

MSc SHIPPING MANAGEMENT- MARITIME LAW

FOR SESSION / SEMINAR / LECTURE 2 - WEEK 2

WEEK 2 — MARITIME ENTERPRISE, SHIP FINANCE, SALVAGE AND TOWAGE

1. The Maritime Enterprise

1.1. From the ship to the shipowning enterprise

A commercial ship is normally operated through an organised business structure. The ship is a valuable asset, but it is also the centre of a continuing commercial enterprise involving ownership, management, financing, insurance, employment and contractual relationships with third parties.

The legal owner may be an individual, several co-owners or a corporation. In modern commercial shipping the corporate form is particularly common. Often the corporate type preferred is that of a limited liability company, as a limited liability company provides a separate legal vehicle through which the vessel can be owned and operated. The vessel can be registered in the company's name and the company, rather than its shareholders, becomes the legal shipowner.

This distinction is important. A company has a legal personality separate from its shareholders. Where a company is the registered owner of the ship, the shareholders own shares in the company; they do not, merely because of that shareholding, own proprietary shares in the vessel. The ship is an asset of the corporate entity.

For example, as I stated in the lecture, in an example / problem question provided, suppose the following scenario, i.e., suppose a family owns all the shares in Blue Sea Shipping Ltd and Blue Sea Shipping Ltd is the registered owner of M/V Horizon. The legal owner of M/V Horizon is Blue Sea Shipping Ltd. The family owns the company, but the company owns the vessel. This must be distinguished from direct co-ownership, for example where A owns 40/64 shares and B owns 24/64 shares in the vessel itself.

The distinction between corporate share ownership and ownership of the ship matters for contracts, liabilities, mortgages and enforcement. When analysing a maritime

problem, it is therefore necessary to identify the legal person that owns the vessel rather than simply the persons who ultimately control the corporate enterprise.

1.2. Why is the corporate form commonly used?

The corporate form facilitates the organisation of a shipowning business. The ship is registered under the corporate name rather than the names of individual shareholders. Ownership interests in the company can change without necessarily changing the registered owner of the vessel. This provides continuity and simplifies the organisation of the enterprise.

Corporate ownership also assists management and finance. The company can enter contracts, appoint managers, borrow money and grant security over the vessel. A lender can identify the corporate shipowner and take a registered mortgage over the ship and assignments over related income streams.

The important analytical separation is therefore the one between the ownership of the company and the ownership of the ship, and it is crucially important for the reasons mentioned above. A shareholder may exercise substantial economic control over the company, but that does not make the shareholder the legal owner of the company's vessel.

2. Co-ownership of Ships

2.1. Joint owners and part owners

Where a ship is owned by more than one person, in such a case traditional maritime law distinguishes between joint owners and part owners or co-owners properly so called.

Joint owners hold the relevant property in the ship or in a share jointly. There is unity of title and no separate individual interest in the jointly held share. Thus, if for example, A and B are jointly registered as owners of 16/64 shares, they own that 16/64 interest together. A cannot simply say that 8/64 belongs exclusively to A and the remaining 8/64 exclusively to B. This resembles joint tenancy in property law.

Part owners, by contrast, each hold a separate and identifiable proprietary share in the vessel. If A owns 40/64 and B owns 24/64, A's 40/64 and B's 24/64 are distinct proprietary interests. Part ownership therefore resembles tenancy in common in property law.

The expression 'undivided interest in the whole ship' is important. It does not mean that the vessel is physically divided. A does not own 40/64 of the bow, decks or machinery. The fraction describes the extent of A's legal interest in the whole vessel.

2.2. The traditional 64-share structure

A ship has traditionally been notionally divided into 64 shares. The device provides a convenient mechanism for expressing and transferring ownership interests. One person or corporation may own all 64 shares, or different persons may own different proportions.

The register records the proprietary structure. Joint ownership of a particular share must be distinguished from separate ownership of fractions of the ship. The 64-share structure is therefore a legal and registration device rather than a physical division of the vessel.

2.3. Relations between co-owners

The first source governing relations between co-owners is any express agreement between them. Such an agreement may determine how decisions are taken, how the vessel is commercially employed, how profits and losses are shared, who is appointed as manager and what powers the manager possesses.

In the absence of an express agreement, what applies is the traditional English-law principle stating that the will of the majority prevails, while the interests of a dissenting minority must nevertheless be protected. The majority is determined by ownership interests rather than simply by counting the number of co-owners.

A minority owner cannot normally prevent the majority from commercially employing the vessel merely because that owner considers a proposed charter commercially unattractive. The minority may, however, rely on restrictions contained in the co-ownership agreement, challenge conduct falling outside the manager's authority and,

in appropriate circumstances, seek security against the risks of the proposed voyage or employment.

2.4. Co-ownership does not automatically mean partnership

Part owners are not necessarily partners in the strict legal sense. They may nevertheless participate together in particular ventures undertaken by the ship and may share profits and losses. Their exposure to obligations incurred by a manager depends upon the authority of that manager.

This is why the concepts of ownership and management must be kept separate. A person may own a share in the vessel without personally managing it, while a manager may manage the vessel without owning any proprietary share in it.

2.5. Practical method for co-ownership problems

By way of example, let us illustrate the below:

Suppose four part-owners disagree about whether their vessel should accept a profitable but commercially risky charter and the manager wishes to conclude the fixture immediately. The analysis to be made so as to understand the legal relationships and related issues, should proceed in a logical order:

- First, examine the co-ownership agreement and determine whether it regulates the decision.
- Secondly, identify the ownership interests and the position of the majority and minority if there is no express rule.
- Thirdly, determine whether the manager has express or implied authority to conclude the charter.
- Fourthly, consider whether the dissenting minority has any contractual or legal means of protecting its position.

The later commercial success or failure of the charter does not retrospectively determine whether the manager had authority. The central point for consideration is whether authority existed when the transaction was concluded.

3. Management of the Ship

3.1. Why does a ship need a manager?

Commercial operation requires decisions to be made continuously. Where a ship has several owners, it would be impractical for every owner to approve every charter, appointment of an agent, repair, supply or operational expense. Management may therefore be delegated to a ship's manager, traditionally known as the ship's husband.

The manager acts as the commercial and administrative link between ownership and operation. The manager may enter into transactions with third parties on behalf of the owners, provided that the transaction falls within the manager's authority.

3.2. Express and implied authority

The manager's authority may be express or implied. Express authority is specifically granted by the owners. Implied authority arises from the ordinary functions associated with managing and commercially employing the ship.

Registration of a manager does not itself create unlimited managerial power. Registration identifies the manager, but the legal authority to bind the owners must arise from the relationship between the manager and the owners, either expressly or by implication.

Ordinary commercial employment of the vessel may fall within implied authority. Examples include negotiating and concluding ordinary charterparties, appointing agents, arranging routine repairs and supplies and dealing with ordinary operational expenses.

Implied authority is not unlimited. An unusual or fundamental transaction, including a major alteration or cancellation of an existing contractual arrangement, may require express authority.

3.3. Why implied authority matters commercially

Shipping is a fast-moving business. Freight markets can change rapidly, and a charter opportunity may be available only for a short period. Requiring the manager to obtain

specific consent from every part-owner before every ordinary fixture could make effective commercial operation impossible.

The recognition of implied authority therefore protects commercial functionality. At the same time, the limits of implied authority protect owners against transactions outside the normal scope of management.

By way of example again, suppose a manager fixes the vessel under a voyage charter without first obtaining the consent of every co-owner and a minority owner objects after the freight market falls. Fixing a vessel under a voyage charter is normally part of the ordinary commercial employment of the ship and may therefore fall within the manager's implied authority. A later fall in the market does not retrospectively remove authority that existed when the charter was concluded.

The central point for consideration is always to seek to ask and answer the following question, i.e., what authority did the manager actually possess at the relevant time?

4. Ship Mortgages and Finance

4.1. Why ship finance matters

Ships are capital-intensive assets. Their acquisition and operation commonly require external finance. The Week 2 materials distinguish secured lending from leasing arrangements. Under secured lending, the borrower receives funds and undertakes to repay principal and interest, while the lender requires security against the risk of non-payment.

The ship mortgage is a principal form of security in maritime lending. It links the financing transaction to the ship register and allows the vessel to stand as security for the secured obligation.

4.2. Mortgagor and mortgagee

The mortgagor is the shipowner or in simple terminology the borrower granting the mortgage. The mortgagee is the bank or in simple terminology any other lender receiving the security.

A registered mortgage gives the lender a legally recognised proprietary security interest, but it does not ordinarily make the bank the owner of the ship. The owner continues to possess, operate and commercially employ the vessel unless and until enforcement rights arise.

The mortgage is therefore primarily a security device rather than a day-to-day management mechanism.

4.3. Registration of the mortgage

Registration is central to the operation of the ship mortgage. It gives publicity to the security interest, allowing third parties to identify registered mortgages and other encumbrances / charges. It also performs an important priority function between competing registered mortgages.

The relevant date for priority is the date of registration rather than merely the date on which the underlying loan or mortgage agreement was signed. The public register is commercially valuable because a prospective lender can investigate existing registered security before advancing funds.

4.3.1. Financing a Newbuilding and Purchasing a Second-Hand Ship

Ship finance should be understood in the context of the transaction being financed. Where a new vessel is being built, the shipowner enters into a loan agreement with the bank and a separate shipbuilding contract with the shipbuilder. The construction price is normally paid by instalments linked to construction milestones. During this period, the lender's security arrangements must take account of the fact that the completed vessel does not yet exist as an operational asset. Once construction is completed and the vessel is delivered, the ship becomes an important part of the security available to the lender.

The purchase of a second-hand vessel involves a different sequence. The vessel already exists and can normally be inspected before purchase. The buyer and seller enter into a sale and purchase contract, while the buyer may obtain acquisition finance from a bank. At completion, the purchase price is paid, title is transferred and the vessel is delivered. Existing mortgages and other encumbrances will normally

have to be discharged, and the financing bank's new mortgage registered. Financing, transfer of ownership and creation of the lender's security are therefore closely coordinated at completion.

4.4. Priority between registered mortgages

Where several registered mortgages exist, chronological registration is central. An earlier registered mortgage normally takes priority over a later registered mortgage.

By way of example, suppose Bank A signs a loan and mortgage on Monday but registers the mortgage on Friday. Bank B signs on Tuesday but registers on Wednesday. Attention needs be directed to registration rather than merely the date of the loan agreement. Bank B has registered first and therefore ordinarily has priority as between the two registered mortgages.

Priority matters particularly where the value realised from the vessel is insufficient to satisfy all secured creditors. A later mortgagee may recover only part of its debt or nothing.

However, priority between mortgages must be placed within the wider maritime ranking of claims. Being the first registered mortgagee does not necessarily mean being the first creditor paid from a judicial sale. Certain maritime liens and other privileged claims may rank ahead of registered mortgages under the applicable priority rules.

4.5. Default and enforcement

The mortgage becomes operationally important when the borrower defaults or the lender's security is threatened. Depending upon the mortgage and the wider contractual security package, enforcement rights may arise.

Possible enforcement consequences entail possession, interference with operation for the purpose of protecting the security, and private or judicial sale. The precise rights depend upon the mortgage documents and applicable law.

A mortgagee may take possession when the relevant enforcement conditions are satisfied. Possession can bring rights over the earnings of the ship, but it also brings

responsibilities concerning the prudent use of the vessel. Enforcement rights are exercised for the purpose of protecting and realising the security; the lender is not simply transformed into the beneficial shipowner for every purpose.

4.6. Sale by the mortgagee

The mortgagee may possess a power of sale. Such a power must be exercised consistently with the mortgagee's enforcement duties and in good faith. After the secured debt and relevant claims have been discharged, any surplus is held for the mortgagor.

Downsview Nominees Ltd v First City Corporation Ltd [1993] AC 295 is an example of a case that can illustrate the boundary between security enforcement and ownership. Mortgagee powers are exercised for the purpose of realising the security rather than as incidents of unrestricted beneficial ownership.

A private sale by a mortgagee should also be distinguished from a judicial sale. We need hereby emphasize that a private sale does not have the same cleansing effect on maritime liens as a judicial sale.

4.7. The deed of covenants

The registered mortgage is normally supported by a wider contractual security package. A deed of covenants may regulate how the vessel is owned, registered, classed, surveyed, insured and managed.

The deed may restrict additional borrowing or further mortgages, restrict material modification of the ship, give the bank inspection rights, define events of default and identify remedies available when default occurs.

These covenants protect the value of the bank's security. A valuable vessel that is uninsured, badly maintained, improperly classed or burdened by additional security may no longer provide the protection that the lender expected when the loan was made.

4.8. Additional security

The lender may also require assignments of the ship's earnings, including hire and freight, assignments of insurance proceeds and assignments of compensation payable on requisition. The commercial objective is to capture the principal income and value streams connected with the vessel.

The ship mortgage therefore operates as part of a package of complementary securities rather than in isolation.

4.8.1. Guarantees and the Wider Security Package

The bank's security may extend beyond the vessel, its earnings and its insurance proceeds. A guarantee may provide the lender with an additional person against whom repayment can be sought if the borrower defaults. The financing structure may therefore involve several legally separate relationships: the bank and borrower under the loan agreement; the owner and shipbuilder or seller under the underlying acquisition contract; and the guarantor and beneficiary under the guarantee.

This illustrates why a ship mortgage should not be considered in isolation. The lender seeks both to preserve the value of the vessel and to create alternative routes to repayment. The mortgage, deed of covenants, assignments and guarantees operate together as a security package designed to protect the lender against different forms of risk.

4.9. Mortgage process and practical analysis

The commercial sequence can be summarised as follows: the bank advances funds; the shipowner acquires or finances the vessel; the owner grants a registered mortgage; the owner operates the vessel and uses earnings to service the debt; covenants protect the condition and value of the security; default may activate possession, enforcement or sale; and sale proceeds are distributed according to the applicable priorities.

By way of example, suppose a shipowner stops paying interest, allows the vessel's insurance to lapse and begins negotiations to grant a second mortgage. Each fact threatens the first lender's security. Non-payment may constitute a financial default;

lapse of insurance exposes the vessel and the bank's security; and a second mortgage creates a potential competing security interest.

Relevant covenants may include the obligation to make payments when due, maintain adequate insurance and refrain from creating further mortgages without consent. Possible outcomes in this scenario include declaring an event of default, accelerating repayment, taking possession and enforcing the mortgage through sale.

4.10. Cases on ownership and mortgages

The Horlock (1877) 2 PD 243 is used as an example of a case (see the lecture 2 slides) in relation to ownership and documentary title. A registered bill of sale supported the transferee's title despite an allegation of fraud by the transferor. The broader point is that registration and bills of sale provide important evidence of ownership, although documentary registration must still be understood within the underlying proprietary transaction.

The Myrto [1977] 2 Lloyd's Rep 243 (see the lecture 2 slides) is used to illustrate circumstances in which a mortgagee may act to protect its security. It helps demonstrate that a mortgage is more than a passive notation on the register.

Downsview Nominees Ltd v First City Corporation Ltd [1993] AC 295 (as noted above and in the lecture 2 slides) is relevant to mortgage enforcement and sale and the principle that mortgagee powers are exercised for the purpose of realising the security.

5. Salvage

5.1. Why does maritime law reward salvage?

Ships and other maritime property may encounter serious danger at sea, often far from immediate public assistance. Maritime law encourages private parties to provide useful assistance by granting a salvage reward where the legal requirements are satisfied.

The reward creates an incentive to preserve maritime property and, under the modern regime, to protect the environment. A right to salvage reward can arise independently

of a pre-existing contract. Salvage is therefore a distinctive maritime institution rather than simply an ordinary claim for the price of services.

The *Five Steel Barges* (1890) 15 PD 142 is a case that can illustrate the equitable foundation of salvage. The right to remuneration does not depend exclusively upon an ordinary service contract. The owner of property saved may become liable to reward those who conferred the benefit.

5.2. Definition and analytical structure

Salvage may be described as the voluntary saving of maritime property from danger. The 1989 Salvage Convention defines a salvage operation by reference to an act or activity undertaken to assist a vessel or other property in danger.

For the purposes of problem solving or analyzing a case, the analysis can be divided / asserted into four core issues:

- Is the subject a legally recognised subject of salvage?
- Was the service voluntary in the legal sense?
- Was the property in real maritime danger?
- Did the service produce a useful result?

Only after these requirements are considered then the amount and apportionment of the reward are to be considered.

5.3. What property can be salvaged?

Recognised subjects include vessels and their equipment, cargo and merchandise, bunkers, wreck and other recognised maritime property. Freight at risk may also be relevant in the traditional analysis.

The central point for consideration is that ordinary property salvage is concerned with maritime property. The existence of danger alone is not sufficient if the subject of the assistance falls outside the relevant legal concept of salvaged property.

5.4. Life salvage

Saving human life is a fundamental maritime obligation, but life salvage is treated differently from property salvage. The ordinary salvage reward is proprietary in character and should not be confused with the duty to rescue persons in danger.

Under the modern legal / maritime framework, a person who saves life may share in a property salvage reward in appropriate circumstances. The master also has a duty to render assistance to persons in danger at sea, subject to safety constraints. The distinction is therefore between the humanitarian duty to save life and the proprietary basis of the ordinary salvage reward.

5.5. Voluntariness

The salvor must act voluntarily in the legal sense. Voluntariness does not mean that the salvor acts without expecting payment. A professional salvor may plainly expect remuneration. The central point for consideration is whether the person was already under a pre-existing legal or contractual duty to provide the same service.

A crew member, pilot or tug already obliged to perform the relevant service will not ordinarily become a salvor merely by performing that existing duty. However, services that go beyond the scope of the pre-existing obligation may potentially acquire a salvage character.

A salvage agreement does not itself destroy voluntariness. The legal question remains whether the assistance is outside an obligation that already required the salvor to perform it.

The Neptune (1824) 1 Hag Adm 227 is used as a case law example as it contains the classical definition of salvage and salvor. In the case / judgment the judge namely Lord Stowell provided a classic description of the salvor as a volunteer adventurer. The case remains useful for understanding why a pre-existing duty may prevent a salvage claim, although modern analysis must be read with the 1989 Salvage Convention.

5.6. Danger

The property must be in real maritime danger. The danger need not be immediate, but it must be real and reasonably apprehended rather than imaginary, speculative or remote.

Whether danger exists is assessed objectively in the circumstances. Practical indicators include loss of propulsion or steering, grounding or risk of grounding, fire, flooding, structural damage, drifting towards hazards and collision risk.

Weather, sea state, location and the availability of alternative assistance may all affect the assessment. A disabled vessel close to a lee shore in deteriorating weather may be in serious danger even before grounding actually occurs.

The existence of danger establishes one element of entitlement. The degree of danger also becomes relevant later when the amount of the salvage reward is assessed.

5.7. Success and the principle of ‘no cure – no pay’

Article 12 of the 1989 Salvage Convention links the ordinary reward to a useful result. The traditional expression is ‘no cure – no pay’. A wholly unsuccessful service does not generate the ordinary property salvage reward.

Success need not necessarily be complete. Partial success may justify a reward where the services have contributed to the preservation of maritime property. Causation remains important, i.e., the salvor’s services must have contributed to the useful result.

This success requirement distinguishes salvage from an ordinary contract under which payment may become due simply because specified work was performed.

6. The 1989 Salvage Convention

6.1. The modern framework

The International Convention on Salvage 1989 provides the principal modern international framework for salvage. It regulates the rights and duties of salvors and

property interests, sets criteria for the salvage reward, addresses environmental protection and recognises the role of salvage contracts and coastal-State interests.

The Convention retains the traditional incentive structure of salvage while modifying it to respond to modern environmental concerns.

6.2. Duties of the salvor

The salvor must carry out the salvage operation with due care. In performing the operation, the salvor must exercise due care to prevent or minimise damage to the environment.

The Convention also contemplates that the salvor should seek assistance from other salvors when circumstances reasonably require and accept the intervention of other salvors when reasonably requested by the owner or master, subject to the Convention.

Failure to perform the relevant duties may affect remuneration. Salvage reward is therefore not simply a prize for intervention, and the quality and propriety of the salvor's conduct remain legally important.

6.3. Duties of the owner and master

The owner and master are required to cooperate fully with the salvor during the operation and to exercise due care to prevent or minimise environmental damage. When the ship or property has been brought to a place of safety, redelivery should be accepted when reasonably requested.

Salvage is therefore not a one-sided relationship. The Convention places duties upon both the salvor and the interests whose property is being assisted.

6.3.1. Reciprocal Duties of the Owner and Master in Salvage

The obligations arising during a salvage operation do not fall exclusively upon the salvor. The owner and master of the vessel must cooperate fully with the salvor during the operation and must exercise due care to prevent or minimize damage to the environment. Once the vessel or other property has been brought to safety, they must also accept redelivery when reasonably requested by the salvor.

These obligations are important because salvage is a cooperative response to maritime danger rather than a purely unilateral service performed by the salvor. The success and environmental consequences of the operation may depend upon cooperation between the salvor, master and shipowner.

6.4. When does the right to reward arise?

A salvage operation that produces a useful result gives rise to a right to reward. Liability for the ordinary reward attaches to the interests in the salvaged property and the burden is distributed in proportion to the salvaged values.

The reward is not simply an ordinary contractual fee fixed before performance. Its amount is assessed under the specialist salvage regime, even though a salvage agreement may regulate the procedure through which that amount is determined.

6.5. Article 13 — criteria for fixing the reward

Article 13 of the 1989 Salvage Convention directs attention to a range of factors. No single factor automatically determines the amount. The assessment reflects the circumstances of the casualty, the value preserved and the nature and quality of the salvage effort. More specifically, what is assessed is as follows:

- the salvaged value of the vessel and other property;
- the skill and efforts of the salvors in preventing or minimising damage to the environment;
- the measure of success obtained;
- the nature and degree of danger;
- the skill and efforts of the salvors in saving the vessel, other property and life;
- the time used and the expenses and losses incurred by the salvors;
- the risk of liability and other risks run by the salvors or their equipment;
- the promptness of the services rendered;
- the availability and use of vessels or other equipment intended for salvage;
- the state of readiness, efficiency and value of the salvor's equipment.

These criteria show that the law rewards more than the bare value of the work performed. Professional preparedness, rapid response, exposure to danger,

specialist skill and investment in salvage equipment are relevant because the policy of salvage is to encourage effective assistance when maritime casualties occur.

6.6. The reward and the salvaged value

The ordinary property salvage reward is linked to the value preserved and cannot exceed the salvaged value. The salvaged fund therefore places an economic ceiling upon the ordinary property reward.

This creates a difficulty where the salvor performs expensive work of great social value, particularly pollution prevention, but the vessel or cargo has little residual value. A purely property-centred system could provide an inadequate incentive to undertake such operations.

7. Environmental Protection and Special Compensation

7.1. Why environmental salvage changed the traditional model

The traditional model rewards the successful preservation of property. Modern casualties, however, may present a different problem. A severely damaged tanker may have little remaining property value while presenting an enormous pollution risk. If the salvor's remuneration depended exclusively upon the value of ship and cargo successfully preserved, there could be too little financial incentive to undertake costly operations primarily directed at preventing environmental damage.

The 1989 Salvage Convention therefore supplements the traditional 'no cure – no pay' model rather than abandoning it.

7.2. Article 14 special compensation

Article 14 of the 1989 Salvage Convention addresses specified salvage operations involving a vessel that threatens damage to the environment. Special compensation can respond where the ordinary Article 13 of the 1989 Salvage Convention reward is insufficient.

Where the conditions are met, the salvor may recover expenses from the shipowner and, where environmental damage has actually been prevented or minimised, the compensation may be increased. The mechanism is intended to encourage

intervention even where the residual salvaged value would not support an adequate ordinary reward.

The environmental regime therefore demonstrates an important policy development in salvage law, i.e., the fact that the law recognizes that the social value of preventing pollution may be much greater than the value of the damaged property ultimately saved.

7.2.1. The Practical Difficulty with Article 14 – *The Nagasaki Spirit*

Article 14 created difficulties concerning the meaning of the salvor's "expenses". Article 14(3) includes reasonable out-of-pocket expenses and a "fair rate" for equipment and personnel actually and reasonably used in the salvage operation. In *The Nagasaki Spirit* [1997] 1 Lloyd's Rep 323, the House of Lords held that the "fair rate" was concerned with expenditure and did not include an element of profit. This interpretation reduced the commercial attractiveness and predictability of Article 14 remuneration for professional salvors.

The decision illustrates the tension underlying environmental salvage. Salvors must decide rapidly whether to commit expensive specialist vessels, equipment and personnel to a casualty, yet an expense-based system which does not provide a commercial return may weaken the incentive to intervene. The practical difficulties associated with Article 14, including the calculation of expenses, contributed to the development of the contractual SCOPIC mechanism.

7.3. *The Nagasaki Spirit*

An important case in connection with Article 14 of the 1989 Salvage Convention is that of *Semco Salvage & Marine Pte Ltd v Lancer Navigation Co Ltd (The Nagasaki Spirit)* [1997] 1 Lloyd's Rep 323. The case addressed the calculation of special compensation, including the meaning of a 'fair rate' for equipment and personnel.

The House of Lords held that the fair rate terminology referred to expenditure and did not include an element of profit. The case illustrates the distinction between ordinary reward under Article 13 of the 1989 Salvage Convention and the expense-based special compensation mechanism under Article 14 of the 1989 Salvage Convention.

7.4. Salvage and Coastal-State Intervention

A salvage contract does not give the salvor an unrestricted right to determine how and where the casualty will be handled. The 1989 Salvage Convention preserves the rights of coastal States under international law to take measures for the protection of their coastline and the prevention of pollution and to give directions concerning salvage operations. Those powers may derive from UNCLOS, the Intervention Convention 1969 and other applicable international or domestic rules.

Consequently, commercial salvage arrangements operate within a wider public-law framework. A coastal State may intervene where a casualty threatens serious environmental harm and is not necessarily required to permit a damaged vessel to enter the place that would be commercially most convenient for the salvage operation. This demonstrates particularly clearly the interaction between private maritime law, environmental protection and public international law.

8. Salvage Contracts and the Lloyd's Open Form (LOF).

8.1. Why use a salvage agreement?

A maritime casualty may require immediate action. Lengthy negotiation over the final price of assistance may increase danger, property loss and environmental damage. A standard salvage agreement allows the operation to begin while remuneration is determined later.

The agreement therefore provides procedural and contractual certainty without converting the relationship into ordinary towage. The underlying legal requirements of salvage remain important.

8.2. Lloyd's Open Form (LOF)

Lloyd's Open Form is the best-known standard form used for marine salvage. Its traditional commercial principle is the 'no cure – no pay' principle as per which there is no special compensation if no salvaged property exists. The final amount of reward is not fixed in advance but is determined after the event through the agreed arbitration machinery.

This structure allows urgent assistance to begin without requiring the parties to bargain over a final price while the casualty is developing.

The existence of an LOF agreement does not destroy the legal character of salvage. Salvage rights can arise independently of contract, while the parties may also regulate the operation through a salvage agreement. The legal character of the service depends upon the salvage context and the applicable specialist regime.

The *Tojo Maru* [1971] 1 Lloyd's Rep 341 case is an important salvage authority illustrating the relationship between salvage rights and contractual analysis. The takeaway for the present module's purposes is that salvage remains a specialist maritime regime even where an agreement exists.

8.3. Master's authority to conclude salvage arrangements

The master may need to act urgently on behalf of the ship. The salvage framework recognises broad authority to conclude salvage arrangements because delay may worsen the danger.

The commercial rationale is clear, i.e., it states that it would often be impossible to obtain instructions from every interested party before accepting urgently needed assistance. The authority must nevertheless be exercised *bona fide* and reasonably in manner, in terms of the interests represented.

8.4. SCOPIC

SCOPIC is a commercial response to the environmental concerns that challenged a strict application of 'no cure – no pay'. It operates alongside LOF as a contractual mechanism addressing specified salvage expenses and environmental-response incentives.

SCOPIC reduces dependence upon uncertain salvaged value where expensive pollution-prevention services are required. It should be understood together with, rather than as a substitute for, the Convention framework.

8.4.1. SCOPIC

SCOPIC means Special Compensation P&I Clause. It was developed by the salvage and P&I industries to address the practical difficulties associated with Article 14 special compensation and operates in conjunction with Lloyd's Open Form. Where SCOPIC is incorporated into the salvage agreement and subsequently invoked by the salvor in writing, Article 14 is displaced as the relevant special-compensation mechanism. Unlike Article 14, SCOPIC remuneration does not depend upon proving a threat of environmental damage and is not confined to a particular geographical area. Remuneration is calculated according to predetermined tariff rates for personnel, tugs and equipment, with a standard 25 per cent uplift. SCOPIC therefore gives the professional salvor considerably greater predictability as to remuneration where the value of property ultimately salvaged may be insufficient to produce an adequate Article 13 reward.

SCOPIC does not abolish the traditional Article 13 salvage reward. The Article 13 award continues to be assessed under the ordinary “no cure – no pay” principles, while SCOPIC remuneration is payable by the shipowner only to the extent that it exceeds the Article 13 award. Invocation of SCOPIC also creates important procedural safeguards. The shipowner must provide security — traditionally US\$3 million — within two working days, and a Special Casualty Representative (SCR) may be appointed to monitor the reasonableness and efficiency of the operation and provide estimates of SCOPIC remuneration, although operational control remains with the salvage master. The shipowner also has a contractual right to terminate SCOPIC subject to the stipulated notice requirements. SCOPIC consequently represents a contractual compromise: salvors obtain greater certainty of remuneration and security, while shipowners and their P&I insurers obtain greater transparency and control over escalating salvage expenditure.

8.4.2. Article 13, Article 14 and SCOPIC Compared

The three mechanisms should therefore not be confused. Article 13 provides the ordinary salvage reward and remains centered upon the successful preservation of maritime property, although environmental efforts form one of the factors relevant to

assessment. Article 14 is the Convention's statutory special-compensation mechanism for qualifying environmental cases. SCOPIC is instead a contractual mechanism which, where incorporated and invoked, replaces Article 14 and calculates remuneration according to agreed tariffs. The practical question is therefore not simply whether environmental damage has been prevented, but which remuneration regime governs the particular salvage operation.

9. Towage

9.1. Nature of towage

Towage is essentially a service provided by one vessel to another for agreed remuneration. The tug may pull, push, manoeuvre, berth, unberth or escort the tow.

Port towage is commonly a relatively short operational service connected with harbour navigation and berthing. Ocean towage may involve the long-distance movement of ships, barges, offshore structures or other unusual and high-value tows.

The legal relationship between tug and tow is primarily contractual. The towage contract therefore provides the starting point for determining the agreed service, the parties' obligations and the allocation of financial risk.

9.2. The towage contract

Standard contractual terms are particularly important in towage. Contractual risk allocation may differ substantially from the result that would otherwise follow from ordinary fault-based liability.

This is why a towage problem cannot be resolved simply by asking which party was negligent. The applicable contractual form must first be identified and interpreted.

9.3. Port and ocean towage

Port towage is a routine component of ship operations. The operation is usually short and closely connected with entering or leaving port, berthing or unberthing.

Ocean towage is more specialised. It may involve considerable distance, difficult weather, unusual structures and substantial operational risk. The different commercial context is reflected in the contractual forms and insurance arrangements used.

9.4. Standard forms — port towage

In the UK, the UK Standard Conditions for Towage and Other Services area device mechanism invented so as to officially place substantial contractual risk upon the tow or tow-owner, including risk arising during the tug's performance of the service.

The precise result always depends upon the wording of the applicable version. The commercial purpose is to allocate operational risk in advance and support predictable insurance arrangements.

9.5. Standard forms — ocean towage

BIMCO forms such as TOWCON and TOWHIRE are commonly used for ocean towage. TOWCON is associated with towage for a lump-sum price, whereas TOWHIRE is associated with payment on a daily hire basis.

TOWCON and TOWHIRE are standard BIMCO contracts designed particularly for ocean towage operations. Their purpose is to provide a comprehensive contractual framework for an operation which may involve considerable distance, duration and risk. The forms regulate not merely the price of the towage service but also matters such as the description and condition of the tug and tow, the place of departure and destination, preparations for the voyage, performance of the towage operation, delay, deviation, termination and the allocation of liabilities between tug owner and hirer.

The principal commercial distinction concerns the method by which the tug owner is remunerated. Under TOWCON, the towage service is performed for an agreed lump-sum price. The tug owner therefore assumes a greater degree of time-related risk: if the operation takes longer than anticipated, the agreed remuneration does not simply increase on a daily basis, although the contract may provide separately for particular delays or additional services. Under TOWHIRE, by contrast, the tug is engaged on a daily hire basis. The amount ultimately payable therefore depends more directly upon the duration of the service. The choice between the forms consequently reflects the commercial allocation of the risk of time and delay.

Both forms also seek to allocate operational risks in advance rather than leaving every casualty to be resolved solely by ordinary principles of negligence. This is particularly important in ocean towage because both tug and tow may be extremely valuable and the consequences of an accident may be substantial. The contractual allocation of liability, including the knock-for-knock provisions discussed below, enables each party to know in advance which risks it is expected to bear and insure.

For example, if an ocean tow is expected to take ten days but severe weather extends the operation considerably, the financial consequences may differ depending upon whether the parties have contracted on TOWCON or TOWHIRE terms. Under TOWCON, the starting point is the agreed lump sum, subject to the contractual provisions dealing with delay and additional services. Under TOWHIRE, the additional time is more directly reflected in the hire payable. The distinction is therefore not simply one of terminology but one which determines how the commercial risk of the duration of the tow is allocated between the parties.

The forms commonly use knock-for-knock risk allocation. Broadly speaking, specified losses relating to each party's own property and personnel are borne by that party, subject to the wording and exceptions of the contract. The allocation may operate irrespective of which party was negligent. For example, if the tug negligently damages the tow, the agreed knock-for-knock allocation may leave the tow-owner bearing the specified loss to the tow rather than recovering it from the tugowner. Conversely, if the tow causes specified damage to the tug, the tugowner may bear its own property loss. The commercial objective is certainty and insurability. Instead of litigating every casualty through a detailed fault investigation, each party knows in advance which categories of loss it must insure.

9.6. Why use knock-for-knock?

Complex ocean and offshore operations may involve several high-value assets and multiple participants. Fault investigations can be lengthy and uncertain. Knock-for-knock clauses allocate defined categories of loss in advance so that each side can arrange insurance for the risks contractually assigned to it.

The expression “knock-for-knock” describes a contractual allocation of risk under which each party agrees, broadly speaking, to bear specified losses affecting its own property and personnel, rather than determining liability according to which party caused the loss. Each party therefore looks primarily to its own insurance for the categories of loss allocated to it under the contract.

The important feature is that the allocation may apply irrespective of negligence or fault. Thus, if the tug owner’s negligence causes damage to the tow, the tow-owner may nevertheless be required to bear the loss relating to the tow where that loss falls within the contractual allocation. Conversely, if the tow causes damage to the tug, the tugowner may bear the loss relating to its own vessel. The purpose is not to establish who was at fault, but to determine which party has contractually assumed that particular category of risk.

This produces an important distinction between fault and contractual liability. A party may have caused the casualty in a factual sense but may not ultimately bear the financial consequences of a particular loss as between the contracting parties. In a problem question scenario, therefore, identifying negligence is not enough. The contract must then be examined to determine whether the relevant loss has been allocated to one party under the knock-for-knock regime.

The commercial justification is closely connected with insurance. Ocean towage may involve a valuable tug, a valuable tow, specialist equipment and several categories of personnel. If liability depended entirely upon proving fault after every casualty, the parties could face lengthy and expensive disputes concerning navigation, causation and contributory fault. Under a knock-for-knock arrangement, each party knows in advance which risks it is expected to insure. This promotes certainty, predictability and insurability. For example, suppose that during an ocean tow the tug negligently alters course and the tow strikes an obstruction, causing substantial damage to the tow. The first instinct may be to conclude that the tug owner must pay because the tug was negligent. Under a knock-for-knock regime, however, that is not necessarily the result. The relevant question is whether damage to the tow has contractually been allocated

to the tow-owner. If it has, the tow-owner may bear that loss and claim under its own insurance despite the tug's negligence.

The knock-for-knock arrangement must nevertheless be understood as a contractual allocation between the parties. The knock-for-knock arrangement does not mean that fault is irrelevant for every purpose. It operates between the contracting parties and within the scope of the particular clause. It does not automatically determine liability towards third parties. If, for example, the tug and tow collide with an independent vessel, that third vessel is not deprived of its rights merely because the tug owner and tow-owner have agreed between themselves to allocate losses on a knock-for-knock basis. Liability towards the third party must be determined separately, while the contract may subsequently determine how the resulting financial burden is allocated between tug and tow interests.

9.7. Implied obligations of the tug

Unless displaced or modified by contract, the tug must be reasonably crewed, equipped and fitted for the contemplated service and must exercise reasonable care, skill and diligence.

Adequate preparations must be made for the tow. This includes appropriate power, suitable towing equipment and arrangements and proper performance of the operation.

Unforeseen difficulty does not automatically terminate the contractual obligation. The tug may be required to stand by, reconnect and continue the operation rather than simply abandon the tow.

9.8. Duty to persevere

Towage cannot ordinarily be abandoned merely because performance becomes more difficult or inconvenient. Abandonment is to be associated with impossibility rather than mere difficulty.

The Minnehaha (1861) Lush 335 is a case which we referred to in Lecture 2 and which is used to illustrate that a towage contractor may have a duty to stand by and attempt

to reconnect. The case supports the proposition that interruption or difficulty does not necessarily justify abandonment of the contractual service.

9.9. Obligations of the tow

Responsibility is not automatically concentrated on the tug. The tow must be fit for the contemplated towage operation and may have obligations concerning preparation, cooperation, manning and equipment depending upon the nature of the service and the contract.

The contractual allocation remains the primary source for determining the respective responsibilities of tug and tow.

9.10. Collision during towage

A collision during towage requires two legal relationships to be kept separate.

First, as between tug and tow, their contractual arrangements ordinarily govern their respective rights and liabilities. Secondly, towards an innocent third vessel, the tug–tow contract does not itself determine the third party’s rights.

Liability to the third party must instead be analysed by reference to navigational fault, control, causation, the COLREGs and ordinary good seamanship. Relevant questions to be posed hereby include the following: a) who had navigational control? b) which vessel committed the relevant fault? c) has that fault caused or contributed to the casualty? and d) have more than one vessel contributed?

This illustrates a recurring principle in maritime law, i.e., that a contractual allocation of risk between two parties does not automatically alter the legal rights of a stranger to that contract.

9.11. Towage claims and enforcement

A towage claim is fundamentally contractual. We need distinguish the statutory *in rem* basis that may support a towage claim from the maritime lien associated with salvage.

The distinction matters for enforcement and priority. A salvage claim generally enjoys the stronger proprietary status associated with the maritime lien. Classification of the service as towage or salvage can therefore have significant financial consequences.

10. Towage or Salvage?

10.1. The starting distinction

Towage is an agreed contractual service for remuneration. Salvage is voluntary assistance to maritime property in danger under the specialist salvage regime.

Ordinary towage does not become salvage merely because it becomes difficult. A towage relationship may, however, encounter a new danger and services may be rendered that fall outside the original contractual engagement.

The correct analysis therefore requires careful attention to the facts and to the scope of the pre-existing towage contract.

10.2. Can towage become salvage?

A tug already engaged under a towage contract normally performs a pre-existing contractual duty and therefore does not acquire a salvage claim merely by completing the agreed tow. However, circumstances may change.

If a new danger arises and the tug provides services going beyond what can reasonably be regarded as due performance of the original towage contract, the relationship may potentially acquire a salvage character.

In the example illustrated in Lecture 2 we discussed the example of a towline parting in circumstances in which weather places the tow in danger. The legal question becomes whether the subsequent assistance remains performance of the towage contract or whether it is sufficiently outside the original obligation to satisfy the requirements of salvage.

10.3. Differences in payment

Towage remuneration is determined by the towage contract. Salvage remuneration is assessed after the event under salvage principles and any applicable salvage agreement.

Towage payment is owed by the contracting party according to the contract. The ordinary salvage reward is borne by the interests in the salvaged property in proportion to salvaged values.

The classification therefore affects not merely terminology but the basis, amount and incidence of payment.

10.4. Differences in legal basis and enforcement

Towage rights normally arise from contract. Salvage rights can arise independently of contract.

Towage claims may support statutory in rem enforcement where the relevant requirements are satisfied. Salvage is supported by a maritime lien arising from the salvage service. This difference can affect arrest, enforcement and priority.

10.5. Differences in standard of performance and allocation of risk

In towage, duties and financial risk are strongly shaped by the contract, including standard forms and knock-for-knock provisions. In salvage, the Convention imposes duties of due care and applies specialist criteria to remuneration.

Salvage remuneration reflects danger, success, skill, effort, risk and value saved. Classification therefore affects both liability and remuneration.

11. Applying the Salvage Rules

11.1. Container ship drifting towards a lee shore

By way of example, suppose a container ship suffers engine failure and drifts towards a lee shore. A nearby tug voluntarily assists, prevents grounding and tows the vessel to safety.

The first question to pose and answer is whether recognized maritime property is involved. The ship, cargo and bunkers are capable of being salvaged. Secondly, there is a strong basis for finding real maritime danger because the disabled vessel is drifting towards a lee shore. Thirdly, if the tug was not already contractually obliged to provide the service, the assistance may be voluntary in the legal sense. Fourthly, preventing grounding and bringing the vessel to safety provides a useful result.

The analysis needs then move and include Article 13 of the 1989 Salvage Convention. Relevant factors to consider include the salvaged value of ship and cargo, the seriousness of the danger, the success achieved, the tug's promptness, skill and

effort, the risks undertaken, the time and expense involved and the availability and value of the tug and its equipment.

11.2. Damaged tanker and environmental protection

By way of example, suppose a damaged tanker threatens to release oil. Salvors undertake expensive operations and successfully prevent pollution, but little property value is ultimately preserved.

A purely property-based reward may be inadequate because the salvaged fund is small even though the environmental benefit of the operation is substantial. This is the policy problem addressed by the environmental provisions of the 1989 Convention.

Article 14 of the 1989 Convention envisages a special compensation which supplements the ordinary Article 13 of the 1989 Convention regime by creating an incentive for salvors to intervene in qualifying environmental-threat cases even where the prospects of preserving valuable property are limited.

12. Salvage as a Distinctive Maritime Remedy

The statement that salvage is a distinctive maritime remedy rather than simply payment for services rendered can now be explained more precisely.

First, entitlement does not arise merely because work has been performed. The claimant must establish recognised maritime property, real danger, voluntariness and a useful result.

Secondly, the ordinary reward is not calculated simply by multiplying hours worked by a contractual rate. Article 13 of the 1989 Convention applies specialist criteria concerned with value, danger, success, skill, effort, risk, promptness and the readiness and value of salvage equipment.

Thirdly, the right can arise independently of a pre-existing contract, while a salvage agreement such as LOF may regulate the operation and provide a mechanism for determining reward.

Fourthly, salvage has distinctive proprietary consequences, including the maritime lien supporting the salvage claim.

Finally, the modern law incorporates environmental policy. The 1989 Convention supplements the traditional property-centred model through special compensation and the development of contractual mechanisms such as SCOPIC.

13. Overall Conclusions from Lecture 2 - Week 2

The starting point for the Lecture 2 of Week 2 is the maritime enterprise rather than the ship viewed only as a physical object. A vessel may be owned by an individual, co-owners or a corporate entity. Where a company owns the ship, the company is legally distinct from its shareholders, i.e., in other words the shareholders own shares in the company, while the company owns the vessel.

Direct co-ownership requires separate rules governing proprietary shares, decision-making and the protection of minority interests. Joint ownership must be distinguished from part ownership. The traditional 64-share structure expresses proprietary interests in the whole vessel rather than physically dividing the ship.

Management connects ownership with commercial operation. The ship's manager may possess express or implied authority. Ordinary employment of the vessel may fall within implied authority because shipping markets require rapid commercial decisions, while unusual or fundamental transactions may require express authority. Registration of the manager does not by itself determine the scope of authority.

Ship finance demonstrates the importance of the vessel as a form of security. A registered mortgage converts the ship into security for financing without ordinarily making the mortgagee the shipowner. Registration provides publicity and is central to priority between competing registered mortgages. Default may activate possession and sale remedies, while the mortgage is commonly reinforced by covenants and assignments of earnings, insurance and other proceeds.

Salvage governs exceptional assistance to maritime property in danger. The core requirements are recognised maritime property, voluntariness, real danger and a useful result. The 1989 Salvage Convention provides the modern framework, and Article 13 assesses reward by reference to value, danger, success, skill, effort, risk, promptness and professional readiness.

Environmental protection modifies the traditional property-centred ‘no cure – no pay’ model. Article 14 responds to the problem that an operation may produce great environmental benefit even where little property value is preserved. LOF enables urgent salvage assistance without prior agreement on a final price, while SCOPIC represents a contractual response to environmental and expense-related concerns.

Towage, by contrast, is primarily contractual. Port and ocean towage have different commercial structures and standard forms. TOWCON and TOWHIRE may use knock-for-knock allocation so that specified losses are borne by each side irrespective of ordinary fault, subject to the wording of the contract. The purpose is the encouragement of certainty, predictability and insurability.

Towage and salvage must nevertheless be connected analytically. A towage relationship can develop into a salvage situation where new danger arises, and the services rendered go beyond the pre-existing contractual duty. The classification affects the basis of payment, the allocation of risk, enforcement and priority.

Therefore, we need always identify the legal relationship before asking who bears the risk. Company law determines who owns and organises the maritime enterprise; management determines who acts for it; finance and mortgages determine how the ship is funded and secured; salvage governs exceptional assistance to maritime property in danger; and towage governs an important category of contracted maritime assistance.

Indicative Sources and Further Reading

- Hill, C, *Maritime Law* (6th edn, LLP 2003), Chapter 1, particularly the discussion of ship ownership, co-ownership, management and mortgages.
- Hill, C, *Maritime Law* (6th edn, LLP 2003), Chapters 8 and 9, on salvage and towage.
- Baatz, Y (ed), *Maritime Law* (3rd edn, Informa Law from Routledge 2014), Chapter 7, particularly salvage and towage.
- Baatz, Y (ed), *Maritime Law* (5th edn, Routledge 2021), Chapter 7, particularly the sections on the Salvage Convention, salvage reward, Lloyd’s Open Form and towage.
- International Convention on Salvage 1989, particularly Articles 8, 12, 13 and 14.