers have provided security for the salvage reward. The shipowner's hull insurer will provide such security, and sometimes also pay the entire reward on behalf of all the other interests as well as their own part¹²⁰. It is in such a case that the YAR rules allow for the reward to be included in general average to help the hull insurer retrieve the part(s) of the reward paid on behalf of other parties, e.g. the cargo owners' part. If, on the other hand, each party pays their share directly there is no need for the reward to be involved in general average.

¹¹⁹ York Antwerp Rules 2004, rule 6.

¹²⁰ Hovelsrud (2011). Interview.

4.21 Special Casualty Representative¹²¹

There is no mentioning of the insurer in the standard LOF contract. The insurer is, however, mentioned in the supplementary form SCOPIC 2011, which regulates the scopic clause, and in Appendix B to SCOPIC 2011 which deals with the Special Casualty Representative (SCR). As explained earlier, by invoking the scopic clause the salvor secures for himself a 25% surplus on his expenses regardless of success. At the same time he also gives the shipowner a contractual right to oversee his use of resources during the operation, and keep daily records of his expenses. This job is done by the Special Casualty Representative (SCR).

According to SCOPIC 2011 the shipowner may appoint an SCR once the scopic clause has been invoked by the salvor¹²². In practice the SCR will often be appointed by the shipowner as soon as it is apparent that scopic will be invoked by the salvor. He is present on the site where the salvage operation takes place¹²³ and his job is to monitor the salvor's work, use of resources and the scopic costs. He safeguards the interests of the shipowner, the cargo owner and their insurers. He should be objective in his assessment, and he also has the same duties as the salvor in assisting to salvage the vessel and safeguard the environment¹²⁴. The preferred SCR is a former salvage master who is experienced in operational salvage work, but there are also SCRs with other technical and maritime backgrounds.

The SCR may not be the only special representative on the site of the casualty. The hull insurer (or claims leader) and a cargo owner may also appoint a special representative each to oversee the operation alongside the SCR¹²⁵. The P&I insurer may also send their own representative if they have a lot at stake in the operation, e.g. oil spill. So in a big operation the insurers may send their own representatives, but it is the SCR who officially keeps track of the costs. The SCR has full access to the vessel and the daily

¹²¹ Note: information in this section is from the interview with Paul Lange, Skuld P&I Club.

¹²² SCOPIC 2011, sub-clause 12.

¹²³ SCOPIC 2011, sub-clause 12.

¹²⁴ SCOPIC 2011 APPENDIX B, sub-clause 2.

¹²⁵ SCOPIC 2011, sub-clause 13.

salvage report¹²⁶, of which he must transmit a copy to Lloyd's, the shipowner, the insurer and to the other representatives (or their employers).

If scopic is invoked LOF is no longer a no cure-no pay contract, and the salvor is guaranteed payment for his use of salvage resources and equipment during the operation, i.e. tugs or other craft, personnel, towing lines, pumps, generators, diving equipment, welding and cutting equipment etc. The rates for the salvor's use of equipment and personnel under the scopic clause is calculated based on tariffs in SCOPIC 2011 Appendix A. The salvage master must deliver daily reports of the operational costs, and the SCR checks that his statements are correct. If the SCR should disagree with the salvor on expenses or use of equipment he will prepare a dissenting report and send this to the shipowner, the insurers and their special representatives, and also to the salvage master and to Lloyd's¹²⁷. When the salvage operation is completed the SCR is responsible for the final "scopic account", so one could therefore call him a "scopic adjuster".

4.22 Wreck salvage – wreck removal

If the ship is considered a total constructive loss (a wreck) after salvage, then the owner may claim the total sum insured from the insurer. According to NMIP "the conditions for condemnation are met when casualty damage is so extensive that the cost of repairing the ship will amount to at least 80% of the insurable value, or the value of the ship after repairs, if the latter is higher..."¹²⁸. The wording is clear enough, but that does not mean determining whether or not a ship should be repaired is easy. Sometimes there is a dispute as to whether or not the ship can be repaired within the economic framework of the rules¹²⁹. If the shipping market is low, then the shipowner may be

¹²⁶ SCOPIC 2011 APPENDIX B, sub-clause 5b.

¹²⁷ SCOPIC 2011 APPENDIX B, sub-clause 5ciii.

¹²⁸ NMIP section 11-3.

¹²⁹ Hovelsrud (2011). Interview.

more eager to claim for a total loss than to repair the ship. The insurer may be of the opposite opinion, and claim the ship can be repaired. The salvage company will reduce their risk by invoking scopic as soon as it becomes apparent that the ship they are attempting to salvage is a wreck. Alternatively the parties may agree on a commercial contract for wreck removal, such as Wreckhire.

“Rocknes” is one example of such a dispute¹³⁰. The fall pipe vessel hit a reef in Vattestraumen, Norway, and consequently capsized and floated upside down for many days. The shipowner claimed the damages were so extensive that the vessel was a wreck. They wanted to declare the ship a total constructive loss and claim the sum insured. The salvage company also thought so and invoked scopic to ensure an acceptable compensation for their work. However, the insurer, Norwegian Hull Club, did not agree and claimed it was possible to repair the vessel within the required economical limit. They were right, although very close to the limit. Everything onboard from interior to electrical systems and electronic equipment was destroyed, also the machinery. After turning the ship, surveys were conducted to assess the cost of repair very thoroughly. When it was concluded that repairs were possible within the economical limit the vessel was towed to Poland where it was built up from scratch¹³¹.

In the Rocknes case, if the insurer had agreed and acknowledged that the ship was a total constructive loss, they would have become liable for the total sum insured in addition to any salvage reward for the salvaged values. As a consequence the ship would have become the hull insurers' property in accordance with NMIP¹³². With the vessel towed to a safe harbour the hull insurer may then sell the vessel for scrap to retrieve some of the expenses. If, however, the ship is still stuck on a reef and will have to be removed, it is important for the hull insurer to waive his right in the vessel to avoid the wreck removal expenses¹³³. The wreck will then remain the property of the shipowner, and the P&I insurer will be liable for the wreck removal expenses¹³⁴. If the market is so

¹³⁰ Hovelsrud (2011). Interview.

¹³¹ Hovelsrud (2011). Interview.

¹³² NMIP section 5-19.

¹³³ NMIP section 5-19.

¹³⁴ Skuld Statutes and Rules 2011, article 15.1.

good that the price of replacing the vessel is higher than the total loss compensation, the owner may prefer salvage, even if the insurer disagrees. This would be a typical case during the recent booming years in shipping which ended abruptly in the end of 2008. However, according to NMIP¹³⁵ the insurer has the right to decide not to salvage, and pay the sum insured to avoid further liability.

4.23 Casualty response teams¹³⁶

According to NMC¹³⁷ the shipowner has certain duties in relation to the salvage company. These include cooperation and to prevent or limit environmental damage. The salvor's duties in relation to the owner are also described. These include performance with due care, to prevent or limit environmental damage and to accept intervention from other salvors if this is requested by the shipowner or master. The insurer is not mentioned but in reality the insurer contributes in taking care of the shipowner's duties. There is a lot to handle when planning and executing a salvage operation. In order to handle their duties and manage the operation the parties must work together. The practical solution is that both parties have casualty response teams that cooperate and exchange information during the operation.

The shipowning company is obliged to have a casualty response team (contingency team), but the members of this team are not engaged in casualty work on a daily basis. The shipowner's team knows a lot about their ship and how it is managed, but is seldom or never involved in a major crisis. Unless a casualty or crisis occurs the members normally have other work in the shipping company. In a salvage situation the shipowner's contingency team gets together, and the members leave their other daily work to concentrate on the salvage operation. They receive information from their ship,

¹³⁵ NMIP section 4-21.

¹³⁶ Note: information in this section is from the interview with Anders Hovelsrud, NHC.

¹³⁷ NMC section 444 (cf. SALVAGE 1989 article 8)

the salvor, the insurers and other parties. They rely on the insurers teams for support in planning and executing the salvage operation. The insurer's casualty response team handle small and big crisis continually, which makes them much more experienced than a shipowning company's own casualty response team.

Both the hull insurer and the P&I insurer have expertise through the experience they gain from all the incidents they are involved in as insurers. NHC's work can involve anything from a minor incident in the port of Alexandria to an oil tanker grounded in the English Channel or a fire onboard a passenger ferry. The same is the case for Skuld P&I Club. When a casualty occurs that concerns Skuld the Oslo office is notified. Oslo then notifies the Casualty coordinator in the local office closest to the casualty site¹³⁸. The casualty coordinator takes steps to prepare for any known potential threats. If the ship has 1000 cubic meters of oil onboard, a contingency plan with equipment ready to handle 1000 cubic meters of oil spilled is prepared. One must always prepare for the worst possible scenario, preferably before it happens.

The insurer's contingency team channels useful information and important decision making material to the shipowner's team. The insurer's team assists by finding available salvage companies and negotiates terms with them, providing the best contracts for the situation and prepares these, communicate with the salvor and help handling the media, provide weather forecasts and assess the risks etc. The insurer usually has people onsite and keeps a close contact with the salvage company and other parties. Status updates on the situation and advice on how to proceed are continually sent to the shipowner's team so they can concentrate on making decisions. So even though the insurers are not mentioned in either NMC's chapter 16, SALVAGE 1989 or LOF 2011 they are of essential importance for the shipowner's ability to fulfill their obligations.

¹³⁸ Lange (2011). Interview.

5 Conclusion

5.1 Summary of major findings

In this thesis I have discussed the rules governing salvage and the practical solutions to how the insurers are involved in marine salvage. The aim was to describe how the insurers are involved and compare this to the legal sources to see if the relationships between the parties are covered by the legal sources. One main conclusion is that the rules do not describe the full extent of the insurers involvement in salvage, as much of the work they do is not regulated by the rules. This is surprising to learn, as the insurer has such a large role in the salvage processes. It is far from possible to learn everything there is to know about the insurer's involvement simply by reading the legal sources alone. By doing that one might think that the insurers are merely there to provide funding, which is not true. The fact is that a lot of the work undertaken by the insurers and the cooperation taking place between the parties is not described in the legal literature. Therefore the interviews and correspondence with the marine insurers have been very important in my writing process. What I have found is that the marine insurers are much more involved than what the legal framework suggests, e.g. as a representative for the shipowner in relation to the salvage company. It is usually the insurer, not the shipowner, who contacts the salvage company and negotiates the terms with them. The shipowner is the contractual counterpart, but the insurer acts on behalf of the shipowner in relation to the salvor. There is no contract between the insurer and the salvor, so this and other solutions have evolved for practical reasons, simply because it works well. This is because it is the insurer who is the expert in handling a casualty and has the right connections, not the shipowner. The insurers have the experience and knowledge, while the shipowner's team is not used to handle casualties

on a daily basis. In fact, my research shows that the insurers are usually involved in all the phases of a salvage operation, and in this thesis I have linked their involvement to the salvage-processes described by the legal sources.

A short summary of interesting findings follows here. In most cases the insurers are involved from the very beginning when a casualty occurs. In a few cases, however, a salvage contract is signed directly by the captain, without consulting the shipowner or the insurer first, because there is no time to wait. The captain must act immediately to get the salvage operation started and save the ship. LOF may even be agreed verbally via VHF to save time, but even in cases like this the insurer takes over much of the contact with the salvor as soon as they are involved in the situation. The hull insurer has a lot more influence than the P&I insurer. It is the hull insurer that chooses the salvage company and negotiates the terms. The P&I insurer's involvement depends on the circumstances of the casualty, e.g. whether or not the scopic clause has been invoked. The costs can be high for the P&I insurer, as a salvage situation could also involve personal injury or loss of lives, pollution and much more. However, it is the scopic remuneration that usually makes the big difference for the P&I insurer. It is the part of a scopic remuneration exceeding the salvage reward that is paid by the P&I insurer. Therefore a ship and cargo with low value may result in more expenses for the P&I insurer when scopic is invoked, because low value means less reward. The P&I insurer has little or no influence on the terms of the salvage contract and the salvage operation. This is the hull insurer's domain. From the P&I insurer's point of view a salvage contract without a scopic clause is better because this removes their risk of having to pay scopic remuneration. The hull insurer on the other hand prefers a salvage contract with the scopic clause included and invoked. In that case, if the reward is higher than the scopic remuneration, the hull insurer will pay less as the reward is deducted by "the 25% penalty". If the operation does not have a useful result no reward is paid by the hull insurer, but the scopic remuneration must still be paid by the P&I insurer.

It can sometimes be difficult to agree on what kind of assistance is needed in different situations, salvage with LOF, or some other form of assistance with a commercial contract. The hull insurers have contributed in preparing 3 categories of danger to make this easier. These categories seem to be very much the insurers' point of view, while a salvor will always be eager to work under a LOF contract as soon as there is any hint of danger. This gives an impression of a constant struggle between the insurers and the salvage companies. This struggle is influenced by the market, the supply and demand of salvage. When there are several providers of salvage assistance available the insurer will have a possibility to negotiate better terms. The insurer acts on behalf of the shipowner who is the contractual counterpart of the salvor. However, any benefit for the owner is to the benefit of the insurer who must pay the bill. The insurers want a more restrictive use of LOF, and only as a last resort in clear category 3 situations where no other option is possible. They prefer to agree on a commercial contract, such as Towhire when this is sufficient. The salvage companies, on the other hand, want a more liberal use of LOF as a salvage reward may be much more profitable.

5.2 Outlook

Salvage will always be important to the shipping industry. The marine insurers and shipowners will therefore continue to support salvage rewards and the use of LOF. As more providers of salvage come into the market there is more competition, which may be advantageous for the insurers. On the other hand it is important to maintain the strong incentive of salvage rewards to ensure a good salvage contingency in all parts of the world. Some of the rules on salvage are as ancient as shipping. Could some upgrade of the rules make life easier for the different parties involved in salvage? How about including a more detailed definition of "danger" in the salvage convention? This could be based on the 3 categories defined by the insurers, but may need some adjustment for parties such as the International Salvage Union to agree. Another development worth

mentioning is ISU's and the Nautical Institute's project of preparing Casualty Management Guidelines directed against the national governments. In the future these guidelines may improve the involvement of the national government when a casualty occurs in their waters.

5.3 Suggestions for future research

The involvement of local authorities and national governments in salvage operations is an interesting topic that can be investigated further. After some years such research can also include an evaluation of the practical consequences of the Casualty Management Guidelines mentioned in this thesis. One could also evaluate whether the additions in the new LOF 2011 has been an improvement or made any difference for the salvage industry.

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7 Abbreviations and terminology clarifications

Commercial contract -

an alternative to a pure salvage contract, where the salvage company performs work for a lump sum or pre agreed tariff, e.g. Towhire

GA - General Average

GA adjuster - General Average Adjuster

IGP&I - International Group of P&I Clubs

IOPC - International Oil Pollution Compensation Funds

ISU – International Salvage Union

LOF - Lloyd's Standard Form of Salvage Agreement,
also called "Lloyd's Open Form"

LOH – loss of hire

NHC – Norwegian Hull Club

NMC - The Norwegian Maritime Code

NMIP - Norwegian Marine Insurance Plan

“25% penalty” -

the salvage reward will be deducted by 25% of the difference between the Article 13 salvage reward (or settlement) and the amount of SCOPIC remuneration that would have been assessed had scopic been invoked on the first day of the services

SCR - Special Casualty Representative

SCOPIC 2011, “scopic clause” or “scopic” - Special Compensation P&I Club Clause

SALVAGE 1989 – International Convention on Salvage 1989,
or “Salvage Convention”

TEU - Twenty-foot Equivalent. 3000 TEU = capacity of 3000 20-foot containers

VTS station - Vessel Traffic Service Station, e.g. Oslo VTS Station

YAR-Rules - York Antwerp Rules