

Salvage and Wreck Removal From the P & I Club Perspective



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Introduction

Other than the fact that wreck removal may follow an unsuccessful salvage attempt the two are really quite different topics with respect to Club involvement. That is because wreck removal following a casualty and when ordered by a competent authority is a P & I liability and has historically been so, while salvage has historically been dealt with by the hull underwriters with little involvement by the P & I Clubs. In the following discussions one should never forget that Protection and Indemnity (P & I) Insurance is liability insurance. The vessel as property is generally the concern of the hull underwriter.

The law of salvage is of ancient origin and generally based upon principles of equity. Simply put, it means the act of saving or rescuing the vessel, and its cargo without any prior legal or contractual obligation from danger at sea.¹ Compensation has historically depended on success - the so called “no cure no pay” principal. Until the relatively recent focus on the environment, particularly oil pollution resulting from casualties, the P & I Clubs had little involvement with salvage. Currently the P & I Clubs’ role in salvage centers mainly upon the Special Compensation P & I Club Clause or “SCOPIC” discussed below.

Conversely, P & I Clubs are very much involved with wreck removal as will be evident in the accompanying visual presentation. Indeed, the International Group of P & I Clubs with its USD 4.2 Billion claims limit for any one vessel, one event, is one of the few facilities for covering the expenses modern wreck removal may entail.

Because the two topics are very different, each will be dealt with separately. We will take the temporal view and begin with salvage.

1. Salvage – what is SCOPIC?

SCOPIC is an acronym for Special Compensation P&I Club Clause, which provides special conditions for remuneration to a salvor for efforts to prevent or minimise environmental damages in relation to the salvage of a vessel.

¹ There is also something called “life salvage” or the saving of people in similar circumstances but this is not discussed here.

SCOPIC is not a separate contract, but rather special terms and conditions that may be invoked and applied to a Lloyd's Open Form salvage contract or a similar salvage contract that applies the "no cure – no pay" remuneration principle to the salvage services.

As the term suggests, the P&I Association will cover SCOPIC compensation. See for example Gard Statutes and Rules, Rule 42(c):

"The Association shall cover liability for special compensation awarded to a salvor..... (c) pursuant to the Special Compensation P&I Clubs Clause (SCOPIC) as incorporated into Lloyd's Open Form of Salvage Agreement or any other "No cure – no pay" salvage contract approved by the Association."

A revised edition of Lloyd's Open Form entered into force as from 1 September 2000. In that connection it was found necessary to make certain adjustments to SCOPIC, although the previously agreed two-year test period had not yet been completed. The amendments made at the time have to be characterised as minor only.²

The Origin of SCOPIC

Historically, salvage operations at sea have been carried out on a pure "no cure – no pay" basis. In the Norwegian Maritime Act ("NMA"), this principle is expressed by the following term (Section 445): *"The Salvor is only entitled to Salvage Compensation if the salvage has led to a useful result"*.

The law has not established how to interpret the term *"useful result"*, but the practice has been that assets with a financial value have been salvaged such as the ship in distress or cargo on board or cargo lost from the ship³. The rescue of human lives does not entitle the "rescuer" to salvage compensation, but whomever has saved another human's life in the course of a salvage operation is entitled to a reasonable share of the salvage compensation payable (NMA Section 445, second paragraph).

The 1989 Salvage Convention introduced for the first time rules of law intended to create a right to special compensation in respect of salvage efforts that served to prevent or minimise environmental damage. These rules are

² For further details, please see Gard's Member Circular No 5/2000. This circular can be found on our Website – www.gard.no under the heading Publications\P&I Circulars.

³ Also other salvaged assets than a ship or its cargo has been subject of salvage compensation. As an example, some years ago, a helicopter owned by the Norwegian Air Force was wrecked at sea off the South coast of Norway and towed ashore by a fishing vessel. The court held that this qualified as a salvage operation under Norwegian law.

found in Article 14⁴ of the Salvage Convention, which are reflected in NMA Section 449 regarding “Special Compensation”. The special compensation shall be assessed as a percentage mark-up on “the salvor’s expenses”, which in NMA is defined as *“those expenses that the salvor has reasonably incurred during the salvage operation, plus reasonable remuneration for the equipment and crew employed during the operation.”*

During the years following the entry into force of the Salvage Convention, several legal disputes arose regarding how to assess special compensation for environmental salvage, and in particular what would represent a reasonable remuneration for equipment and crew employed during the operation. The most comprehensive and cited case in this regard was perhaps “Ocean Blessing vs. Nagasaki Spirit”, a case which was before the English courts throughout most of the 1990’s, and which ended with a ruling from the House of Lords in 1997.

The commercial parties financially affected by salvage operations (primarily salvors, P&I Clubs, hull insurers and cargo interests) realised the unfortunate effects of time-consuming and highly expensive litigation that could arise out of disputes concerning the application in practice of Article 14 of the Salvage Convention. Moreover, the P&I Clubs were concerned about being exposed to liabilities concerning expenses that they in practice could hardly influence because they were not part of the decision-making process within the salvage operation. Efforts were therefore made to create an alternative and more equitable compensation system. SCOPIC is a result of those efforts.

SCOPIC’S Main Purposes are to:

- Simplify the process of assessing compensation for environmental aspects of marine salvage operations. Agree pre-defined standard rates for crew, tugs and other salvage equipment deployed rather than relying on the court’s or arbitration tribunal’s assessment in each case.
- Secure the salvor’s claim for compensation through provisions of Club guarantees.
- Reduce the litigation risk relating to the assessment of compensation.

When to use SCOPIC?

- If the SCOPIC terms form part of the salvage contract agreed (as will be the case with LOF2000), then it is up to the salvor (unilaterally) whether or not to invoke the SCOPIC terms to the salvage operation. SCOPIC can be invoked at any time during the salvage operation, but it is a requirement that the salvor must do so by way of a written notice to the shipowner. It is not a condition for invoking SCOPIC that there be a threat of environmental damage (SCOPIC Clause 2).

⁴ Decisions corresponding with Articles 13 and 14 in the 1989 Salvage Convention was adopted in Lloyd’s Open Form of Salvage Agreement 1990 (LOF 90) before the Salvage Convention entered into force.

- Apart from salvage situations where substantial efforts to prevent or minimize environmental damage are made (and thus high level expenses are incurred by the salvor), SCOPIC is sometimes invoked in situations where the salvor is uncertain whether the salvage operation will succeed or not, and therefore wish to ensure that he will receive an equitable compensation for his efforts.

Immediate legal effects of invoking SCOPIC

- When the salvor invokes SCOPIC, he will be entitled to claim special compensation as per the SCOPIC terms. However, at the same time, the salvor has then made his choice of compensation scheme and thus cannot claim special compensation in accordance to Article 14 of the Salvage Convention (SCOPIC Clause 1).
- If the salvor chooses not to invoke SCOPIC, this will not automatically cause him to be entitled to special compensation according to Article 14 of the Salvage Convention. In fact, if salvage services are offered on the basis of a salvage contract that includes SCOPIC, the salvor cannot claim Article 14 compensation (SCOPIC Clause 1).
- When the shipowner receives written notice from the salvor that SCOPIC has been invoked, he [the shipowner] is obliged to provide adequate security (bank guarantee or letter of undertaking from the P&I Underwriter) for future SCOPIC compensation to the salvor within two working days. The security amount shall be USD 3 million inclusive of interest and costs (SCOPIC Clause 3.i)
- If the Shipowner does not provide such security the salvor will be entitled - by written notice to the shipowner – to completely abandon the SCOPIC conditions, and to claim special compensation in accordance with Article 14 of the Salvage Convention. It is a condition though that the shipowner has not provided adequate security by the time the salvor provides such written notice (SCOPIC Clause 4).
- The shipowner may demand at a later stage that the amount of security be reduced if it is reasonable to assume that the SCOPIC compensation will not reach the security amount. Similarly, the salvor is entitled to demand additional security from the shipowner if it is reasonable to assume that the SCOPIC compensation will exceed the amount of security already provided (SCOPIC Clause 3 ii – iii).
- Whenever SCOPIC is invoked, the shipowner's P&I Club will become more directly involved in the salvage operation. The shipowner will – usually in consultation with his P&I Club – appoint a Special Casualty Representative ("SCR") to be on site and monitor the salvage operation, as well as consider whether the salvage measures taken and the costs thereby incurred are reasonable in the circumstances. The SCR shall be

independent and impartial in order to protect the interests of everyone involved in and affected by the salvage operation. The SCR will frequently submit reports regarding the deployment of crew, vessels and salvage equipment (SCOPIC Clause 11).

Assessment of SCOPIC compensation

- The tariff-based compensation runs from the point in time when the salvor by a written notice to shipowner invokes SCOPIC. As to salvage services provided prior to SCOPIC being invoked, salvage compensation shall be assessed in accordance with the principles contained in Article 13 of the Salvage Convention, as incorporated in the salvage contract (SCOPIC Clause 2).
- SCOPIC compensation for the overall salvage operation will be estimated on the basis of predetermined tariff rates for crew, tows, mobile units etc. SCOPIC also provides for compensation in respect of other expenses (inclusive of bonus), that are incurred by the salvor in order to prevent pollution from ship or cargo, as well as removing pollutants in the immediate vicinity of the ship, are covered as long as this is necessary for the purpose of the salvage operation, but not otherwise (SCOPIC Clause 13).
- To the extent the salvor incurs expenses to subcontractors/third parties with regard to crew, equipment and/or other services, the SCOPIC compensation shall also cover such expenses. Such expenses will, however, also be object of considerations concerning reasonableness, e.g. taking into account whether suitable crew, equipment and/or services were available from a member of "the International Salvage Union" (SCOPIC Clause 5 iii).
- The salvor is entitled to a standard bonus for his effort in form of a 25 % uplift on the total costs and expenses incurred that are compensable under SCOPIC. To the extent that expenses incurred by the salvor to subcontractors/third parties have exceeded SCOPIC's tariff rates, the bonus shall be calculated as the highest of SCOPIC tariff plus 25 % or the actual expenses incurred plus 10 % (SCOPIC Clause 5 iv).
- If the salvage operation has been successful, the salvage remuneration shall be assessed in accordance with the principles contained in Article 13 of the Salvage Convention (see NMA Section 446). Salvage situations frequently give rise to general average (as there will be an issue of common safety to the ship and cargo). As a consequence, salvage remuneration is normally included in and allocated to the parties in general average, who, together with their respective insurers will share the total costs. Liability to pay SCOPIC remuneration, however, is borne solely by the shipowner (but the liability is covered by the P&I Club) (See SCOPIC Clause 14 and Rule 42(c) in the Gard Rules for Ships).

- If the salvage remuneration assessed in accordance with Article 13 exceeds what is subject to remuneration under SCOPIC, the shipowner will not be liable to pay SCOPIC remuneration at all. Moreover, in such circumstances, the remuneration otherwise payable under Article 13 shall be reduced by 25 % of the calculated difference between the assessed Article 13 remuneration and what *would have been* the total SCOPIC remuneration payable had SCOPIC been invoked by the salvor from the very first day of the salvage operation (SCOPIC Clause 7).

The parties' right to terminate SCOPIC

- The salvor is entitled to terminate the salvage contract by providing a written notice to the shipowner if the total sum of salvage expenses incurred and estimated future costs calculated by the use of SCOPIC's tariff rates exceeds the value of what is assumed to be salvaged plus the estimated SCOPIC remuneration plus uplift (SCOPIC Clause 9 i).
- The shipowner is entitled to terminate his obligation to pay SCOPIC remuneration at any time, but the salvor shall be informed about this at least five days in advance. The salvor is entitled to SCOPIC remuneration in accordance with the tariff rates for these five days plus additional reasonable time to demobilise vessels, crew and equipment etc. (SCOPIC Clause 9 ii).
- The parties' mutual right to terminate SCOPIC will apply unless any competent public authority having jurisdiction for the area of the salvage operation prohibits or otherwise prevents the demobilization by the salvor (SCOPIC Clause 9 iii).

Dispute resolution

- Any disputes arising in respect of SCOPIC shall be referred to the same forum for dispute resolution as is agreed in the salvage contract. Lloyd's Open Form refers to the arbitration in London.

Practical Experiences with SCOPIC

- In general, Gard's experiences with SCOPIC have been positive. SCOPIC has established a system for quicker and more predictable remuneration for salvage services that have served to protect the environment than was the result of Article 14 of the Salvage Convention. The assessment of special compensation under Article 14 turned out to be time consuming with substantial legal and expert costs being incurred.
- It is very important to have a good cooperation and communication between hull insurers and P&I underwriters. If a salvage operation seems to fail, new problems usually occur:

- Hull insurers will consider whether the ship has to be considered a total or constructive total loss or whether it is still feasible to continue the salvage operation.
- The shipowner may wish to abandon the ship and demand payment the hull insurance sum. This is particularly tempting when the hull insurance exceeded the sound market value before the incident.
- The P&I underwriter may spot a wreck removal “ghost” lurking, and may wish to assume more control with the operation as well as the expenses, because if the ship turns out to be a total loss (wrecked) and has to be removed, he will be liable to pay the wreck removal costs.

Despite these challenges, the involvement of P & I by virtue of SCOPIC is a positive development and one that further safeguards the marine environment after a casualty.

2. The Whole Enchilada – P & I and Wreck Removal

The International Group of P & I Clubs shares claims that exceed USD 5 Million under what is known as a “pooling agreement.” In the five year period 1998 – 2002, Fifteen out of the total of eighty-two pool claims were for wreck removal. The total estimated pool cost for wreck removal within the International Group⁵ for the period is \$162,000,000. Clearly wreck removal is a major liability albeit a relatively infrequent one. Currently Gard Services is involved with the TRICOLOR wreck removal in French waters. The wreck removal of the vessel and cargo is expected to exceed \$24 Million U.S. dollars.

When does a Ship become a wreck?

A Ship becomes a wreck for purposes of insurance when, following a casualty it becomes a “total loss” (TL), or a constructive total loss (CTL). A loss is constructive essentially when the costs of repair effectively exceed its value. A CTL under the Norwegian Insurance Plan is met when the costs of repair exceed 80 % of the insurable value, or 80% of the value of the ship after repairs if the latter is higher than the insurable value. For purposes of the P & I cover, the hull underwriter must accept that the vessel is a TL or CTL and must abandon the vessel to the owner. Before the hull insurer abandons the vessel, it is not a wreck for purposes of the P & I insurer and any removal order is the concern of the hull underwriter rather than the owner (and by indemnity his P & I Club).

Currently there is no international convention covering wreck removal although there is discussion at the International Maritime Organization (IMO). Coastal states do have authority to demand removal of wrecks within their territorial waters. While this is generally done so because of a threat to

⁵ And the IG Group reinsurer.

navigation, that is not always the case - witness, the NEW CARISSA saga. Assuming that there is a valid and enforceable order to remove the wreck, the costs are covered by the P & I rules.⁶

In reviewing a removal order, owners, their P & I Club and its advisors will consider:

- Is the wreck located within territorial waters?
- Was the order issued by a competent authority?
- Does the order cite the legal basis?
- Does the cited law apply to the facts?
- Is full or only part removal needed to comply with the order?
- Is it an order in the true sense or subject to negotiation?
- Can the order be challenged in court
- If so, what are the odds of getting a fair hearing?

Is wreck removal subject to limitation?

Clearly given the sums involved, there must be consideration of the right to limit liability. Many coastal states have specified that liability for wreck removal shall be unlimited. That is the case in the United States,⁷ and the United Kingdom.⁸ Gard Services involvement with Japan, Belgium and France also indicate that these jurisdictions do not honour limitation when it comes to wreck removal. A second vessel responsible for the collision that leads to the sinking of the first vessel may be treated differently. Gard's experience indicates that at least in Belgium, neither the sunken vessel nor the vessel that is liable or partially liable for the collision, is subject to limitation. But this is not necessarily true of other jurisdictions, thus encouraging forum shopping when it comes to recourse.

⁶ Gard's Rule 40 provides:

The Association shall cover:

- a. costs and expenses relating to the raising, removal, destruction, lighting and marking of the Ship or parts thereof or of its cargo lost as a result of a casualty, when such raising, removal, destruction, lighting and marking is compulsory by law or the costs or expenses thereof are legally recoverable from the Member;
- b. liability incurred by reason of the Ship as a result of a casualty, causing an obstruction,
provided that:
 - i. recovery from the Association under this Rule shall be conditional upon the Member not having transferred his interest in the wreck otherwise than by abandonment; and
 - ii. The realised value of the wreck and other property saved shall be credited to the Association.

⁷ See, e.g. *United States v. Blaha*, 889 F2d 422, 1989 AMC 2705, (2d Cir. 1989).

⁸ The UK made a reservation in respect of Art 2(1)(d) of the 1979 Limitation Convention.

If TL or CTI what is covered by whom?

There are several types of insurance involved in the event a vessel becomes a wreck. The hull policy covers the insured value of the ship, the additional hull interest at a declared sum and freight. Cargo insurance is covered for a sum certain by a cargo underwriter.

The P & I covers in addition to wreck removal:

- Clean-up costs and pollution damages (if spill)
- Damage to other vessel (if collision and RDC included)
- Damage to other property (if striking and FFO included)
- Loss or damage to cargo (if unseaworthiness)
- Crew, passenger and other death/personal injury
- Third party economic loss (for example loss of berth)

Wreck Removal – Who does What?

Following the issuance of a valid and enforceable removal order, the Owner and Club issue tender documents and invite salvors to bid on the project, The companies then prepare and submit the bids for the review of the Owner and Club. Price is only one consideration as it is most important that the effort be successful. There is likely to be interviews on both sides to clarify aspects of the bids before the Owner and Club select the preferred bid and company. The contract is of course subject to negotiation.

After finalizing the deal, the Salvage company mobilizes equipment for the work on site. Both may handle dealing with the authorities and the media. Once the salvage company finalizes removal, disposes of the refuse and cargo, the Owner and Club will verify the completion of the contract and issue the final payments. Salvage contracts are routinely set in stages and may include a bonus for completion within a certain time frame. Generally speaking the contracts begin with one of the BIMCO standard wordings with much tailoring. These are known as the

- Wreckfixed – Lump sum. No cure no pay.
- Wreckstage – Stage payments. Risk sharing
- Wreckhire – Daily rates. Ceiling. Termination of rights.

Wreck removal is a highly specialized business with relatively few able to manage it both technically and financially given the outlays for equipment. Hence the rewards for expertise and success are substantial. We will discuss some of the more challenging projects during the visual presentation.