

**THE FUTURE OF LLOYDS OPEN FORM**

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**Lloyd’s Open Form, the most commonly used salvage contract, has been in use for over 100 years. The International Salvage Union supports and promotes the use of this unique contract.**

**Introduction**

Those of us who have spent a significant period of our careers within the salvage industry cannot help but have great affection for Lloyd’s Open Form. It is a unique, simple and highly successful contract that has stood the test of time for over a hundred years. This paper will examine the development of the Lloyd’s Standard Form of Salvage Agreement, to give it its full title, and will consider whether it needs reviewing, and/or amending taking into consideration modern priorities.

**Recent changes**

The first version of LOF made its appearance in 1908. I have a copy in my office and it is interesting to note that many of the original terms have been retained today. The use of ‘best endeavours’, for example, and the concept of ‘no cure – no pay’. The establishment of the reward was made by the salvor naming, within the contract, a lump sum or a percentage of the salved property, and the provision for security was included. There was the provision for arbitration and, of course, there is no mention of the environment.

I believe it is fair to say that LOF has been amended over time to reflect market changes and keep it fit for purpose. It has retained its notable properties in that it can be agreed swiftly with no time lost to contract negotiations; there is an onus on the salvor to use his ‘best endeavours’ and the reward is paid by all property interests in the venture in proportion to their value.

The first major change came with the introduction of LOF 80 following a series of high profile tanker casualties. LOF 80 introduced the first ‘safety net’ for cases involving laden, or partly laden, tankers and it was the first time the strict principle of ‘no cure – no pay’ was mitigated. It had limited use, however, as according to my research there were only four cases in the following ten years when the ‘safety net’ was successfully applied. There is little doubt, however, that the concept of the ‘safety net’ was taken forward into the construction of the1989 Salvage Convention.

The 1989 Salvage Convention fundamentally changed the dynamics of marine salvage. The following year saw the introduction of LOF 90 which gave effect to Article 14 of the 1989 Salvage Convention. It could not incorporate the Convention entirely as parts of the Convention were in conflict with English law and LOF is an English law contract.

These conflicts were removed with the introduction of the UK 1994 Merchant Shipping (Salvage & Pollution) Act and LOF95 quickly followed which did, indeed, incorporate all aspects of the Salvage Convention.

The Salvage Convention finally entered into force on 14th July 1996. It was greeted warmly by the salvage, shipping and marine insurance industries but, in some aspects, I suggest it has been the catalyst for the decline in the use of LOF and some of the contract’s current unpopularity.

**Special Compensation**

According to my research there were a total of 18 Article 14 claims of which 7 were appealed.

Article 14 was a safety net designed to allow the salvor to recover his costs, based on a fair rate, with an increment for protecting and minimising damage to the environment. Its continued use was seriously questioned following the ‘Nagasaki Spirit’ ruling on the term ‘fair rate’ in respect of personnel and equipment. The salvage and marine liability insurance industries put their heads together and came up with the Special Compensation P&I Club Clause, known as SCOPIC. In was, in my view, an excellent development and has successfully been in common use since 1st August 1999. It has almost replaced Article 14 as the method of special compensation in LOF although Article 14 is still available. To my knowledge there have not been any Article 14 claims since 2001.

LOF2000 incorporated an option to include the SCOPIC Clause as the method of special compensation, however, the option still exists for a salvor not to incorporate SCOPIC and to fall back on Article 14.

**Does LOF need reviewing and amending?**

LOF is at a crossroads and, in my view, needs to be reviewed if it is to remain the “contract of choice” for emergency response services. Its continued decline is of great concern to salvors and property underwriters and I believe it not only needs reviewing but also needs to be promoted to the wider shipping and marine insurance industries. The ISU and Lloyd’s have been in discussions regarding an educational programme for industry on the benefits of LOF. When agreed it will be a long term commitment on both parties to educate the industry on the benefits of LOF and improve its use.

Will educating industry be enough to improve the use of LOF? As previously stated, it is a fair comment that LOF has been amended to reflect market changes and keep it fit for purpose. I believe that in recent times it has fallen short in a couple of areas, the key one being the important area of protection of the environment. In the current edition of LOF, LOF2011, the only recognition of the environmental services carried out by the salvor is in Clause B, ‘Environmental Protection - While performing the salvage services the Contractors shall also use their best endeavours to prevent or minimise damage to the environment.’

In my view the use of the words ‘shall also’ implies that environmental protection is a secondary priority to the saving of property. To a salvor this is absolutely correct because the salvor will usually earn an encouraging reward from saving property but is unlikely to do so from Article 14 or SCOPIC compensation payments which provide a ‘safety net’ only. However, priorities have changed which leads to my first argument on why LOF needs reviewing. Prior to the introduction of the 1989 Salvage Convention the priorities relating to a casualty were:

1. Safety of life

2. Saving of property

3. Protection of the environment

However, since the Salvage Convention became incorporated into LOF there has been a fundamental change in priorities to:

1. Safety of life

2. Protection of the environment

3. Saving of property

There is not a single LOF case nowadays that does not feature protection of the environment as the number one priority before the saving of property. The LOF process is well structured to make an award against property with its known values. However, unless the salvor puts together a detailed and compelling case it lacks any focus for a Lloyd’s Arbitrator to make an award for the environmental services undertaken by the salvor. It is a matter of record that Lloyd’s Arbitrators can separate out the environmental services from an Article 13 claim but they need the details on those services in order to do so.

ISU members are concerned that salvors are not properly recognised for the environmental services they undertake on an LOF contract. Further, with the current LOF and its associated processes, it is impossible for a satisfactory award for environmental services to be made. As it stands, under an Article 13 claim, property underwriters will pay for the environmental services not the liability underwriters. Therein lies a problem, for as long as this remains the case the reward for environmental services under LOF will never be clearly identified but will be lost amongst the award for the saving of property. It will also remain dependent upon there being a sufficient salved fund. It surprises me that property underwriters are not more vocal on this point, after all they are paying for action that benefits the liability insurer. With the protection of the environment being such a high priority there is a strong case for a review of Article 13 element of the LOF contract.

At this point I should refer to the Environmental Salvage concept, previously promoted by ISU, which proposed a change to the 1989 Salvage Convention with a new Article 14 based on an environmental award. The concept failed because it did not have the support of the wider shipping and marine insurance industries. It is paramount that any proposed change to LOF should have cross-industry support.

There is no clear answer, but the ISU will consider starting work this year to come up with a proposal that will satisfy all parties and, importantly, will not place an unreasonable burden on the liability insurers or appear to have the effect of an increase in LOF awards. I have been told by some liability insurers that we have SCOPIC therefore why do we seek recognition of environmental services? The simple answer is that environmental protection is now far more important than saving of property and the current LOF contract does not reflect this. In addition, SCOPIC is not based on any environmental criteria and is designed for use as a ‘safety net’ where there are insufficient salved funds for the salvor to receive a reasonable reward under Article 13 and also when the chance of a successful operation is limited. In cases where an Article 13 award is made, whether SCOPIC is invoked or not, it is becoming important to clearly recognise the contribution that environmental services have made to the protection of the environment during the salvage services. I believe there is a business case for this in order for salvors to target their investments in areas which will give them satisfactory returns.

There is a second reason why I believe the current LOF needs reviewing and this relates to the cost of administering the LOF at the lower end of awards, in other words, where the legal and administrative costs are disproportionate to the award. We can all complain about high legal costs in whatever field we work in but the fact is that legal costs are set at the market rate. It is a commercial fact that if anyone sets their rates too high they will not get any business. Therefore I dismiss any suggestion that high legal costs are one reason that LOF is unpopular except, where I stated above, the legal and administrative costs are disproportionate to the award. For the sake of clarity I include the costs of expert witnesses when referring to legal costs.

An attempt was made a few years ago to address this problem with the introduction of the Fixed Cost Arbitration Procedure (FCAP) which can be used when parties to the LOF agree. FCAP can be used when security demands are below US$1.5 million and, if used, FCAP caps ‘party and party costs’ at GBP £15,000 and also caps the Arbitrator’s and Lloyd’s costs. It is disappointing that FCAP has not been used on a single case and therefore can be regarded as a failure. It does remain a good concept and I suggest that consideration should be made to make it mandatory for low value cases.

**Salvors and contractual challenges**

The principle that LOF awards should be encouraging to salvors is long established. It ensures that there is a viable, effective salvage industry that will invest for the future. However, with so few LOF cases and more salvage cases being undertaken on tariff-based contracts there is a serious threat to the viability of the traditional emergency response salvage industry.

I will mention a few of the causes why I believe that the salvage industry is facing contractual pressures and what the consequences will be for the shipping and marine insurance industries.

Under the International Convention on Civil Liability for Oil Pollution Damage 1992, there is a channelling provision (protecting salvors) by which claims are directed to the registered owner. However, IMO member governments rejected a similar provision when adopting the International Convention on Civil Liability for Bunker Oil Pollution Damage 2001 and this is a concern for salvors, as the removal of bunkers is the first priority in the majority of salvage operations. Indeed, I believe lack of immunity does not encourage swift response. It is correct that negligence should bear consequences, but not a strict liability in response to risky and expensive operations. Feeding a blame culture more interested in scapegoats than prevention conflicts with the very essence of salvage.

In 2012 the International Group of P&I Clubs sought to introduce a ‘Bunker Removal Clause’ into LOF. It gave the P&I Clubs the ability to invoke the Clause at their option, at which point the salvors switched to a tariff-based operation, based on SCOPIC rates, to remove the bunkers instead of remaining under Article 13 conditions. All other LOF conditions would have remained. It would have had the effect of reducing the Article 13 award, therefore was never going to be agreed by the ISU membership.

More recently at a meeting of the Lloyd’s Salvage Group the property underwriters re- introduced a proposal for a Property Salvage Consultant (PSC) for LOF cases where SCOPIC had not been invoked. This proposal was first introduced in 2009 but had not been

developed. The PSC would have a similar role to that of the SCR. In discussions with hull and cargo interests it became apparent that the main driver for the PSC proposal was the fact that property interests, particularly cargo, felt that they did not receive timely or sufficient information on the casualty and salvage operation. It is a fact that salvors have an obligation to submit a Daily Salvage Report to Lloyd’s when under SCOPIC but no such obligation exists when SCOPIC is not invoked. Therefore, and in response to property interests’ concerns, the ISU has requested its members to submit a Daily Salvage Report to Lloyd’s when working under LOF when SCOPIC has not been invoked. Despite the fact that the submission is on a voluntary basis it is pleasing that Lloyd’s reports that ISU members are complying and the information to property interests has improved considerably.

It has been brought to my attention from a couple of sources that there is a practice amongst some property insurers to ‘cap’ an LOF award when SCOPIC has not been invoked. This is achieved through a “side letter” which sets out the process for settlement of an Article 13 claim based on SCOPIC rates to which a multiplying factor is applied. I do not have specific details of the arrangement but understand that it can have the effect of capping the Article 13 reward by as much as 50% of its true worth. This is a worrying development and highlights several issues within the salvage industry:

Firstly, that the salvage industry has too much capacity leading to greater competition amongst salvors for LOF contracts.

Secondly, there is the accusation that the salvage industry is not investing in the equipment to successfully salvage the new generation of large vessels. It does not need a detailed explanation from me to understand that investment is difficult when salvors are not receiving the appropriate rewards that they are entitled to because rewards are being capped. How will innovation, development of new systems and equipment and techniques happen? At the recent annual ISU Associate Members’ Day in London the salvors in the audience were asked who was investing in the equipment needed to salve large container vessels. There was a show of two hands, which in one respect is encouraging, but in another a confirmation that few salvors are targeting investment for large vessel salvage.

Thirdly, if salvors do not receive encouraging and appropriate rewards then the industry will contract and there is evidence that this is already happening. I expect that the next 2-5 years will see the salvage industry go through significant change, both contracting and consolidating. Will this be a good thing for the shipping and marine insurance industries? In the short term I do not believe that it will be of too much concern, but longer term it will lead to fewer salvors, hence less choice, and could lead to slower response times brought about by a reduced geographical spread of salvage bases.

**Summary**

There is little doubt that stagnation in revenues from emergency response salvage is causing difficulties for salvors. This is being exacerbated by oversupply in the emergency response market.

A contraction in the emergency response market is inevitable through both consolidation and companies withdrawing from the market. A fall in LOF cases and a greater reliance on tariff- based salvage will fail to provide salvors with the funds required to invest in the equipment required for major casualties. It does not need a crystal ball to predict that this is a bad

development for ship owners and property insurers who will see an increase in claims for hull and cargo. And property values in individual cases, particularly container ships, have risen dramatically in the past decade and will continue to do so as more post-Panamax container ships enter service.

The LOF contract is at a crossroads and I believe a review of LOF is required to ensure its future use. The two main aspects are the recognition of the environmental services undertaken under an LOF and amendments to the FCAP system to make LOF cost-effective in low value and low award cases.

Having said that it is a fact that 78% of all LOF contracts are settled without recourse to arbitration, a very worthy statistic. Over the coming months we may have some clarity on what the market thinks about LOF and what it wants from the contract as we focus on our initiative with Lloyd’s and other parties with strong interests in LOF.