LLOYD'S OPENED FORM – AN ENDURING CONTRACT?

Disclaimer

I should begin with a disclaimer: the views which follow are entirely my own and don't necessarily reflect those of either Lloyd's Salvage and Arbitration Branch or the panel of LOF arbitrators.

Background

When I first started in practice – almost 40 years ago – LOF arbitrations were the "bread and butter" work of Admiralty counsel.

- By the mid-1980s, I was appearing in 40 or more salvage arbitrations per year. At that time Lloyd's did not require the signature of LOFs to be reported to them. However, one can get some idea of the number of LOFs being signed from the number of arbitration appointments being made: **slide 2.**

- From about 2010, I was probably appearing in 3, or possibly 4, LOF arbitrations per year as counsel, and several as arbitrator. In that period, the number of LOFs signed per year declined rapidly: **slide 3** (I have added the number of first instance appointments to allow at least some comparison with slide 2.)

Does it necessarily follow from that comparison that LOF is on its way out, with the result that the answer to my opening question is 'no'?

Statistics

You will, I am sure, all be familiar with the ISU statistics, so I will not take up too much time with them. I will just show you three slides, with the usual caveats:

- "All things are relative".
- "Depends on what figures you are looking at."
- "Headlines can be misleading."
- "One poor year is not a trend.

Slide 4: A quick glance at this and you would think that all was well with LOF – save for a 'blip' in 2015, the trend for LOF revenue is an increasing one. Taken in isolation, that is encouraging and suggests that LOF is doing well, particularly in a very thin marine market.

Slide 5: But this suggests a rather different picture – the general trend of the total number of LOF cases signed per year is downwards. The other interesting feature of this slide – to me, at least – is the increasing trend of **non**-LOF cases.

I personally find **Slide 6** very interesting, because it shows the increasing role played by wreck removal in the income stream of ISU members. Just to put a bit of perspective on that:

- In 1999, earnings from wreck removal provided 22.2% of total revenue and by way of comparison, such earnings were only 41.33% of what had been earned by way of LOF revenue.

- In 2015, earnings from wreck removal provided 56.14% of total revenue and by way of comparison were now 478% of what had been earned by way of LOF revenue!

Why?

My theory is that there are two factors at play here:

(a) Many of the major salvors are now small parts of much larger commercial organisations, who are used to thinking in terms of regular utilisation of resources and reasonably regular and – to a degree at least – predictable cash flow. Wreck removal provides that to a much greater degree than does LOF salvage.

(b) States and local authorities are much more keen than they used to be on requiring the removal of wrecks on or near their shores.

I would be interested to know in due course what your views are.

Decline in popularity

The statistics suggest that LOF has declined in popularity, if not for the really big cases, at least numerically.

Why?

I throw out some thoughts for you to consider: **slide 7**

"Why pay more if you don't have to"

The starting point is the 1989 Salvage Convention, which dominates the world of modern salvage. Dominates because Article 13 of the Convention [**slide 8**] contains a rewards system which has in almost equal measure promoted the salvage industry **and** made it unpopular amongst property interests and their insurers.

We should remind ourselves what provoked the 1989 Convention:

(1) 1978 – "Amoco Cadiz". 220,000mt crude oil spilt on the French coast.

(2) 1981 – CMI report. There was a debate whether the Convention should have mandatory effect, particularly where there was a risk of damage to the environment. Rejected: contractual freedom (or national laws if no contract is agreed) won the day.

(3) So what was new in 1989 compared with Brussels Convention of 1910? Art 13.1, (b)(g)(h)(i). What are they? They are new criteria for fixing the award: in other words they were new ways in which it was **agreed that salvors should get more money for carrying out salvage services**.

(b) is about preventing/minimising damage to the environment, something which is even more important today than when the Convention was first agreed.

(g), (h), (i) are about encouragement to salvors. They tie in with the words of the preamble which the CMI was at pains to emphasise – that "*the reward **shall** be fixed with a view to encouraging salvage operations*."

(4) We also need to remind ourselves of the loss of the "Braer" in 1993 and the Donaldson report – 'Safer Ships, Cleaner Seas' – which was produced a year later and made 103 recommendations. That report was also very influential in prompting arbitrators to enhance awards to encourage investment in salvage capability.

(5) Shortly before the "Braer" incident and the Donaldson report, a Salvage Working Group was set up (1990) by shipowners, insurers and salvors, reporting in 1993. The great and the good in the maritime world signed up to its recommendations – the International Group (P&I), BIMCO, ILU, IUMI, International Chamber of Shipping, Intertanko, Intercargo, national underwriters' organisations, virtually everyone. It's important to remember what <u>everyone</u> signed up to and to refresh memories of what was universally agreed, because I believe that people have forgotten and that everyone needs to remind themselves of what was agreed nearly a generation ago:

Slide 9: (a) – how that resonates even more today!

Look at (b) in particular.

Slide 10: Look at (d) in particular.

Needless to say, those recommendations were wholeheartedly endorsed by the Donaldson report. And the 1989 Convention was warmly welcomed by ALL parties to it – salvors, ship and cargo owners <u>and</u> insurers. All in all, as at about 1993, it was universally agreed that there needed to be a much greater focus on encouraging salvors by giving enhanced awards under LOF and the Salvage Convention. Quite properly, the arbitrators on the Lloyd's panel at that time took all of that on board, as do the arbitrators on the panel today.

(6) So far, so good. BUT: past experience tells me that most insurers only agreed <u>in theory</u>. The trouble is that in practice no one likes having to pay. Insurers, because <u>unless</u> they can put up premiums, they hate paying out claims. Assureds, because claims go on their record and so affect renewal premiums. So people look for ways of avoiding being exposed to an Article 13 award. So they turn to Wreckhire or Towhire or other fixed rate contracts. Or LOF with caps. OR

SCOPIC – which ought to be at salvors' option – automatically invoked and perhaps at reduced rates. Even Supplytime. Why have salvors agreed to all this? You will know the answer to that better than I, but I suspect that competition has a lot to do with it.

(7) But ultimately all this is in my view self-defeating. The whole principle of LOF is to encourage salvors to invest at the margins and for the exceptional – marginal locations, tugs which have very uncertain expectations of return, personnel who are trained for exceptional situations. History and experience tell us that if we do not have investment and capacity at the margins and for the exceptional then we will have maritime disasters – "Amoco Cadiz" being an example which springs to mind. They will be increasingly expensive, particularly if they involve pollution, or the threat of it, in environmentally sensitive areas. Insurers and property interests may say: *'hey, enough is going into the pockets of salvors through ordinary big contract work – they don't need the enhanced rewards from Article 13'.* But that is, I would suggest, misguided and inaccurate. I am sorry to say that, in my view, those in the industry who have walked away from LOF have very short memories.

Too few LOF cases means a reduced opportunity to recoup the investment in salvage for the emergency response salvors – be it dedicated tugs or specialist equipment or, perhaps most importantly of all, highly trained and experienced personnel. The maritime industry seems to have forgotten that without the icing on the top of the cake there will be no bake off. There MUST be a flow of 'run of the mill' cases, as well as major casualties, to keep professional salvors in the market. And I suspect that that is even more true today, given that a number of the major players in the salvage sphere are, in commercial terms, simply the pimple on the backside of very much larger elephants.

(8) Investment in the salvage industry through Article 13 Awards is a form of insurance against such disasters. The maritime industry in my view ignores it at its peril.

Mischievous misinformation [Slide 7]

I think that there has been a good deal of mischievous misinformation spread about LOF and Article 13. Things like *"it's far too pro salvor", "it's not fair" "the awards are far too high", "it's all a bit of a lottery".*

Let's consider the first 3 of those together, because they are merely variants on a theme: **slide 11**

Again and again in my professional life I have heard it said that salvage awards are too high and that **LOF awards** are 'unfair'. I beg to disagree. You have to remember what Article 13 provides:

(1) 13.1: the reward shall – i.e. must - be fixed with a view to encouraging salvage operations. A reward which does not encourage does not comply with English law. Indeed, some might go so far as to say that the Convention requires an arbitrator, in fixing the reward, to be 'pro-salvor' – because that is what "encouragement" means. Look at the dictionary definition of "encourage" – *promote, assist, stimulate by help or reward*.

(2) The award must be assessed by reference to the 13.1 criteria. Thus it is simply impermissible for an arbitrator to use as his starting point for the assessment of an award some other basis, such as cost plus, or percentage of salved value. Those criteria may have some place as checks or correctives but they can never be the starting point.

There is an additional "overriding objective" in LOF, namely clause 2 (d) of the LSSA clauses

> *"to ensure that the reasonable expectations of the salvors and owners of the salved property are met…"*

In every LOF case the parties can and should reasonably expect that Article 13 is going to be applied, root and branch. It has to be reasonably expected that the award will include a measure of compensation for investment and idle time and an element of encouragement.

You also have to remember a critical difference between LOF and a commercial rate contract. In the former there is an obligation on salvors to use best endeavours to salve the property and to take it to a place of safety. That goes way beyond merely making a tug and crew available on hire to help to salve. It is an obligation to do your best to salve and take the property somewhere where she is safe, where the property can be restored to her owners. Sometimes there is not much difference between the two, but at other times there is a world of difference. Too often, I regret to say, property interests fail to see the potential for there to be a difference.

And there is a further critical difference. Salvors under LOF are in possession, in charge and at risk: risk with regard to the casualty, with regard to her cargo, with regard to her bunkers, with regard to getting a port of refuge to accept her, with regard to non-payment and with regard to their own craft, equipment and personnel. Those are quite some risks. It is only fair – I think – that high risk attracts high reward.

That risk with regard to bunkers is a major issue in today's world. Paranoid local authorities mandate removal of bunkers as a first step in salvage; sometimes they are right, but often they are wrong and seriously hinder the success of the operation. And when bunkers do leak there is a worryingly high incidence of unfair and wrongly targeted criminalisation. Salvors operating under LOF shoulder most of that nightmare responsibility

Finally, it is a clear and simple contract, which allows immediate intervention and engagement in an evolving casualty situation, without the need for haggling and amendment, and covers almost all the bases. The fact that it gives rise to remarkably few **legal** disputes demonstrates just what a good contract it is.

As regards the *"it's all a bit of a lottery"* complaint, I would simply make three points:

(a) The assessment of salvage remuneration is an art, not a science.

(b) No two cases are identical: it is therefore frequently not a profitable exercise to point to one (for example) main engine break down followed by a pick up and tow and say, 'well, the arbitrator in that case awarded X, surely the arbitrator in the next pick up and tow case should also have awarded X.'

(c) Under LOF there is an automatic right of appeal to the appeal arbitrator. Hopefully that provides something of a corrective and a degree of uniformity of decision.

The "VOUTAKOS" effect [Slide 7]

A previous appeal arbitrator, without warning to anyone, decided that the awards for rescue tows following main engine breakdowns and such like were at too low a level – and so he upped the level of awards across the board, one such case being the "VOUTAKOS". Up to that time an effective (if not strictly rational) system had operated whereby the top emergency response salvors were able to finance some of the huge cost of maintaining tugs on full time salvage station by generous awards given in rescue tow cases where, for the most part, they performed the service using sub-contracted tugs. It was a sort of robbing Peter to pay Paul. However, it worked and it gave effect to the Donaldson recommendation to provide encouragement, so the payers didn't grumble too much: next time they might need the big station keeping tug to help them out.

But then (unusually for an LOF case) there was an appeal to the court in the "VOUTAKOS". The sub-contract tug had cost $875,000. The salvors did no more than take on risk and responsibility (which in that case was pretty low) and find a tug. The first instance arbitrator awarded US$1.75m to take account of the risk and responsibility which a salvor takes on under LOF, and to provide encouragement. The appeal arbitrator felt that the salvors needed even more encouragement to fund their emergency response salvage capability and so increased this to US$2.7m. Thus the salvors effectively made a profit of 308%. Many, including myself, privately disagreed with that result.

The fall out was massive. First, the case went to Court on the basis that the appeal arbitrator should have taken more account of commercial rates for the service – which in practical terms was simply a towage service - when assessing his award. The appeal to the Court succeeded and the case was sent back to the appeal arbitrator for reassessment in the light of the Court's findings as to the proper approach in such cases. The appeal arbitrator awarded the same figure all over again. Some thought that that was a tad arrogant – and wrong. Shock waves went round the system. Some called for the appeal arbitrator's head on a platter. He was in due course replaced.

And the response by the marine market was to put a stop – to a large extent – to the agreement to LOF in rescue tow cases. That particular goose was now dead.

Costs

You, and perhaps even more so the insurers of the property interests, will know better than I how much of a disincentive costs are. For myself, I am unsure:

On the one hand:

- Most LOF cases are settled short of arbitration, thus saving costs.

- Sensible parties are costs conscious and tough on their claims handlers.

- FCAP (Fixed costs arbitration procedure) provides – at least in some cases – a cheaper dispute resolution system.

- If costs are really viewed as a concern, why do property interests seem increasingly keen to **add** to the level of costs by bringing in casualty representatives in non-SCOPIC cases, whose involvement will only add to the paperwork, dispute resolution complexity and cost at all levels of the process?

On the other hand:

- Salvage performed on commercial terms does not appear cause many disputes; thus few or no legal costs are incurred. One can see the attraction to all commercial parties involved.

- Prior to the Iran-Iraq tanker war in the late 1980s, it was virtually unheard of for a QC to act as counsel in salvage arbitrations. If they did, arbitrators generally did not permit the party appointing the QC to recover costs for more than a junior counsel. So that was quite a strong commercial disincentive. Then came the tanker war. The issues which the early cases threw up were such that all parties to those cases appointed QCs (at least for the first year or so, until the approaches to be applied became more certain). No issue was taken about the propriety of using QCs and the winning party recovered their costs of such use in full. People became used to using QCs as counsel and recovering their costs in full for so doing. Salvors began to use

QCs as a matter of course in pretty much all their cases. Ship respondents, and sometimes even cargo respondents, responded in kind – they did not want to be out-gunned at the hearing. Now it is a rare LOF arbitration in which no QCs at all appear as counsel.

- The photocopier has a lot to answer for. When clearing out my room in chambers a year or two ago I came across papers in an early 1980s arbitration, in the days when everything had to be copied typed; the evidence of all parties was contained in a single, slim, hardback folder no more than half an inch thick. Compare that to an arbitration in which I sat earlier this year, where about 100 pages of DPRs appeared three times in the arbitration bundles: once attached to the salvage master's statement, once attached to the shore co-ordinator's statement, and once as a separate section in its own right. I could give many more examples of wasteful copying of endless documents of marginal, if any relevance. The thinking seems to be: photocopy everything and let counsel decide what he or she wishes to refer to.

The future?

We can carry on as we are, with the good intentions of Article 13 of the Salvage Convention remaining unfulfilled. To some it might appear that when it comes to salvage capability we are muddling along quite nicely – LOF income seemingly at least holding up in a depressed marine market and with the hope that things will improve as and when seaborne trade picks up. But are we? By turning our backs on Article 13 for nearly all but the most compelling of emergency response cases, haven't we distorted the careful balance struck in the Salvage Convention? Have we really got the right tugs and equipment and properly trained and experienced personnel? Even now the next "EXXON VALDES" or Ultra Large Container ship casualty could be just around the corner. And when we find that we don't have the salvage capability to deal with such cases promptly and efficiently, what will be the judgement of the world? In an increasingly criminalised maritime world, that is a serious – not merely a rhetorical - question.

What is the solution? If I knew, I would tell you; sadly, I don't. BUT I do think that it is time for all involved in maritime transport to go back the report of the salvage working group in 1993 and remind itself of the market's conclusions and the reasons for them.