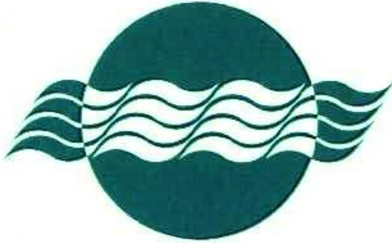

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COMPENSATION
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ADMISSIBILITY OF CLAIMS RELATING TO SALVAGE OPERATIONS AND SIMILAR ACTIVITIES

Note by the Director

1 Introduction

1.1 In the *Aegean Sea*, *Braer*, *Sea Prince* and *Sea Empress* cases, the shipowner engaged the services of salvors under Lloyd's Open Form salvage agreement 1990 (LOF 90). In these cases the shipowners have made or will make payments to the salvors based on this agreement.

1.2 The question now arises as to whether these payments are admissible for compensation and to the question of admissibility in general for claims for similar activities. This leads to the question of which criteria should be applied to determine the admissibility of claims against the 1971 Fund for the recovery of amounts paid for the services tendered under LOF agreements.

1.3 This issue was briefly considered by the Executive Committee at its 44th session on the basis of a document presented by the Director (document FUND/EXC.44.14). The Committee instructed the Director to study this matter in depth (document FUND/EXC.44/15, paragraph 3.14.6).

1.4 This document contains the study requested by the Executive Committee.

2 Policy applied by the 1971 Fund

Applicable provisions in the Civil Liability Convention

2.1 The admissibility of claims relating to salvage operations and similar activities is to be determined pursuant to Articles I.6 and I.7 of the 1969 Civil Liability Convention which defines the concepts of "pollution damage" and "preventive measures" as follows:

> I.6 'Pollution damage' means loss or damage caused outside the ship carrying oil by contamination resulting from the escape or discharge of oil from the ship, wherever such escape or discharge may occur, and includes the costs of preventive measures and further loss or damage caused by preventive measures.

> I.7 'Preventive measures' means any reasonable measures taken by any person after an incident has occurred to prevent or minimise pollution damage.

"Primary purpose test"

2.2 Following the *Patmos* case, the Executive Committee took the position that operations could be considered as falling within the definition of "preventive measures" only if the primary purpose was to prevent pollution damage. In reaching this decision, the Committee noted that it was necessary to encourage preventive measures. It was noted that the assessment of compensation in respect of operations whose primary purpose was to prevent pollution damage should not be made on the basis of criteria applied for assessing salvage awards, but should be limited to costs (including a reasonable element of profit). This "primary purpose test" was endorsed by the Italian Court of first instance in Messina which stated that salvage operations could not be considered as preventive measures since the primary purpose of such operations was that of salving the *Patmos* and her cargo, even if the operations had the further effect of preventing pollution.

2.3 This "primary purpose test" was applied in the *Rio Orinoco* case to claims submitted in respect of the removal of the stranded tanker and her cargo.

"Dual purpose test"

2.4 Following the *Agip Abruzzo* incident certain activities were undertaken both for the purpose of preventing pollution and for the salvage of ship and cargo, but in respect of which it was not possible to establish with any certainty the primary purpose of the operations. Accordingly the costs were apportioned between pollution prevention and other activities.

2.5 In the *Portfield* case, a claim was submitted for certain operations connected with the salvage of the tanker. The claimant maintained that if his sole purpose had been to salve the ship, without considering the risk of causing further pollution, he would have chosen a method which could have been both quicker and cheaper. The Executive Committee accepted that the measures had a dual purpose. In the settlement of this claim, the costs were apportioned between preventive measures and salvage.

1992 Civil Liability Convention

2.6 The scope of the definition of "preventive measures" has been extended by the 1992 Protocol to the Civil Liability Convention to cover also measures taken when there was a grave and imminent threat of pollution damage. This was accomplished by an amendment to the definition of "incident", which reads as follows in the Protocol:

> I.8 'Incident' means any occurrence, or series of occurrences having the same origin, which causes pollution damage or creates a grave and imminent threat of causing such damage.

3 International Convention on Salvage, 1989

3.1 The International Convention on Salvage, which was adopted under the auspices of the International Maritime Organization (IMO) in 1989, entered into force on 14 July 1996. The provisions of that Convention have been incorporated, prior to that date, in standard forms of salvage agreement, such as Lloyd's Open Form.

3.2 Traditionally, the maritime law on salvage was based on the principle of "no cure, no pay". The salvor would thus be able to receive a reward only to the extent that he was successful in salving the property at risk (ie the ship and the cargo).

3.3 The salvage regime based on the 1989 Salvage Convention has changed the international law on salvage in several respects. Under this Convention, "salvage operation" means any act or activity undertaken to assist a vessel or other property in danger in navigable waters or any other waters whatsoever. The salvor has a duty to the owner of the vessel or other property in danger. The Convention also imposes an obligation on the salvor to exercise due care to prevent or minimise damage to the environment.

3.4 The provisions of the Convention which govern the rights of the salvor to payment of his services are Articles 12, 13 and 14. Article 13 entitles the salvor to remuneration which is essentially on the traditional "no cure-no pay" basis. Article 14 however creates an exception by entitling the salvor to special compensation in certain circumstances (which had to some extent been anticipated by the 1980 version of the Lloyd's Open Form salvage agreement) regardless of whether or not he has succeeded in saving property. The main policy consideration leading to the creation of this exception was the perceived desirability of providing a financial

incentive to professional salvors to take measures aimed at preventing or minimising damage to the environment and to maintain the level of investment in equipment and expertise necessary to enable them to continue to offer their services. Article 14 therefore provides that where in the course of the salvage operations the salvor has in fact prevented or minimised damage to the environment he may be entitled to special compensation, which is calculated by reference to his out-of-pocket expenses in the salvage operation plus a fair rate for the equipment and personnel used in it, on top of which a discretionary uplift to a maximum of 100% may be applied. However, Article 14 operates only as a "safety net", because the amount of the award, if any, under Article 13 must be deducted from it. If the amount of the Article 13 award is greater than the amount determined as "special compensation", no payment is recoverable by the salvor under Article 14.

3.5 Article 14 is not confined to oil pollution cases. It can apply in any case where the salvor prevents or minimises damage to the environment.

3.6 Awards under Article 13 are borne by the owners of the property salved, and in practice they are normally paid by underwriters of the ship, cargo and freight. This remains the case despite the fact that, when such awards are assessed, they may be 'enhanced' to reflect any success in avoiding damage to the environment. Awards of special compensation are borne by the shipowner alone, and this liability is expressly insured under the standard form of P & I cover for pollution risks.

4 Position of the shipowners and their respective P & I Clubs involved in the *Aegean Sea, Braer, Sea Prince and Sea Empress* cases

4.1 In the discussions with the Director, the shipowners involved in the *Aegean Sea*, *Braer*, *Sea Prince* and *Sea Empress* incidents and their P & I Clubs (the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited and Assuranceföreningen Skuld respectively), have taken the view that the payments which they have made to the salvors constitute the reasonable cost to them of measures taken to prevent or minimise pollution damage, and that these payments accordingly give rise to admissible claims for preventive measures under the 1969 Civil Liability Convention and the 1971 Fund Convention. More particularly they have maintained:

(i) that the payments made to the salvors are admissible under Article V.8 of the Civil Liability Convention as a claim ranking equally with all other claims against the shipowner's limitation fund; and

(ii) that, to the extent that the shipowner's claim suffers pro rata reduction under the Civil Liability Convention, he is entitled, along with all other claimants with admissible claims, to be compensated under the Fund Convention.

4.2 In both the *Aegean Sea* and the *Braer* cases, the claims under the 1969 Civil Liability Convention and the 1971 Fund Convention have been made not by the salvors who undertook the relevant measures, but by the parties who engaged them and paid for their services (ie the shipowners). The salvors were entitled to be paid for their services by those who engaged them in accordance with the terms of the contract. The shipowners and their P&I Clubs now seek compensation under the Conventions on the basis that the payments they have made represent the cost of the measures which were undertaken. It is expected that corresponding claims will be made also in respect of the *Sea Prince* and *Sea Empress* incidents.

4.3 The shipowners and the P & I Clubs have raised the question of whether the proper approach should differ according to whether the services were considered to be contractual or non-contractual. They have mentioned that it has been maintained that this should not make any difference to the amount of compensation, if any, to be paid under the 1969 Civil Liability Convention and the 1971 Fund Convention. The shipowners and the P & I Clubs have stated that they do not agree with an approach which would treat the shipowner as if he were subrogated to the rights which the salvor would have had under the Conventions. They have maintained that the claimant who engaged the salvor should be considered as making a claim in his own right, in the same way as if he had hired any other type of services in response to the incident.

4.4 The shipowners and the P & I Clubs have argued that the contract is a relevant part of the shipowner's claim. In their view, his objectives when entering into the contract and the terms of the contract are relevant in classifying the nature of the services which the contractor was engaged to provide, and in quantifying the reasonable costs. They have also maintained that the reasonableness of the shipowner's own actions is to be

considered, and not merely those of the contractor. They have expressed the view that it would be open to the Fund to argue that it was unreasonable for the contract to have been concluded on the terms of Lloyd's Open Form, eg because the situation was not urgent and time clearly allowed a less onerous agreement to be negotiated. They have also stated that the reasonableness of the owner's action might be called into question if the salvor was allowed to continue rendering services under Lloyd's Open Form after the point in time when there was no longer any reasonable prospect of him earning a reward under Article 13. In those circumstances it might in their view be a more reasonable course to terminate the services under the "haul off" provision of Lloyd's Open Form and to engage a contractor on less onerous terms to perform any remaining services to avoid pollution.

4.5 The shipowners and the P & I Clubs have stated that as the shipowner is making a claim in his own right, the proper quantification of the claim depends on the "expenses" which he himself has reasonably incurred - not on those incurred by the contractors. Absent evidence that the conclusion of the contract was unreasonable, there would in their view be no grounds for limiting claims under the 1969 Civil Liability Convention and the 1971 Fund Convention to the salvor's "expenses", as defined in Article 14.3 of the Salvage Convention, excluding any increment thereon which the shipowner may be obliged to pay under the salvage contract. They have made the point that limiting the claim to salvor's expenses plus profit would be justified only if the sole basis for the shipowner's claim was a right of subrogation.

4.6 The shipowners and the P & I Clubs concerned have suggested that it would not be appropriate to develop and refine the "primary purpose test" and the "dual purpose test" in cases where the operations have been carried out pursuant to a contract which includes the provisions of Articles 13 and 14 fo the 1989 Salvage Convention.

4.7 In the view of the shipowners and the P & I Clubs, there are good reasons for adopting a solution for determining the admissibility of claims under the 1969 Civil Liability Convention and the 1971 Fund Convention by considering claims relating to awards rendered under Article 13 of the Salvage Convention as costs incurred for salvage and special compensation awards under Article 14 of that Convention as costs incurred for prevention of pollution.

4.8 It has been maintained by the shipowners and the P & I Clubs that, for a number of years, the 1971 Fund and the Clubs have resisted claims for the cost of conventional salvage awards on the basis that the primary purpose of salvage operations is the saving of property rather than pollution avoidance. The shipowners and the P & I Clubs have drawn attention to the fact that, in the *Patmos* case the Court of Messina made a general statement of principle that, in the view of the Court, a conventional salvage award could never be the subject of a claim for preventive measures, because by its very nature it related primarily to the saving of property. However, they have pointed out that the services in the *Patmos* case were rendered purely on the principle "no cure-no pay", and that there was no mechanism for remunerating the salvors for measures to avoid pollution. They have taken the view that, where such a mechanism existed, it was not possible to apply any general statement as to the primary purpose of salvage operations.

4.9 The shipowners and the P&I Clubs have mentioned that this solution has been adopted in the so-called Funding Agreement between the International Group of P&I Clubs, the Institute of London Underwriters and Lloyd's Underwriters' Association.

4.10 They have pointed out that the same approach forms the basis of the 1990 revision of the York-Antwerp Rules. Under Rule VI as amended in 1990, expenditure allowed in general average should include any salvage remuneration in which the skill and efforts of the salvor in preventing or minimizing damage to the environment, such as that referred to in Article 13.1(b) of the Salvage Convention, have been taken into account, whereas special compensation paid by the shipowner under Article 14 of that Convention should not be allowed in general average.

5 Director's analysis of the issues involved

5.1 The Director takes the view that the "primary purpose test" and the "dual purpose test" have proved to be useful and workable. Nevertheless, he agrees with the shipowners and P & I Clubs that the entry into force of the 1989 Salvage Convention and the inclusion of the terms of that Convention in standard forms for salvage contracts justify an examination by the 1971 Fund of the issues involved. The amendment to the definition of "incident" in the 1992 Protocol to the Civil Liability Convention also makes such an examination appropriate as regards the 1992 Fund.

5.2 An important point raised by the shipowners and the P & I Clubs is whether the criteria for admissibility should differ according to whether the services were contractual or not. Their view is that contractual and non-contractual services should be treated differently.

5.3 The shipowners and the Clubs have argued that there is no difference in principle between a claim by the shipowner for payments made under a salvage contract and a claim for payments based on a contract for clean-up operations and preventive measures in general. However, in the Director's view there is a fundamental difference between these two types of contract. As regards clean-up operations and preventive measures in general, the amount payable under the contract relates to the costs of the operations plus an element of normal commercial profit, but the amount relates only to the operations covered by the contract. In respect of salvage contracts, salvage awards usually contain an additional element which should encourage salvors and compensate for those cases where the salvage does not result in any remuneration at all. In the Director's view it is not the purpose of the compensation system established by the 1969 Civil Liability Convention and the 1971 Fund Convention to pay this additional element.

5.4 As regards claims based on salvage contracts, the approach to the admissibility of claims proposed by the shipowners and the P & I Clubs involved is that amounts of special compensation awarded under Article 14 would be admissible for compensation under the 1969 Civil Liability Convention and the 1971 Fund Convention whereas amounts awarded under Article 13 would not be admissible. It has been recognised by the shipowners and the Clubs that a solution along these lines might nevertheless make it possible for those who have paid the amount fixed in an award under Article 13 (such as cargo owners) to seek recovery in some cases against the 1971 Fund under the 1971 Fund Convention (or against the 1992 Fund under the 1971 Fund Convention as amended by the 1992 Protocol thereto). It should be recalled, however, that the way in which a claim is assessed for the purpose of the Salvage Convention (or a contract such as Lloyd's Open Form) is very different from the assessment for the purpose of compensation under the 1969 Civil Liability Convention and the 1971 Fund Convention. Furthermore, it should be noted that awards under Article 13 are normally made on a lump sum basis, so that it is not possible to identify an amount which is attributable specifically to the prevention or minimising of damage to the environment.

5.5 The approach favoured by the shipowners and the P & I Clubs has the consequence that in a case where the contractor's salvage services have been sufficiently successful to attract an award under Article 13 in excess of the expenses assessed under Article 14, there would be no claim by the shipowner or the Club against the 1971 Fund (or the 1992 Fund). However, if the salvage services had been less successful, thus allowing for an award under Article 14, there would be a claim against the Fund. It may be thought rather strange that the right to claim against the Fund should depend on the relative lack of success of the salvage services.

5.6 It should be noted that the 1971 Fund would not be able to intervene in court proceedings and arbitral proceedings fixing the remuneration of the salvor, including the "special compensation" under Article 14. If the approach proposed by the shipowners and the Clubs concerned were to be adopted, the 1971 Fund (or the 1992 Fund) would be bound to pay compensation for amounts fixed in proceedings without the Fund having had the possibility of influencing the outcome.

5.7 The special compensation under Article 14 of the Salvage Convention is calculated on the basis of the salvor's expenses. The notion of salvor's expenses in Article 14 is defined as "out-of-pocket expenses reasonably incurred by the salvor in the salvage operation and a fair rate for equipment and personnel actually and reasonably used in the salvage operation". These expenses also include those relating to measures which do not necessarily have any link to the prevention of damage to the environment.

5.8 Accepting for the purposes of argument that the basic approach proposed by the shipowners and the P&I Clubs is valid (viz that they claim in their own right and not, in effect, in a capacity analogous to that of an underwriter subrogated to the rights of the contractor), it does not follow that the "primary purpose" test is inappropriate. The position of the shipowners and the P&I Clubs is that the preventive measure is the making of the salvage contract. That immediately raises the question of the primary purpose. Even on the express terms of Lloyd's Open Form 90, the prevention of or minimising pollution is merely a secondary purpose. Furthermore, the cost to the shipowner of making the contract is his proportion of the salvage award, which may include both Article 13 and Article 14 components or merely one of either of them. Looked at in this light there can be no logic in an approach which always treats Article 14 compensation as claimable against the 1971 Fund (or the 1992 Fund) and Article 13 compensation as not claimable.

5.9 The 1971 Fund's policy has been to examine each case on its own merits, applying the "primary purpose test" and the "dual purpose test", as appropriate. The question is whether it would be possible to find, within the parameters of the applicable provisions of the 1969 Civil Liability Convention (or that Convention as amended by the 1992 Protocol thereto), a solution which could be applied in all cases and would lead to an equitable result for all parties involved. Unless such a solution could be found, the Director takes the view that it would be necessary for the 1971 Fund (or the 1992 Fund) to continue to examine each individual case on its merits against the above-mentioned tests, but against the background that a salvage contract usually has as its primary purpose the salvage of property.

6 Action to be taken by the Executive Committee

The Executive Committee is invited:

(a) to take note of the information contained in this document; and

(b) to give the Director such instructions in respect of the issues involved as the Committee may deem appropriate, in particular:

  (i) whether the approach to compensation claims relating to salvage services should be the same as for clean-up operations, namely that the person who engages a contractor should be entitled to bring a claim in his own right;

  (ii) to determine the 1971 Fund's position in respect of the relationship between claims relating to awards rendered under Article 13 of the Salvage Convention and claims relating to special compensation awards under Article 14 of that Convention; and

  (iii) whether the 1971 Fund should continue to apply the primary purpose test and the dual purpose test, or replace these tests by other criteria.

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ANNEX

International Convention on Salvage, 1989
(Extract)

Article 12

Conditions for reward

1. Salvage operations which have had a useful result give right to a reward.

2. Except as otherwise provided, no payment is due under this Convention if the salvage operations have had no useful result.

3. This chapter shall apply, notwithstanding that the salved vessel and the vessel undertaking the salvage operations belong to the same owner.

Article 13

Criteria for fixing the reward

1. The reward shall be fixed with a view to encouraging salvage operations, taking into account the following criteria without regard to the order in which they are presented below:

(a) the salved value of the vessel and other property;
(b) the skill and efforts of the salvors in preventing or minimizing damage to the environment;
(c) the measure of success obtained by the salvor;
(d) the nature and degree of the danger;
(e) the skill and efforts of the salvors in salving the vessel, other property and life;
(f) the time used and expenses and losses incurred by the salvors;
(g) the risk of liability and other risks run by the salvors or their equipment;
(h) the promptness of the services rendered;
(i) the availability and use of vessels or other equipment intended for salvage operations;
(j) the state of readiness and efficiency of the salvor's equipment and the value thereof.

2. Payment of a reward fixed according to paragraph 1 shall be made by all of the vessel and other property interests in proportion to their respective salved values. However, a State Party may in its national law provide that the payment of a reward has to be made by one of these interests, subject to a right of recourse of this interest against the other interests for their respective shares. Nothing in this article shall prevent any right of defence.

3. The rewards, exclusive of any interest and recoverable legal costs that may be payable thereon, shall not exceed the salved value of the vessel and other property.

Article 14

Special compensation

1. If the salvor has carried out salvage operations in respect of a vessel which by itself or its cargo threatened damage to the environment and has failed to earn a reward under article 13 at least equivalent to the special compensation assessable in accordance with this article, he shall be entitled to special compensation from the owner of that vessel equivalent to his expenses as herein defined.

2. If, in the circumstances set out in paragraph 1, the salvor by his salvage operations has prevented or minimized damage to the environment, the special compensation payable by the owner to the salvor under paragraph 1 may be increased up to a maximum of 30% of the expenses incurred by the salvor. However, the tribunal, if it deems it fair and just to do so and bearing in mind the relevant criteria set out in article 13, paragraph 1, may increase such

special compensation further, but in no event shall the total increase be more than 100% of the expenses incurred by the salvor.

3. Salvor's expenses for the purpose of paragraphs 1 and 2 means the out-of-pocket expenses reasonably incurred by the salvor in the salvage operation and a fair rate for equipment and personnel actually and reasonably used in the salvage operation, taking into consideration the criteria set out in article 13, paragraph 1(h), (i) and (j).

4. The total special compensation under this article shall be paid only if and to the extent that such compensation is greater than any reward recoverable by the salvor under article 13.

5. If the salvor has been negligent and has thereby failed to prevent or minimize damage to the environment, he may be deprived of the whole or part of any special compensation due under this article.

6. Nothing in this article shall affect any right of recourse on the part of the owner of the vessel.