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Challenges to Lloyd's Open Form Salvage Contract

- from a Shipowner's Perspective

The Lloyd's Open Form salvage contract (LOF) has been in use for more than a century. It provides for salvage services on a "no cure-no pay" basis with an award for success based on the values of the property saved. Our guest author, Johnson Chiu, compares the LOF to national salvage forms, BIMCO forms for towage and wreck removal and ISU forms. He concludes that the LOF will remain an important contract when the crew, the ship and the environment are in imminent peril yet technology and communication advances make consideration of other contracts attractive to shipowners for minor casualties that do not immediately put the crew, vessel or environment at risk. We thank Mr. Chiu for his contribution to Insight and remind our readers that the author's views are his own.

The use of the traditional Lloyd's Open Form "No Cure-No Pay" salvage contract has been declining slowly but steadily. According to Lloyds Statistics, there were 255 LOF contracts awarded in 1980 but only 37, the record low, in 2014. In the 1990s, the average number of LOF contracts was 138.7, and the average value of an award was 9.56% of the property salvaged (the highest was 18.8% in 1999). In the 2000s, the annual average declined to 102.6 while the average award went up to 12.99% (the highest was 20.4% in 2009). In 2018, the number went even lower to 53 (63 in 2017) and the average award also decreased to 11.9%.

The International Salvage Union publishes statistics for revenue from "dry" and "wet" operations for its members. Dry salvage is emergency response and wet salvage is wreck removal. According to [ISU 2018 Statistics](#), revenue from LOF cases represented 58% of all dry salvage revenue, and LOF cases accounted for 24% of all dry salvage cases. Similarly, the number of LOF cases, as a percentage of all dry salvage cases, was 18% in 2017 and 11% in 2016. These numbers may imply a trend that other commercial contracts and terms are replacing the LOF for dry salvage. ISU did comment that wet salvage, i.e. wreck removal, is an increasing source of revenue for ISU members.

Technological advances and improvements in safety regimes have made the seas a safer place, and casualty numbers are greatly reduced. Naturally, the fewer the casualties, the fewer salvage contracts signed, and this is also one of the main factors that has led to a reduction of LOF cases.

Various salvage contract forms

National forms

In addition to the well-known Lloyd's Open Form, there are various alternative, national forms of salvage contracts, such as U.S. Form, Japanese Form, Beijing Form, Moscow Form, Turkish Form and so on. However, these contracts are generally used only by vessels and salvors who are in the waters of, or who are nationals of, the particular countries concerned.

1. Beijing Form – Approved by China Maritime Arbitration Commission (CMAC). Named China Maritime Arbitration Commission Standard Form (CMAC 1994).
2. French Form – Approved by Chambre Arbitrale Maritime de Paris. Named as Contrat d'Assistance Maritime – Form of Maritime Salvage Agreement.
3. German Form – Approved by German Maritime Arbitration Association. Named as Conditions of German Court of Maritime Arbitration (Deutsches Seeschiedsgericht), Hamburg.
4. Japanese Form – Approved by Japan Shipping Exchange, Inc. Named as The Documentary Committee of The Japan Shipping Exchange, Inc. – Salvage Agreement (JSE 91).
5. Moscow Form – Approved by Maritime Arbitration Commission at the Chamber of Commerce, Moscow. Named as USSR Salvage Contract (MAK Form).
6. Scandinavian Form – Approved by Scandinavian Tugowners Association. Named as Scandinavian Salvage Contract (1987).
7. Turkish Form – Approved by Turkish Maritime Organization. Named as Turkish Maritime Organization Salvage and Assistance Agreement.
8. Ukraine Form – Approved by Maritime Arbitration Commission. Named as Standard Form of the Salvage Agreement Recommended by the MAC at the UCCI.
9. U.S. Form – Approved by The Society of Maritime Arbitrators, Inc. Named as U.S. Open Form Salvage Agreement (MARSALV).

There are some key differences between the above-mentioned contracts. With the exception of the Beijing Form (CMAC 1994), “No Cure-No Pay” is the basic principle shared by the national forms, and the term is printed on the face of most of the documents. In practice, the MARSALV is usually signed at the completion of a successful salvage operation. This is because its terms can hardly be agreed in advance, particularly if the peril faced is acute. Unlike the LOF, the JSE 91 rewards the salvor on the costs he has incurred instead of the total value of the property salvaged. Overall, with the exception of the Japanese Form, JSE 91, the above-mentioned contracts are not widely used.

BIMCO forms

TOWCON 2008/TOWHIRE 2008

When a vessel encounters engine problems and is drifting without motor power, there may be no imminent danger if the weather is calm, and there is no busy traffic, coastline or reef in the path of the drifting vessel. When there is no immediate threat to the crew, the vessel or to the environment, there should be ample time to consider what measures to take. The only service needed may be to supply spare parts to the vessel or a tow to a harbor with appropriate repair facilities. This is a straightforward towage situation, and the preferred contract would be TOWCON/TOWHIRE.

WRECKFIXED 2010/WRECKHIRE 2010

When a vessel rests lightly aground in calm conditions and in sheltered waters, the risk of further damage caused by waves, a shift in weather or wind direction is very low. Any threat to the environment is unlikely, and any hull breach requiring temporary patching would be minor. Refloating of the vessel can be done by shifting of ballast water and bunkers between tanks. Alternatively, clean ballast water can be discharged into the sea, along with removing some cargo or bunkers to lighten the vessel, in order to refloat the vessel at high tide with towage assistance. This kind of situation does not call for urgent measures, and WRECKFIXED/WRECKHIRE may be the best option.

ISU forms

SALVCON 2005 is a fixed price, lump sum salvage contract published by ISU. This agreement is designed to be used by a salvor, working under the LOF or a similar contract, who wishes to engage additional assistance from another salvor on a lump sum and non-award sharing basis. Other commonly used alternatives are the ISU Award Sharing Sub-Contractors Agreement and SALVHIRE 2005, a daily hire agreement.

A tug owner who wishes to hire out his tug to a salvor on a lump sum or daily hire basis can use SALVCON 2005 in addition to SALVHIRE 2005. The format of these documents is very similar to BIMCO Towage Agreements, TOWCON/TOWHIRE, and the BIMCO Wreck Removal Agreements, WRECKFIXED/WRECKHIRE.

Lloyd's Open Form

The LOF is simple and straightforward allowing parties to reach a swift agreement on contractual terms when a vessel is in distress. In this way, the LOF is designed and ideally suited to emergency situations since saving precious time from negotiations serves to protect the safety of the crew, property and environment. If a vessel or her cargo is in imminent danger, such as from fire, explosion, sinking, grounding on rocky shore, or if it poses a substantial threat to the environment, the LOF would be a proper and appropriate choice. Although the LOF is a contract, salvage services performed pursuant to LOF are deemed as pure salvage, not contract salvage. This is because, under LOF, the salvor is engaged on a "no cure -no pay" basis, and the reward amount is open until the event of success.

The challenges to the LOF

Way back in the 1970s, there was hardly any real-time communication among vessels, shipowners and insurance companies. The Master of the vessel would have had little experience in dealing with casualties and could not have consulted others in time. Under such circumstances, the Master often ended up signing a LOF contract with the salvor when salvage was rendered, even for a minor engine breakdown. With today's technology, the shore side can receive updated notifications from the vessel within a very short period of time, sometimes even in real time. Masters in the modern world no longer need to make unilateral decisions when facing difficult moments. The proper type of salvage contract can be chosen and concluded by shipowners and salvor, and the LOF may not be used for minor casualties.

The salvage industry has changed a lot, and there is rigorous competition amongst salvors. There are currently 5 to 6 global salvage operators dominating the scene. Improvements in technology and speed of communication also benefits salvors. When a casualty is announced from the ship's side, the main players in the market will receive tender notices at almost the same time. Salvors find it harder to insist on the LOF, and they are more likely to offer flexible contract terms in minor cases.

Understandably, the shipowner facing a casualty wants the salvor to arrive on scene as quickly as possible, to efficiently and successfully complete the salvage and keep the salvage award as low as possible. However, in reality such an outcome is not always possible. In general, LOF awards which are based on salvaged values, can be very expensive in comparison with TOWCON or other fixed price salvage contracts. That is the nature of no cure-no pay.

In the past, the LOF was sometimes unnecessarily used by shipowners in non-salvage situations, e.g. traditional immobilization or slight grounding on sand/mud seabed, where the casualty was minor and could be dealt with via commercial tow or another fixed price salvage contract. The "VOUTAKOS", a typical "hook up and tow" case, resulted in a salvage award of USD 2.7 million when the tug services were provided by subcontractors at a cost of USD 874,122. It's no wonder shipowners have concerns and doubts on the potential abuse of the LOF system.

Both shipowners and salvors expect to apply a proper and appropriate salvage contract when a casualty occurs. However, the definition of "proper and appropriate" will depend on the circumstances around the casualty, such as crew health, vessel condition, casualty type, weather, and distance. In fact, most minor casualties, especially "hook up and tow" cases, do not need the LOF at all, and TOWCON or other commercial tow contracts will suffice.

One of the London Maritime law firms proposed what was soon described by commentators as "LOF light". The LOF light wording automatically incorporated SCOPIC and then allowed parties to elect for services to be carried out at the SCOPIC rate with an optional bonus. The bonus reflected encouragement factors listed under Article 13 of the 1989 Salvage Convention such as skill, danger, salvaged value, and length of the service. The salvors through their association, International Salvage Union (ISU), did not support the proposal. Shipowners do not like its consideration of the elements of Article 13 of the 1989 Salvage Convention since they cannot estimate their exposure or the total cost of the salvage operation. The uncertainty makes the proposal unattractive to shipowners.

Conclusion

No shipowner wishes to engage salvors on LOF terms unless it is necessary. They would prefer instead to use salvage contracts calculated on a daily rate or lump sum basis. However, when a vessel is in an urgent and dangerous situation, where time is of the essence, the LOF is still the most preferred salvage contract as it may be the surest way to protect the crew, property and environment. However, before making such decision, a shipowner should consider the key elements – urgency and danger.

Shipowners are not anti-LOF. In reality, the LOF remains the most commonly used standard contract form when dealing with urgent and serious casualties, especially when environmental issues are involved. The shipping industry always has concerns and doubts about LOF, and sometimes these are simply misconceptions and prejudices. Some experts even worry the LOF will disappear or die out someday. In our opinion, this will not happen, at least not in the near future. No one will have a second thought engaging LOF when a case like the Maersk Honam fire incident occurs. The fact is that casualties will never completely disappear, and neither will the LOF.

Continuing innovation is a good thing. For shipowners, new concepts for amending and/or reviewing salvage contract terms are always welcome. The industry should keep working hard to eliminate the debate around choosing a proper and appropriate salvage contract. However, it is not easy to change this long-standing conservative mindset. After all, it is crucial to use the right contract for the circumstance.

Source of Information: The Gard P&I Club