THE LAW OF SHIPBUILDING CONTRACTS

FOURTH EDITION

SIMON CURTIS

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BY

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To my parents,
Sheila and Frank

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Foreword

The first edition of this book was published in 1991. A copy has been on my shelves for over 20 years. Its battered cover and well-thumbed pages are the best possible testimony to the huge value that the book was to me over many years; as too have been the two later editions which are in similar condition. I have no doubt whatsoever that they have been equally invaluable to all practitioners throughout the world who are involved in legal matters concerning shipbuilding—whether in the course of negotiating a shipbuilding contract, during construction itself or in the unhappy event of dealing with disputes between builder and buyer.

The legal principles applicable to shipbuilding contracts are, of course, no different from those applicable to contracts generally. However, the various wordings used in the industry and the specific features of the business of shipbuilding frequently present particular problems which require careful consideration and handling often against a background of having to give prompt advice in a difficult commercial context involving high stakes. In such circumstances, this book is a godsend. As the legal guru of shipbuilding, Simon Curtis has succeeded once again in combining his legal scholarship and immense practical experience in a clear updated text—providing a detailed analysis and comparison of the different standard form contracts (including, where appropriate, that recently published by The China Maritime Arbitration Commission) as well as identifying the problems and pitfalls and (even better) possible solutions.

So I very much welcome this latest edition and I am sure that it will continue to be of great value.

The Hon Mr Justice Eder
Royal Courts of Justice, London

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Preface

It is ten years since I wrote the third edition of this book in 2002 and much in the shipbuilding world has changed in this period.

For a large part of the so-called "noughties", substantial demand for modern shipping tonnage, fuelled by global economic growth and rocketing freight rates, led to very significant competition for newbuilding slots. In consequence, and for the first time in several decades, the world's leading shipbuilders could demand significant price increases for their products, develop large long-term order books and even "pick and choose" their customers from among the many shipowners wishing to contract with them. Many countries responded by developing and implementing significant expansion plans for their national shipbuilding industries. In particular, China, whose already huge economy had been growing by 10% or more per annum, generating massive demand for the importation of raw materials and exportation of manufactured goods, embarked upon a shipyard construction programme intended to make it the world's largest shipbuilder by 2016.

This period of shipbuilding prosperity ended, of course, with the economic collapse that followed the global financial crisis beginning in September 2008. Within months, many shipowners who had committed themselves at newbuilding prices that had become hugely overvalued faced the prospect of crippling losses; in extreme cases, and as the shipping banks retreated from the finance marketplace, some owners were unable to secure the funding needed to complete the purchase of their newbuilds, thereby exposing them to the loss of their previously paid instalments of the contract price. The period since 2008 has seen numerous attempts by owners to renegotiate the prices and/or delivery dates of such tonnage, and an enormous increase in the level of "vessel rejection" and cancellation disputes, a phenomenon not previously seen since the very early part of the decade.

World shipbuilding markets remain deflated, with limited demand, and with the major shipyards concentrating their marketing efforts on promoting the fuel-saving and/or environmental, rather than the direct commercial, benefits of purchasing new tonnage.

The "roller-coaster" ride of the last decade has, however, had no appreciable effect upon the much longer-term process of the transfer of shipbuilding economic power from Europe to northern Asia, which has been continuously evident since the 1960s. Within the civilian (as opposed to the naval) sector, more than 80% by deadweight tonnage of the world's new ships are now constructed in South Korea and China,[1] with most of the remainder being built in Japan.[2] The major shipyards in these countries have furthermore developed the expertise not merely to produce cheaper, low value tonnage, but also to successfully

1 According to Clarksons Research Services.

2 Owing to the strength of the Japanese Yen, most of Japan's shipbuilding capacity is, however, directed towards the fulfilment of domestic orders.

undertake the most sophisticated and substantial newbuilding projects, including those for the offshore oil and gas sector.

There have in parallel been a number of developments in the last decade regarding the contractual terms on which export newbuilding projects are normally based. Much of the world's export newbuilding is still undertaken on the so-called "SAJ Form", first published in 1974 by the Shipbuilders' Association of Japan, and its near variants, which are widely used in a number of Asian shipbuilding jurisdictions. The SAJ Form has, however, for many years been viewed by shipowners as unduly favourable to the shipbuilding community and, in an important development in this sector, in 2007 BIMCO published its so-called "NEWBUILDCON" Form of shipbuilding contract, which seeks to address the perceived imbalances in the Japanese form. Additionally, in October 2011, and reflecting the country's growth towards ascendancy in the newbuilding sector, a new version of a standard form Chinese shipbuilding contract was published by the China Maritime Arbitration Commission (CMAC). The various European forms of shipbuilding contract previously in use have, in parallel with commercial developments, significantly declined in importance.

This edition, therefore, retains the previous practice of commenting in detail upon the SAJ Form, but now contrasts this with the NEWBUILDCON and CMAC Forms where these are significantly different.

Fortunately for a number of professionals in London, English law continues to represent the most commonly chosen law for large-scale export newbuilding contracts,[3] and this edition therefore again focuses exclusively upon the interpretation and application of English law principles to the business of shipbuilding. The last decade has seen the handing down of a number of English judicial decisions of importance to the shipbuilding community, including, in particular, the application of non-marine construction law principles in complex disputes relating to delay in delivery of the vessel.[4]

In connection with the preparation of this fourth edition of my book, I should (as with previous editions) like to thank Genrong Yu and Lynn Chen of Sloma & Co. in Shanghai and Makoto Hiratsuka of Hiratsuka & Partners in Tokyo for their considerable assistance in addressing, respectively, issues of Chinese and Japanese law and shipbuilding practice. I am also indebted to David Owen of the London insurance brokers, Robert Fleming Marine, and Paul Culham of Kiln Group plc for their help in relation to various newbuilding insurance issues, to Panos Zachariadis of Atlantic Bulk Carriers in Piraeus for reviewing and amending my commentary on various technical matters and to Grant Hunter of BIMCO for his guidance and encouragement at an early stage of the project. Ian Gaunt, Secretary of The London Maritime Arbitrators' Association commented on various issues and I am equally grateful for his input.

It would have been impossible for me to complete this edition, whilst also managing a busy legal practice, without the support of numerous of my colleagues at Curtis Davis Garrard LLP. I would like to thank in particular Glenn Kangisser, Helen Conybeare Williams, Keith Krut, Dimitrios Vourakis, Affaan Sattar, Andreas Silcher, Andreas Dracoulis, Fiona Cain, Amanda Larrington, Marco Potenza, Rasha Jassim, Mansour Jama and Louise Elmes, each of whom assisted me in researching the authorities and preparing

3 The laws of certain other jurisdictions, in particular Singapore, are, however, increasingly chosen for international shipbuilding contracts.

4 See pages 66–68, *supra.*

first drafts of parts of the revised text; two of my partners also working in the shipbuilding and offshore construction sectors, Will Cecil and Justin Turner, were willing and very useful sounding boards on certain issues. Sarah Bailey, CDG's Head of Administration and my PA, helped me enormously with the logistics and covered for me as needed during several weeks of absences, in mind and/or body, from the office. Any remaining mistakes in the text are nevertheless my responsibility alone.

As in the third edition, references are made throughout this book to the "1979 Act" and the "1994 Act". These again relate, respectively, to the Sale of Goods Act 1979 and the Sale and Supply of Goods Act 1994. The law is stated as at 31 August 2012.

Simon Curtis
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September 2012

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PART 1

The nature of the shipbuilding contract

In English law certain distinctions exist between contracts which are categorised as relating to the sale and purchase of goods and those relating to the supply of workmanship and materials. In particular, contracts for the sale of goods may, depending in part upon their terms, fall within a detailed statutory regime for such contracts,[1] which may alter or supplement the agreement that the parties have themselves reached.

It may, however, be difficult in practice to determine into which of these two categories a particular contract should fall. This is especially so where, as in the case of a shipbuilding contract, the agreement provides that one party, A, will not only undertake a complex manufacturing process under the supervision of the other party, B, but will also sell and deliver the manufactured item to B once the process has been completed. In such a case, it is plain that neither of the categories in question exclusively defines the nature and scope of the transaction.

Until relatively recently, however, shipbuilding contracts could quite safely be regarded as contracts for the sale of goods. Thus, according to Diplock J. in *McDougall* v. *Aeromarine of Emsworth Ltd* (1958)[2] " . . . it seems well settled by authority that, although a shipbuilding contract is, in form, a contract for the construction of the vessel, it is in law a contract for the sale of goods . . . ".[3] On this analysis, shipbuilding agreements are very similar to contracts for the sale of existing or second-hand ships, which are also clearly regarded as goods in English law.[4]

A significant proportion of the content of most shipbuilding contracts is nevertheless directed towards the regulation of a substantial and complex construction project, in which each party assumes long-term obligations to the other and bears significant commercial risks. Although the ultimate purpose of such a contract is to transfer legal title to a good (i.e. a ship) in return for payment of an agreed price, the nature and extent of the commitments assumed by both parties in order to achieve this objective are more akin to

1 Principally contained within the Sale of Goods Act 1979; see below.

2 [1958] 2 Lloyd's Rep. 345.

3 At pages 355–356; see also *Reid* v. *Macbeth and Gray* [1904] A.C. 223, *Sir James Laing & Sons Ltd* v. *Barclay, Curle & Co. Ltd* [1908] A.C. 35 and *Re Blyth Shipbuilding and Dry Docks Co.* [1926] 1 Ch. 494 (where the shipbuilding agreement was said to be "unquestionably a contract for the sale of future goods", *per* Romer J. at page 499). The proposition applies equally to contracts for the construction and sale of machinery and equipment for a newbuilding (e.g., a propeller), *Cammell Laird & Co. Ltd* v. *Manganese Bronze & Brass Co. Ltd* [1934] A.C. 402.

4 *Behnke* v. *Bede Shipping Ltd* [1927] 1 K.B. 649. Shipbuilding contracts relate, however, to the sale of "future" rather than "existing" goods (see Moore-Bick L.J. in *Stocznia Gdynia S.A.* v. *Gearbulk Holdings Ltd* [2009] EWCA Civ 75, at paragraph 12 of his judgment); there are obviously other differences (e.g., the builder provides a post-delivery warranty and retains the copyright in the vessel's plans and drawings), although these are of limited importance in terms of legal classification.

those of a non-marine construction project than a mere agreement of sale and purchase.

Since *McDougall* these features have been recognised in two House of Lords decisions, *Hyundai Heavy Industries Co.* v. *Papadopoulos and Others* (1980)[5] and *Stocznia Gdanska S.A.* v. *Latvian Shipping Co., Latreefer Inc. and Others* (1998),[6] which have cast some doubt on the traditional categorisation of shipbuilding contracts as pure sale contracts.

The issue to be decided in *Hyundai* and *Stocznia Gdanska* was whether unpaid instalments of the contract price which had accrued due to the builder prior to his termination of the contract remained payable by the buyer after such termination had taken effect. In both cases, the House of Lords held that the instalments did indeed remain payable because consideration (i.e., value) had been given by the builder to the buyer in the form of the work it had undertaken in partially constructing the vessel.

In *Hyundai* the House of Lords declined to follow a long-standing authority[7] dealing with exactly the same issue in the context of contracts of sale and distinguished it on the ground that the contract considered in the earlier decision was a contract for the sale of goods, which, unlike a shipbuilding contract, "did not require the vendor to perform any work or incur any expense on the subjects of sale".[8] Further, Viscount Dilhorne stated that the shipbuilding contract under consideration "was not just for the sale of a ship . . . [i]t was a contract to 'build, launch, equip and complete' a vessel and 'to deliver and sell her' . . . ".

The conclusions reached in *Hyundai* were affirmed and applied in *Stocznia Gdanska*, where it was held that the shipbuilding contract under consideration was not simply a contract for the sale of a ship but " . . . rather a contract under which the design and construction of the vessel formed part of the yard's contractual duties, as well as the duty to transfer the finished object to the buyers".[9]

Both *Hyundai* and *Stocznia Gdanska* nevertheless dealt with a very specific issue, namely, the parties' rights and obligations upon termination of the shipbuilding contract, and (it is submitted) neither decision has changed the categorisation of such a contract in English law. Thus, in *Hyundai* Lord Fraser simply spoke of the similarity of the contracts there in question with contracts for work and materials "so far as the present issues [were] concerned". Similarly, Viscount Dilhorne stated that the shipbuilding contract in question " . . . was a contract which was not simply one of sale but which so far as the construction of the vessel was concerned, resembled a building contract".

According to the leading English law textbook on the sale of goods, the *Hyundai* and *Stocznia Gdanska* decisions establish that " . . . a contract to build a ship, though a contract of sale of goods, [has] also some characteristics of a building contract",[10] which (it is respectfully submitted) represents the correct legal analysis. These characteristics mitigate the impact upon the builder of certain principles of English law relating to the sale of goods, but do not alter the fundamental nature of the contract itself.

5 [1980] 2 Lloyd's Rep. 1.

6 [1998] 1 Lloyd's Rep. 609.

7 *Dies* v. *British and International Mining and Finance Corporation Ltd* [1939] 1 K.B. 724, which established that a purchaser's repudiatory breach of a contract for the sale of goods does not prevent him from recovering his pre-paid instalments of the price to the extent that these exceed the vendor's recoverable damages.

8 *Per* Lord Fraser at page 13.

9 *Per* Lord Goff at pages 619–620.

10 Benjamin's *Sale of Goods* (8th edn.) at paragraph 1–041.

Reflecting this categorisation, the impact of construction law principles in the historical development of English shipbuilding contract law has been very limited. Although an important recent decision of the High Court[11] has indicated a judicial willingness to embrace the application of non-marine construction law principles to shipbuilding contracts, it has, for better or worse, largely been to the rules underlying contracts for the sale of goods, rather than those for the provision of work and materials, that English courts and arbitration tribunals have customarily looked for guidance in determining shipbuilding contract disputes.[12]

THE SALE OF GOODS ACT 1979

The English rules governing contracts for the sale of goods derive from common law principles[13] as codified and supplemented by parliamentary statute. The most significant source of law in this area is the Sale of Goods Act 1979 (the "1979 Act"),[14] the principal successor in title to the first major codification of the common law, the Sale of Goods Act 1893.[15]

Before considering in detail the principles of the 1979 Act as these relate to shipbuilding contracts, a number of preliminary points must be made regarding the classification of such agreements within the overall statutory framework.

First, the 1979 Act draws a distinction between "sales", in which property passes to the purchaser at the time the contract is concluded,[16] and "agreements to sell", in which "the transfer of the property in the goods is to take place at a future time or subject to some condition later to be fulfilled".[17] Although this distinction is not of great practical significance,[18] almost all shipbuilding contracts take effect as "agreements to sell", even if property to the vessel is to pass to the buyer continuously throughout the course of her construction.[19]

Secondly, the 1979 Act differentiates for a number of purposes between "unascertained" and "specific" goods (i.e., those "identified and agreed upon at the time a contract of sale is made").[20] "Unascertained goods" are not defined, although the statute makes clear that these comprise two sub-categories, "existing" and "future" goods, the latter

11 *Adyard Abu Dhabi* v. *S.D. Marine Services* [2011] EWHC 848 (Comm). See further, Curtis and Elmes, *Construction Law Principles and Shipbuilding Contracts*, Lloyd's List, 11 May and 18 May 2011 and pages 66–68, *infra*.

12 Shipbuilding agreements are nevertheless "maritime contracts" in the sense that these fall within the Admiralty jurisdiction of the High Court (s. 20(2)(n) of the Senior Courts Act 1981); a shipbuilder may thus bring proceedings *in rem* to enforce his claims under a shipbuilding contract.

13 That is, the general body of English judicial decisions creating legal precedents which, if not distinguished or overruled, are binding in subsequent cases.

14 The common law rules are nevertheless preserved "except in so far as they are inconsistent with the provisions of [the] Act" (s. 62(2)).

15 The 1979 Act has since been supplemented by the Sale and Supply of Goods Act 1994 (the "1994 Act").

16 Section 2(3).

17 Section 2(4).

18 Both are, for example, contracts of sale into which the statutory terms contained in ss. 12–15 of the 1979 Act (as amended by the 1994 Act) may be implied see pages 115–121, *infra*.

19 See pages 135–143, *infra*. An exception is where the buyer purchases a partly-built ship on terms that title will vest in him immediately and that the builder will thereafter complete her. In this unusual situation, the sale may neither relate to future goods nor be undertaken solely by description.

20 Section 61.

being "goods to be manufactured or acquired by the seller after the making of the contract of sale",[21] which obviously includes newbuilds. A contract for the sale of "future" goods always takes effect as an agreement to sell.[22]

Finally, it should be noted that an agreement to sell "future" goods may be a sale either by description or by sample. In the case of a large manufactured item such as a ship, the sale will, for obvious reasons, be undertaken by description. In relation to agreements of this type, the 1979 Act implies (in particular) a condition that the goods should comply with the agreed description.

In summary, therefore, in English law a shipbuilding contract is an agreement of sale, incorporating certain characteristics of a construction contract, by which one party, typically the builder, agrees to sell to the buyer future goods, i.e., a vessel, by description. The legal principles applicable to agreements of this type are examined in detail in the chapters which follow.

21 Section 5(1).
22 Section 5(3).

PART 2

The formation of the shipbuilding contract

There is no requirement in English law that an agreement for the construction and sale of a ship should be concluded in writing. Provided that the necessary formal elements are present (see below), such a contract will be legally enforceable even if made orally. The expenditure, timescale and risks involved in the building of a ship are, however, invariably sufficient to ensure that the parties will record in writing at least the main terms of their agreement. In practice, most shipbuilding projects are undertaken on the basis of a detailed contract and specifications, the latter incorporating outline plans and drawings of the vessel.

FORMAL REQUIREMENTS

In English law three requirements must normally be satisfied in order to create an enforceable agreement:

(a) *offer and acceptance*. First, an offer to contract must be made by one party and accepted by the other; both must have legal capacity to enter into an agreement of the type envisaged. Furthermore, the offeror must intend that the contract should become binding when accepted by the offeree and the latter's acceptance must be unconditional. Acceptance of an offer may, however, be inferred by conduct; in *Brogden* v. *Metropolitan Railway* (1877),[1] where an offer was made on the basis of a draft agreement to which the offeree did not expressly consent, this was held to have been accepted where he acted in accordance with its terms for a period of two years.

(b) *intention to create legal relations*. Secondly, the parties must intend to create a legal relationship between them. In contracts of a commercial nature there is, however, a presumption that the parties intend their agreement to be legally binding. Although the presumption may be rebutted, a heavy burden of proof lies with the party seeking to contend that a commercial agreement is binding "in honour only".[2]

(c) *consideration*. Thirdly, subject to certain limited exceptions,[3] English law will enforce only contracts which have been concluded for good consideration, i.e.,

1 (1877) 2 App. Cas. 666; see also *Howard Marine* v. *Ogden* [1978] 1 Lloyd's Rep. 334, *Nissan U.K. Ltd* v. *Nissan Motor Manufacturing (U.K.) Ltd*, C.A., 26 October 1994 and, in a shipbuilding context, *Anangel Atlas Compania Naviera S.A. and Others* v. *Ishikawajima-Harima Heavy Industries Co. Ltd (No. 2)* [1990] 2 Lloyd's Rep. 526.

2 *Edwards* v. *Skyways Ltd* [1964] 1 All E.R. 494.

3 For example, where the contract is executed as a deed.

where each party has given something of value for the other's promise. Consideration for a promise can, however, comprise merely another promise. Furthermore, provided that some value is given, English law does not require that the consideration furnished by one party should be commensurate in value with that supplied by the other.

Where these requirements are met, an agreement between two or more parties will usually be enforceable in law, irrespective of the signature of a formal contract, if the parties have either (i) reached a consensus on all of its "essentials"[4] or (ii) mutually accepted that they will defer to a later date reaching agreement on any outstanding material terms.[5]

However, if it is clear, from a previous course of dealing or the terms of the negotiations themselves that the parties intend not to be bound unless a formal contract is signed, this will be an indispensable element of any enforceable agreement between them.[6] In practice, most international shipbuilding project negotiations are conducted on the assumption that the parties will not be bound until the contract is signed. The parties' respective obligations to construct and purchase the vessel will thereafter become effective following signature of the contract on the date on which all agreed conditions precedent have been satisfied.[7]

In *Okura & Co. Ltd* v. *Navara Shipping Corporation S.A.* (1980)[8] a shipbuilding contract had been concluded between a Japanese trading house as seller and a Panamanian company as purchaser. The contract provided that the purchaser should be entitled to rescind for delay in the vessel's delivery, which right was in due course exercised.

The parties then sought to negotiate a basis upon which the contract could be reinstated at a reduced price. In the course of such negotiations the purchasers, responding to a proposal made by the sellers, telexed the latter on 3 May listing nine points to be covered by the new contract and concluding as follows:

"10. All other terms and conditions as contained in shipbuilding contract dated 3.9.76 to apply in full.

11. Items 1 to 10 above to be incorporated in memorandum of agreement in mutually acceptable manner."

Further telex exchanges then took place in which the parties discussed the terms of the proposed agreement and the sellers indicated that they had not (as had been promised) received a list of work items still to be completed. These issues were further discussed by

4 *May and Butcher Ltd.* v. *The King* [1934] 2 K.B. 17, *per* Lord Dunedin at page 21. In *ACT Construction Ltd* v. *E. Clarke and Sons (Coaches) Ltd*, 21 January 2001, the Technology and Construction Court held that agreement as to (i) the scope of the works and (ii) the price to be paid for the same were "essential ingredients for a building contract of some complexity", *per* H.H.J. Thornton Q.C. This categorisation is not, however, exhaustive and other terms may well be "essential" depending upon the parties' intentions, viewed objectively, during the course of their negotiations; see *Manatee Towing Co.* v. *Oceanbulk Maritime S.A. (The "Bay Ridge")* [1999] 2 Lloyd's Rep. 227.

5 See, e.g., *Mitsui Babcock Energy Ltd* v. *John Brown Engineering Ltd* [1996] C.I.L.L. 1189. If the parties fail subsequently to reach agreement on the terms they have left outstanding, the contract will not be invalidated unless such failure renders the agreement as a whole unworkable or void for uncertainty; see *The Bay Ridge*, *supra*.

6 See, e.g., *Galliard Homes Ltd* v. *J. Jarvis & Sons plc* [2000] B.L.R. 33 and *RTS Flexible Systems Ltd* v. *Molkerei Alois Muller GmbH & Co. KG* [2010] 3 All E.R. 1.

7 See pages 264–265, *infra*.

8 [1981] 1 Lloyd's Rep. 561.

telephone between London and Tokyo on the evening of the following day (4 May), after which the purchasers sent the work list to the sellers.

The purchasers subsequently alleged that a binding agreement for the sale of the vessel had been concluded during the course of their telephone discussions with the sellers on 4 May. The sellers denied this allegation, contending that an agreement had not been reached in the absence of (i) a consensus between the parties as to the nature and extent of the outstanding works and (ii) execution of a memorandum of agreement as envisaged in paragraph 11 of the purchasers' 3 May telex.

Both these arguments were rejected by the High Court, Neill J. deciding that the sellers were legally bound by an agreement in the terms of the purchasers' telex as supplemented by the subsequent discussions. Holding on the facts that the work list was to be merely sent rather than agreed, the judge found (i) that the parties had reached agreement on the telephone as to all the material elements of a new contract and (ii) that paragraph 11 of the telex did not prevent such agreement from taking effect immediately. However, he also held that the buyers had thereafter committed a repudiatory breach which had been accepted by the sellers, thereby bringing the contract to an end.

The Court of Appeal agreed that the sellers were not liable,[9] but reached this conclusion on quite different grounds to those relied on by Neill J., namely, that the telex of 3 May was nothing more than:

" . . . a preliminary to a future document which was to be binding when signed. The future document [i.e., the memorandum of agreement] was drafted but it was never signed. It was never agreed by the parties".[10]

There was accordingly no enforceable agreement between the parties (and the issue of repudiatory breach did not, therefore, arise). In reaching its judgment, the Court of Appeal took into account the wording of the original contract agreed between the parties, which stipulated that this would become effective upon signature, as well as their conduct during the renegotiations, which clearly indicated that they did not regard the relevant telex as giving rise to a binding agreement.

SHIPBUILDING PRACTICE: NEGOTIATION OF THE CONTRACT AND SPECIFICATIONS

In order to establish the commercial and technical basis of the newbuilding project, the buyer and the builder will usually need to engage in detailed negotiations as to the form and substance of both the contract and the specifications. The shape and course of these negotiations will be influenced by a variety of factors, including the extent of their previous relationship, whether the vessel is to be built to a standard specification previously prepared by the builder and the general state of the newbuilding market.

From a commercial, rather than a strictly legal, standpoint the first of these factors, i.e., the nature of the parties' previous dealings, is of crucial significance. Major shipbuilding projects are more accurately seen as joint ventures than as pure contracts of sale, with both parties assuming significant risks of the other's non-performance over a lengthy period commencing with signature of the contract and ceasing upon expiry of the builder's post-

9 [1982] 2 Lloyd's Rep. 537.
10 *Per* Lord Denning M.R. at page 541.

delivery guarantee.[11] Given the extent and duration of these risks, it is not at all surprising that many shipowners and shipbuilders tend to develop long-term relationships, and that a significant proportion of shipbuilding projects represent repeat business. In such cases, the terms of the contract are unlikely to diverge significantly from those on which the parties have previously reached agreement.

The position may, however, be very different where the parties have no pre-existing business relationship. In this situation, each party will normally wish to consider carefully the other's financial standing and prior experience of newbuilding projects of the type in question. Assuming that the results of these inquiries are satisfactory, both the commercial and the technical basis of the project will need to be negotiated in detail between the parties before a contract can be signed.

Inception of the project

The majority of shipbuilding projects obviously originate with the buyer's decision to commission a newbuilding to replace or add to his existing tonnage.[12] Following detailed discussions with his commercial and technical departments to define in outline the size, type and standard of outfitting of the required vessel, the buyer will usually seek outside advice from a firm of shipbrokers with relevant newbuilding expertise.

The part played by the newbuilding broker, although rarely defined or publicised, is often vital to the development and ultimate success of the project. Drawing on extensive, day-to-day contacts with the shipbuilders specialising in the type of vessel in question, the broker will advise the buyer on the availability of the construction berths to meet his timing requirements for delivery, on the price and on the terms of payment likely to be offered by those shipbuilders with relevant capacity. In light of this advice, the buyer will thereafter normally authorise the broker to approach one or more of the shipbuilders he has recommended in order to establish the extent of their interest in the project.

Where the shipbuilders contacted by the broker have previously developed a standardised design for the vessel in question, they will often be in a position to supply to him immediately a résumé of the specifications, usually known as "Principal Particulars", describing in outline the vessel, the standards to which she will be built and the major items of her machinery and equipment.

Invitations to tender

Alternatively, the buyer may at this stage prepare and submit to a number of shipbuilders identified by his broker an "invitation to tender" (i.e., to submit competitive bids) on the basis of outline specifications and a summary of proposed contract terms. This is particularly common where the intending purchaser is a government or other public body subject to statutory obligations to promote open competition.

The shipbuilders invited to tender will usually be required to do so within a specified time limit and on the basis that they should bear all costs associated with the preparation of their bids. Depending upon the terms of his invitation and all the surrounding

11 See pages 170–192, *infra*.

12 It is rare that newbuildings are constructed for the builder's account, i.e., without a pre-existing contract of sale.

circumstances, the buyer may be obliged as a matter of English law to consider all tenders submitted to him which comply with the conditions he has specified.[13] Furthermore, in circumstances in which the buyer invites tenders in order to "test the market" but with no real intention of placing a contract, he may be liable in damages for misrepresentation to shipbuilders who, believing the invitation to be genuine, incur expenditure in preparing their bids.[14]

Initial negotiations

Following completion of his market evaluation and receipt of responses to his initial inquiries, the buyer will normally make a provisional selection of the builder to undertake the project. Unless the vessel is to be constructed to the builder's standard specification (in which case much of the preparatory work will already have been completed), there will then need to follow a period of several weeks or months in which the technical basis for the project is researched and finalised. It is particularly likely that, if these have not already been undertaken, model tank tests will need to be conducted to establish the vessel's performance in defined sea and weather states; in addition, detailed consultation will need to take place with the classification society and the regulatory authorities[15] to ensure that the vessel's design and method of construction are approved in principle.

These and other development costs will usually be paid for by the builder on the basis that the same will be reimbursed by the buyer if the project does not go forward. Even where this has not been expressly agreed, the builder may in certain limited circumstances be entitled to a restitutionary remedy in respect of his expenses, particularly if the buyer has taken and used the benefit of the work that has been done by the builder.[16]

Letters of intent

Given that these matters will usually involve expenditure by both parties and a commitment on the part of the builder to maintain the availability of the building "slot",[17] it is usual for the parties at this stage jointly to execute a so-called "letter of intent", setting out their mutual understanding of the basis of the proposed project. By the time they agree upon the terms of a letter of intent, the parties will typically have defined the key commercial terms underlying the project. These will usually encompass the price of the vessel, the currency and terms of payment, the delivery date and the choice of law which will govern the contract, as well as the options (if any) the builder is prepared to grant to the buyer should their discussions lead to a concluded agreement.

At this stage of the project, the buyer's ability or willingness to conclude a firm contract is likely to depend upon his obtaining a satisfactory offer of financing in respect of the purchase price, which in turn may depend upon his securing employment from the vessel's expected date of delivery. The letter of intent will therefore often state that the

13 *Blackpool and Fylde Aero Club Ltd* v. *Blackpool Borough Council* [1990] 3 All E.R. 25.

14 See *Richardsons* v. *Sylvester* (1873) L.R. 9 Q.B. 34.

15 See pages 27–33, *infra*.

16 See, e.g., *William Lacey (Hounslow) Ltd* v. *Davis* [1957] 1 W.L.R. 932; such a claim will, however, fail if the parties have proceeded on the clear understanding that either is free to withdraw from the negotiations at any time, *Regalian Properties plc* v. *London Docklands Development Corporation* [1995] 1 W.L.R. 212.

17 That is, the period for which the building dock will be needed to launch or float the vessel.

signing of the contract will be subject to financing and/or a charter and/or to the buyer's board approval. Signature will obviously also depend upon finalisation of the details of contract and specifications in a form acceptable to both parties.

The term "letter of intent" is used in English law and practice to denote a variety of understandings and arrangements, ranging from a mere written expression of the parties' mutual hopes and expectations to a legally binding agreement between them.[18] In a specific shipbuilding context, however, letters of intent are, in the absence of special circumstances, widely regarded within the industry as comprising no more than their name suggests, i.e., statements of the parties' intentions, imposing moral rather than legal obligations.[19]

Where a shipowner or shipbuilder executes such a document other than in good faith he is therefore unlikely to be sued, although his commercial reputation may well suffer. It is nevertheless very important to appreciate that the market perception of arrangements of this type is only marginally relevant to the legal analysis of individual cases. As a matter of English law, the extent to which any particular letter of intent imposes binding obligations upon its signatories depends rather upon whether they intend thereby to create a legal relationship and, if so, whether the letter evidences more than a bare agreement to negotiate in good faith.

These issues turn upon the true construction of the terms of the letter, viewed in light of the "factual matrix" in which it was prepared and executed.[20] In *Wilson Smithett & Cape (Sugar) Ltd* v. *Bangladesh Sugar and Food Industries Corporation* (1985),[21] a case concerning the sale and purchase of sugar, Leggatt J. expressed the view that, in construing a document described as a "letter of intent", he should:

> " . . . look at the document itself, at the surrounding circumstances, and at what happened when [the letter of intent] was brought into existence. The fact that it has the particular label that it has does not brand it at the outset as a contractual document or as a non-contractual document."[22]

Whether a letter of intent is intended to create or evidence a legal relationship will be largely dependent upon the precise wording used.[23] If it is stated expressly that the letter is not intended to impose binding obligations upon the signatories, this will obviously be conclusive. Where, in contrast, it contains provisions detailing the consideration furnished by each party and incorporates a choice of law and jurisdiction, an intention to create legal relations is likely to be presumed, particularly if this is executed at a late stage of the development of the project and/or has been the subject of detailed negotiation between them.[24]

18 See *per* H.H.J. Lloyd Q.C. in *EDRC Group Ltd* v. *Brunel University* [2006] B.L.R. 255 at 265.

19 No direct evidence is offered in support of this contention, which is based solely upon views expressed to the author by industry participants. It is, however, striking that there are no reported English cases in which either a shipowner or a shipbuilder has sought to enforce a shipbuilding letter of intent.

20 *Per* Lord Wilberforce in *Reardon Smith Line Ltd* v. *Yngvar Hansen Tangen (The "Diana Prosperity")* [1976] 2 Lloyd's Rep. 621 at page 625.

21 [1986] 1 Lloyd's Rep. 378.

22 At page 379. See also *Damon Compania Naviera SA* v. *Hapag-Lloyd International* [1985] 1 W.L.R. 435 and *Associated British Ports* v. *Ferryways N.V.* [2009] 1 Lloyd's Rep. 595.

23 However, the subsequent conduct of the parties may also be relevant: *RTS Flexible Systems Ltd* v. *Molkerei Alois Muller GmbH & Co. KG* [2010] UKSC 14.

24 As to the burden of proof that a letter of intent is (or is not) intended to be enforceable, see *Edwards* v. *Skyways* [1964] 1 W.L.R. 349 and the High Court of Singapore decision in *Hong Kong and Shanghai Banking Corporation Ltd* v. *Jurong Engineering Ltd* [2000] 2 S.L.R 54.

Assuming that the letter is intended to create a legal relationship between the parties, the further question arises of whether this constitutes no more than an agreement to negotiate in good faith. Historically, agreements of this type have been viewed in English law as legally worthless because " . . . a contract to negotiate, like a contract to enter into a contract, is not a contract known to the law".[25] The same principle is equally applied to promises to use "best" or "reasonable" endeavours to reach agreement for, as was pointed out by the Court of Appeal in *Little* v. *Courage Ltd* (1995)[26] " . . . an undertaking to use one's best endeavours to agree is no different from an undertaking to agree, to try to agree or to negotiate with a view to reaching agreement; all are equally uncertain and incapable of giving rise to an enforceable legal obligation".[27]

In *Petromec Inc. & Others* v. *Petroleo Brasileiro S.A. and others* (2006),[28] these principles were questioned by the English Court of Appeal. The parties had entered into a contract for the sale and upgrading of an oil production platform. They thereafter agreed that one party would undertake further upgrading works on the basis that it agreed "to negotiate in good faith" the cost of the same. In considering this provision, the Court stated the traditional objections to the enforcement of "agree to negotiate" clauses carried "little weight" on the facts of the case—the clause was part of a series of agreements which had been concluded with extensive legal assistance, on the facts it was difficult, but not impossible, to assess whether one or other party had failed to negotiate in good faith and it was not beyond the court to assess the proper quantum of the extra costs if the parties could not agree.

This reasoning was not, however, strictly required for the decision in *Petromec* and was not followed in *Barbudev* v. *Eurocom Cable Management Bulgaria* (2011),[29] in which a side letter relating to a financial transaction contained an express obligation upon the parties to negotiate in good faith the detailed terms of the transaction. In this context, the High Court held that:

- a "bare" agreement to negotiate in good faith is always unenforceable in English law; but
- an agreement to negotiate in good faith may be enforceable if the parties have agreed objective criteria, or machinery, for resolving any disagreement between them.[30]

In *Petromec*, the obligation to negotiate arose in the context of an existing contractual relationship between the parties (namely, the sale and initial upgrade agreement for the

25 *Per* Lord Denning M.R. in *Courtney & Fairbairn Ltd* v. *Tolaini (Hotels) Ltd* [1975] 1 All E.R. 716 at page 720; see also *Mallozzi* v. *Carapelli* [1976] 1 Lloyd's Rep. 407 and *Walford* v. *Miles* [1992] 2 W.L.R. 174 where Lord Ackner said (at page 181) ". . . the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of parties when involved in negotiations. Each party to the negotiations is entitled to pursue his . . . own interest, so long as he avoids making misrepresentations. . . . Accordingly, a bare agreement to negotiate has no legal content".

26 (1995) 70 P. & C. R. 469.

27 *Per* Millett L.J. See also *Multiplex Construction (U.K.) Ltd* v. *Cleveland Bridge (U.K.) Ltd* [2006] EWHC 1341 and *Covington Marine Corporation and Others* v. *Xiamen Shipbuilding Industry Co. Ltd* [2006] 1 Lloyd's Rep. 745 where (at page 757) the High Court (Langley J.) described it as "trite law that an agreement to agree is of no effect" and clearly accepted that this principle is not affected by the addition of language imposing upon the parties a commitment to use best or reasonable endeavours to reach agreement.

28 [2006] 1 Lloyd's Rep. 121.

29 [2011] EWHC 1560, upheld in the Court of Appeal [2012] EWCA Civ 548.

30 See also Rix J. in *Mamidoil-Jetoil Greek Petroleum Co. S.A.* v. *Okta Crude Oil Refinery* [2001] 2 All E.R. (Comm) 193 at paragraphs 50–68.

platform)—the circumstances were thus very different from those of a shipbuilder and purchaser concluding a letter of intent for a newbuild to be built pursuant to an entirely new contract between them. In light of this, and the decision in *Barbudev*, it seems unlikely that "good faith negotiation" clause contained in a letter of intent will be capable of legal enforcement unless the letter contains objective criteria or machinery (perhaps in the form of a broad-ranging dispute resolution clause) to resolve any issues on which the parties cannot reach agreement—this rarely occurs in global shipbuilding.

It should, however, be noted that, while a bare agreement to negotiate is not normally binding, a so-called "lockout agreement", i.e., an agreement by A with B not to negotiate with anyone except B, is enforceable, but only if the restriction on A's freedom to deal with third parties is expressly stated to apply for a specified period of time. In *Walford* v. *Miles* (1992),[31] a case which concerned the sale of a company, the defendant vendor had agreed that he would "terminate negotiations with any third party or consideration of any alternative with a view to concluding agreements with [the plaintiff]". The defendant thereafter sold the business to a third party and was sued in damages by the plaintiff for the difference between the true value of the company and the price which the plaintiff had offered to pay. Although holding that the agreement could not be enforced as a positive covenant by the defendant to negotiate in good faith, the House of Lords indicated that it would have been prepared to uphold against the defendant the converse, negative covenant not to negotiate with third parties if this had been expressly limited in time.[32]

Where, therefore, either or both of the buyer and the builder agree in the letter of intent that, as an aid to their own negotiations, they will not negotiate with third parties during a defined period, then—provided that the formal requirements of consideration and an intent to create legal relations can be proven—a breach of such commitment may entitle the "innocent" party to an injunction or damages.[33] The assumption by either or both of the parties of confidentiality obligations with regard to the proposed project may similarly give rise to legal liabilities even if other "obligations" in the letter of intent are not enforceable.

It should also be noted that, while letters of intent do not normally give rise to positive obligations to negotiate or to contract with the other party, statements fraudulently or negligently made therein may generate a potential liability in damages in tort. If, for example, the builder incorrectly represents in the letter of intent that he has construction dock capacity available for the project and the parties enter into detailed contract negotiations which ultimately fail for lack of such capacity, the buyer may be entitled to claim his costs of the negotiations if he can show that he reasonably relied upon the false representation made to him.[34]

Bridging contracts

Where substantial work will be involved in developing the project to the point when a contract can be signed, the builder may nevertheless be unwilling to rely only upon a letter

31 [1992] 2 W.L.R. 174.

32 See *per* Lord Ackner at page 183. If a specific time-frame has not been agreed, it is not open to the court to imply that the restriction will last for a "reasonable period" (*ibid.*).

33 The principle established in *Walford* v. *Miles* that limited lock-out agreements are enforceable in English law was affirmed in *Pitt* v. *P.H.H. Asset Management Ltd* [1994] 1 W.L.R. 327; see also *Tye* v. *House* [1997] 2 E.G.L.R. 171

34 See generally, Clerk & Lindsell on Torts, 20th edn., Chapter 8.

of intent.[35] In such circumstances, he may insist that an interim or bridging contract be concluded under which he agrees to provide design and other technical services for the development of the project in return for a fee payable by the buyer. This type of arrangement is particularly common in relation to the construction of highly specialised vessels and structures for use in the offshore (i.e., oil and gas) industry.

In such cases it will normally be agreed that the bridging arrangements should be subsumed within the shipbuilding contract if and when this becomes effective; even if this is not expressly stated, however, such an intention will readily be implied.[36] From the buyer's perspective, it is important that the builder's liability under any express or implied design warranties should not be discharged by termination of the bridging contract unless these are reaffirmed in the shipbuilding contract itself.

Final negotiations

When the technical and commercial parameters of the project have been researched fully, the parties will usually meet to negotiate and finalise the details of the contract and specifications. These negotiations will often be undertaken by different teams of representatives of each party, one commercial/legal and the other technical. Indeed, it is quite common in large-scale shipbuilding projects for the contract and the technical negotiations to take place independently of each other, on the basis that the results will be compared and adjusted by both parties at a relatively late stage in the overall process. This necessarily involves the risk that, if the contract negotiations should fail to reach a conclusion, considerable time and expense may have been wasted in the parallel discussions relating to the proposed specifications.[37]

If a broker has been involved in the development of the newbuilding project, he will usually attend these negotiations and seek to assist the parties in reaching agreement. Although he continues to act in this respect as the agent of the buyer, the broker's commission is customarily payable by the builder. This will be calculated as a percentage of the contract price, payable either in tranches upon receipt of the buyer's pre-delivery instalments or as a lump sum upon delivery.

Standard forms of contract

Most newbuilds are constructed within the framework of a standard contract form amended by the parties to meet their particular project requirements. The choice of form upon which their negotiations will be based is likely to be significantly influenced by the builder's identity and domicile, many shipbuilders being reluctant to contract other than upon standard forms prepared or recommended by the trade associations to which they belong.

35 Particularly since the decision in *Regalian Properties plc* v. *London Docklands Development Corporation*, *supra* at n 16.

36 *British Steel* v. *Cleveland Bridge* [1984] 1 All E.R. 504.

37 It will be rare for the negotiations to fail on the grounds that, having finalised the contract terms, the parties cannot reach agreement on the contents of the specifications.

The SAJ Form

The origin of the majority of the export shipbuilding contracts in current usage is the standard form published in January 1974 by the Shipbuilders' Association of Japan and colloquially known as the "SAJ Form". This wording forms the basis of various standard forms used in South Korea, China, Singapore and Taiwan.

Given its origins, it is wholly unsurprising that the SAJ Form is weighted in favour of the builder. This imbalance can be seen at various points in the text, in particular in the provisions relating to subcontracting (Article I.4), modifications (Article V) and *force majeure* (Article VIII) and in the express exclusion of any liability of the builder for damages in the event of the buyer's rescission (Article X). The underlying approach is, however, also evidenced by a number of significant omissions in the standard wording, in particular the absence of terms relating to design liabilities, the effect of the builder's liquidation or other financial default and the provision of security for the repayment of the buyer's pre-delivery instalments in the event of his rescission of the contract for the builder's default. Depending upon the parties' previous relationship and the strength of their respective bargaining positions, these issues may, however, be specifically addressed by way of negotiated amendments to the standard form wording.

Other contract forms

In addition to the SAJ Form, other standard shipbuilding contract forms are available for use in international shipbuilding projects. In particular, in an effort to address the imbalances perceived to be inherent in the Japanese form, the Baltic and International Maritime Council ("BIMCO") published in 2007 its "NEWBUILDCON" Standard Newbuilding Contract (hereafter the "NEWBUILDCON Form"), the text of which is set out at Appendix A.

Specifically intended for use in the Chinese export market, the China Maritime Arbitration Commission ("CMAC") published in October 2011 a new version of its standard form contract, known as the "CMAC Standard Newbuilding Contract (Shanghai Form)", the text of which is set out at Appendix B; this is referred to hereafter as the "CMAC Form".

In Europe, the Community of European Shipyards' Association, previously the Association of European Shipbuilders and Shiprepairers, recommends that its members continue to use the "AWES Form",[38] which in its current form dates from May 1999.

National forms sometimes seen in specific jurisdictions include the 1999 standard contract prepared jointly by the Norwegian Shipowners' Association and the Norwegian Shipbuilders' Association.

38 This form was the subject of detailed commentary in previous editions of this book. However, reflecting the relative decline of European shipbuilding in the past decade, it is now only infrequently seen in export shipbuilding projects.

PART 3

Standard terms

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The preamble

THIS CONTRACT, made this .....day of , ... 19 (*sic*)....., by and between....., a corporation organised and existing under the laws of Japan, having its principal office at ...., Japan (hereinafter called the "BUILDER"), the party of the first part, and ...., a corporation organised and existing under the laws of....., having its principal office at ....(hereinafter called the "BUYER"), the party of the second part,

WITNESSETH:

In consideration of the mutual covenants herein contained, the BUILDER agrees to build, launch, equip and complete at its .....(hereinafter called the "SHIPYARD") and sell and deliver to the BUYER one (1)..... more fully described in Article 1 hereof (hereinafter called the "VESSEL"), and the BUYER agrees to purchase and take delivery of the VESSEL from the BUILDER and to pay for the same, all upon the terms and conditions hereinafter set forth.

The primary purpose of the introduction or "preamble" to the contract is to identify the buyer and the builder. The wording used is largely formal in nature and little will turn on its precise terms. It is customary, however, to detail the parties' nationalities and legal status, together with the addresses of their registered offices or principal places of business. In the majority of international shipbuilding projects, the buyer will be a single-purpose company acquired or incorporated to enter into the contract; in such cases, the choice of its nationality or corporate domicile will usually be determined by tax considerations and by the registration requirements of the vessel's intended flag.

Reflecting the relative maturity of the Japanese shipbuilding sector, the SAJ Form assumes that the seller and builder of the vessel will be the same company, defined as the "Builder".

However, in other jurisdictions, in particular in China, and especially where the shipbuilder is a company of limited size or international reputation, it is not unusual for the export shipbuilding contract to be concluded on the builder's side by two companies, who will be jointly liable to the buyer for its performance. The two companies, which will be legally and economically distinct, will normally comprise (i) the shipbuilder and (ii) an international trading or finance house located in the shipbuilder's national jurisdiction

which will have assisted the latter in securing the order and may also have arranged or provided construction financing for the project.[1]

Although, as indicated, this structure is not contained within the SAJ Form, the CMAC Form is drafted on the basis that a trading house will participate in the contract, and both it and the builder are jointly defined as the "Seller" and the "Builder", both of which terms are used in the remainder of the document; the "box definition" of the "Builder" in the NEWBUILDCON Form also assumes the possibility of incorporation of a second entity as a joint contracting party.

Clearly, where two parties comprise in this manner the contractual definition of the "Builder" or the "Seller", each of them is (in the absence of express provision to the contrary) fully liable to the buyer for the performance of all aspects of the contract. Indeed, where the trading house or other financial institution lending its name to the contract is of sufficient financial substance, it may be acceptable to the buyer to agree to dispense with any third-party guarantee of the builder's refund obligations, i.e., the joint commitment made by the trading house or institution will in such circumstances normally encompass an obligation to repay the buyer's pre-paid instalments plus interest if contract is lawfully cancelled.

The preamble will usually also set out the scope of the project to which the parties have agreed, reciting in general terms their respective obligations to build and purchase the vessel, and identifying the shipyard at which her construction is to be undertaken. This last point will be of particular importance to the buyer because quality standards may vary from one shipyard to the next.

In a 2010 arbitration award, three London arbitrators considered the legal significance of a contract term which provided for construction of a series of vessels at the builder's Chinese shipyard; lacking sufficient newbuilding capacity at its own shipyard, the builder had indicated an intention to construct the vessels, using its own workforce, at another shipyard which was to be rented specifically for this purpose. The tribunal held, however, that this was legally impermissible. In its view the contractual requirement for the vessels to be built and completed at the "*Seller's Shipyard*" formed a part of their description and "*a substantial ingredient of the 'identity' of the thing sold*".[2] This term was accordingly a condition of the contract with the effect that the buyers could reject the vessels when eventually tendered for delivery if they had been built at another shipyard.[3]

Unlike the SAJ and CMAC Forms, there is no preamble to the NEWBUILDCON Form, which follows the box layout format of the BIMCO "suite" of maritime contracts. However, a short preamble text, which establishes the documentary elements constituting the contract and their order of priority, is included above the signature box on the third page of the form.

1 The previous north Asian practice of concluding two parallel contracts, the first between the buyer and the trading house and the second between the trading house and the builder, has fallen into disuse.

2 Applying *Reardon Smith Line Ltd* v. *Yngvar Hansen-Tangen (The "Diana Prosperity")* [1976] 1 W.L.R. 989; see generally, pages 116–117, *infra*.

3 It should be noted that an arbitration award generates no precedent or binding authority in English law; the tribunal's decision is, however, indicative of the approach likely to be taken if the issue is raised again in an English forum.

ALLOCATION OF THE DESIGN RISK

In defining in general terms the scope of the parties' obligations under the contract, the preamble will often deal expressly with the allocation of responsibility for the vessel's design. Problems with the design of a newbuild often do not emerge until she has commenced trading and their consequences tend, therefore, to be more serious than those arising from inadequate workmanship or materials, which will frequently be detected during construction.[4] It is, however, a curious feature of the SAJ Form that it makes no attempt to legislate for this problem.[5]

Where the design risk is addressed

Although the vessel must as a matter of commercial necessity be built to a design acceptable to the chosen classification society and the regulatory authorities, the parties to the contract are entirely free in English law to allocate between themselves the risks that the design chosen will not be so approved or that, even if approved, will not generate a newbuilding which complies in full with the requirements of the contract.[6] In *A.M. Gillespie & Co.* v. *James Howden & Co.* (1885),[7] a Scottish case, the shipbuilder had contracted to build a vessel with certain specified dimensions "to carry 1800 tons deadweight, including coals, on 1412 feet draught". In these circumstances it was no answer to the purchaser's claim for damages for a shortfall in the vessel's deadweight that this could not possibly have been achieved with the design in question—the shipbuilder had assumed the risk of the inadequacy of the design and this was so even though the design, expressed in terms of a model, had been approved by the purchaser prior to the commencement of construction.

Where, as is usual, it has been agreed between the parties that the design risk will be borne by the builder, it is normal for an express term to such effect to be incorporated in the contract. If, however, the vessel is to be built to a design developed by the buyer,[8] the builder may occasionally refuse to provide any warranty or other assurance that this is adequate to meet the buyer's operational requirements. In such event, the contract may occasionally stipulate that the design risk rests upon the buyer, the builder's obligation

4 See, e.g., *In re Oil Spill* by the "*Amoco Cadiz*" off the coast of France [1984] 2 Lloyd's Rep. 304, where an Illinois court held the Spanish shipbuilders of a tanker jointly liable with her owners for substantial pollution damage resulting from a stranding. The casualty was held to have occurred as a consequence of the insufficiency, and consequent failure, of certain bolts in the vessel's steering linkage, which had been built to a standard specification prepared by the shipbuilders. The fact that the design had been approved by the classification society and the purchaser's supervisors during the vessel's construction did not reduce the extent of the shipbuilders' liability.

5 It is almost as if the authors of this standard form hoped that, by ignoring design issues, they might avoid imposing a liability upon the builder for the same. Where English law was to apply, such an expectation was always over-optimistic (see below).

6 Note, however, that where one party assumes responsibility for the adequacy or safety of the vessel's design, a contractual term purporting to exclude or restrict his liability for the consequences of a design failure may (in the limited category of cases where this applies) potentially attract the operation of the Unfair Contract Terms Act 1977, see pages 188–191, *infra*.

7 (1885) 12 R 800. See also *Thorn* v. *The Mayor and Commonalty of London* (1876) 1 App. Cas. 120, where, in a non-marine context, it was held that, where a party invites tenderers to bid to undertake works according to specified plans and drawings, there is no implied warranty that the same can successfully be performed according to such plans and drawings.

8 The design may in practice have been created by, and remain the property of, an architect engaged by the buyer; this will not, of course, affect the allocation of design responsibilities under the contract.

being limited to the construction and assembly of the vessel in accordance with plans and drawings to be supplied to him.

Where the design risk is not addressed

Where, as in the SAJ Form, no express provision is made for the allocation of the design risk, it will be for the court or arbitration tribunal to seek to establish the parties' intentions by construing the contract as a whole in light of all the surrounding circumstances. In the absence of special circumstances, however, the builder's basic commitment to manufacture and sell the vessel will usually import an obligation to ensure that the design will permit her both to operate safely and to meet the performance criteria promised in the contract;[9] to this extent, design is viewed as no more than one aspect of the workmanship involved in her construction.

Thus, in *Aktiebolaget Gotaverken* v. *Westminster Corporation of Monrovia and Another* (1971),[10] Donaldson J. held that a shiprepairer's post-redelivery obligations to remedy defects in "materials used and work performed" extended to errors in design. In the judge's view:

> "The contract, as varied, required Gotaverken to supply watertight hatch covers. This required good workmanship both in the design and the execution, and if there were design errors, I see no reason why these should not be characterised and attract liability as bad workmanship. The alternative view would be that Gotaverken escaped all liability . . . which seems an improbable result for the parties to have intended."[11]

Although not necessarily appropriate in all cases,[12] it is submitted that the approach adopted by Donaldson J. of defining "design" as merely one element of the "workmanship" involved in the construction of a newbuilding accords with both common sense and industry practice. Put very simply, it is the business of shipbuilders to construct vessels and that of shipowners to operate them. In most cases, the builder will accordingly be both more experienced and better equipped to assess and manage the design risk inherent in the project; even if the contract protects him from liability for the buyer's financial losses caused by defects in the vessel, it is clearly right that the basic responsibility for the design should normally rest with the builder.

As previously indicated, the position may, however, be different where the vessel is to be built to a design produced by the buyer, particularly if this is novel in concept. In such circumstances, the correct inference to draw from the contract may well be that the builder provides no warranty as to the adequacy of the design. In *Dixon Kerly Ltd* v. *Robinson* (1965),[13] the design of a yacht was provided to the shipbuilder by a third party, rather than the purchaser.[14] It was held on the facts that the shipbuilder's obligation was merely to construct the yacht in accordance with the plans and drawings supplied to him and that no

9 This will be particularly clear where the vessel is built to a standard design previously developed by the builder and used without undergoing significant amendment by the buyer.

10 [1971] 2 Lloyd's Rep. 505.

11 At page 512.

12 It may, for example, be clear, either from the contract itself or their performance of its terms, that both parties have chosen to treat "design" and "workmanship" as distinct elements of the production process.

13 [1965] 2 Lloyd's Rep. 404.

14 It is not clear from the judgment by whom the third party (a naval architect) was employed.

warranty could be implied that she would (amongst other things) be reasonably fit for the purposes of cruising in the English Channel.[15]

The standard forms

The preamble to the SAJ Form states that the builder shall "build, launch, equip and complete" the vessel and thereafter "sell and deliver" her to the buyer. This wording omits any reference to the design of the vessel and is often amended to provide expressly that the builder shall be responsible for the same.

Even where this is not done, however, it seems likely, for the reasons described above, that the builder will be held liable for the design risks inherent in the project. This view is reinforced by reference to the provisions of Article XXI of the standard form, which states that the contract price "includes the expenses amounting to ¥..... for design and supply of drawings as the technical services required to be rendered by the BUILDER under this Contract".[16]

The NEWBUILDCON Form is much clearer with regard to the allocation of design responsibility. Clause 1 of the form states simply that "the Builder shall design ..... the Vessel" and Clause 4(a) requires him to "endeavour to take account of the Vessel's ultimate disposal" in so doing. Furthermore, Clause 20(f), which deals with the Buyer's plan approval rights, specifically refers to "the obligations of the Builder to design ..... the Vessel".

In contrast, the CMAC Form seeks to adopt a middle course, although the result is far from satisfactory. Although providing (at Article IV.1) that "the Seller agrees to design" the vessel and shall "endeavour to take due account of the Vessel's recycling disposal when designing . . . " in doing so, it also states in prescriptive terms that the design shall be undertaken by a third-party designer "based on the requirements of the BUYER".[17]

Under the CMAC Form, if the buyer chooses to employ a design company outside China, it is envisaged that he and the designer will conclude an initial contract for the basic design and that the builder will enter into a subcontract with the same company "for the detailed design and workshop design" of the vessel. Critically, however, in such a situation the builder assumes towards the buyer no contractual responsibility either for defects in the vessel "arising from the design" or for delay in delivery of the vessel caused by "delay in delivery of the drawings". Furthermore, this exclusion appears to apply whether the defects or delays in question have emanated from the basic design provided by the third party to the buyer or from the detailed design provided directly to the builder. Furthermore, and very confusingly, these provisions do not apply where the third-party designer has been "assigned by the BUILDER", although the circumstances in which this might occur, and the meaning of "assignment" in this context, are not explained.

Similar provisions are not normally incorporated in the "house forms" used by a number of the larger Chinese shipyards, and they are certainly not in common currency outside China. A clear risk exists under this wording that, in the event of a design defect

15 The judgment of Thompson J. is, however, difficult to follow and (on one view) turns upon the unusual terms of sale to which the parties had agreed.

16 This provision is in practice never used in export projects, although it is submitted that its absence does not indicate that the parties intend to alter the allocation of design risk inherent in the contract form.

17 See Article III; the CMAC Form does not appear to cater for the possibility that the builder will use his own design.

or design-related delay, the buyer would find himself without a clear contractual remedy against either the builder or the third party designer of the vessel.

Plan and drawing approvals

In circumstances in which the builder assumes the design risk, provisions permitting the buyer to approve plans and drawings for the vessel[18] will not normally transfer the design responsibility to him.[19] For the avoidance of any doubt, however, the contract will often incorporate an express term confirming that the builder's design liabilities will be unaffected by any approvals of plans and drawings issued by the buyer.[20]

18 See, e.g., Article IV.1 of the SAJ Form, Article VIII.1 of the CMAC Form and Clause 20 of the NEWBUILDCON Form.

19 See *Gillespie* v. *Howden*, *supra*.

20 See, e.g., Clause 20(f) of the NEWBUILDCON Form, which provides that: "The Buyer's approval or deemed approval of any Plans and Drawings shall not affect the obligations of the Builder to design, construct and deliver, or the obligations of the Buyer to take delivery of, and pay for, the Vessel in accordance with the other provisions of the Contract . . . "

Article I—Description and class

1. Description:

The VESSEL shall have the BUILDER's Hull No. ..... and shall be constructed, equipped and completed in accordance with the provisions of this Contract, and the Specifications and the General Arrangement Plan (herein collectively called the "Specifications") signed by each of the parties hereto for identification and attached hereto and made an integral part hereof.

2. Dimensions and Characteristics:

Length, overall.....

Length, between perpendiculars.....

Breadth, moulded.....

Depth, moulded .....

Designed loaded draft, moulded Gross tonnage.....

Propelling Machinery .....

Deadweight, guaranteed .....

Trial speed, guaranteed.....

Fuel consumption, guaranteed.....

The details of the above particulars as well as the definitions and method of measurements and calculations are as indicated in the Specifications.

3. Classification, Rules and Regulations:

The VESSEL, including its machinery, equipment and outfittings shall be constructed in accordance with the rules (the edition and amendments thereto being in force as of the date of this Contract) of and under special survey of ..... (herein called the "Classification Society"), and shall be distinguished in the register by the symbol of.....
.....

Decisions of the Classification Society as to compliance or non-compliance with the classification shall be final and binding upon both parties hereto.

The VESSEL shall also comply with the rules, regulations and requirements of other regulatory bodies as described in the Specifications in effect as of the date of this Contract.

All fees and charges incidental to the classification and with respect to compliance with the above referred rules, regulations and requirements shall be for account of the BUILDER.

4. Subcontracting:

The BUILDER may, at its sole discretion (*sic*) and responsibility, subcontract any portion of the construction work of the VESSEL.

5. Registration:

The VESSEL shall be registered by the BUYER at its own cost and expense under the laws of ..... with its home port of ..... at the time of its delivery and acceptance hereunder.

It is obviously of great importance to the buyer and the builder that the agreement between them should adequately and accurately describe both the project and the vessel itself. The project having usually been defined in the preamble, the first Article of the contract normally contains a description of the vessel. This will, however, be expressed only in general terms on the basis that a more extensive definition, including details of the vessel's machinery and equipment, will be incorporated in the specifications and the principal plans and drawings.

HULL NUMBER

In the majority of shipbuilding projects, the vessel's name has not been chosen by the buyer at the time the contract is signed. Both in the contract itself and in correspondence between the parties during the construction period, the newbuilding will accordingly be identified by reference to a hull or project number given to her by the builder. In those countries in which it is possible to register ownership interests in a newbuilding under construction,[1] the hull number will form a vital element of the register entry.

As a matter of English law, the hull number of the vessel is regarded as a mere label and not as an essential ingredient of her description.[2] Accordingly, where she otherwise complies with the requirements of the contract and the specification, the buyer cannot refuse to accept delivery of the vessel merely because her hull number is different from that contained in the contract.[3]

However, it is equally clear that the builder cannot, without the buyer's consent, simply redesignate hulls (or parts thereof) built under one contract with a new number for the purposes of ensuring performance of an entirely different contract.

In *Stocznia Gdanska S.A.* v. *Latvian Shipping Co., Latreefer Inc. and Others* (1998),[4] the plaintiff shipbuilder had agreed to build six reefer vessels for the defendant buyer, a special purpose Liberian subsidiary of an East European shipping company. The buyer, seeking to renegotiate the contract prices, refused to pay the keel-laying instalments for hulls 1 and 2 in the series and the shipbuilder accordingly exercised a contractual right to rescind the contracts for such vessels.

The shipbuilder then took the further, highly controversial step of redesignating the keels of hulls 1 and 2 as the keels for hulls 3 and 4 and gave further notices to the buyer demanding payment of the relevant keel-laying instalments under the contracts for these

1 For example, Croatia, Italy and Germany.

2 *Reardon Smith Line Ltd* v. *Yngvar Hansen Tangen (The "Diana Prosperity")* [1976] 2 Lloyd's Rep. 621, *H.L. Sanko Steamship Co. Ltd* v. *Kano Trading Ltd* [1978] 1 Lloyd's Rep. 156, see pages 116–117, *infra*.

3 *Ibid*.

4 [1998] 1 Lloyd's Rep. 609, H.L.

latter vessels. The buyer again refused to pay and the contracts for hulls 3 and 4 were rescinded. Consistent with its previous actions, the shipbuilder then once more attempted to use the original keels (being the only keels it had assembled) to trigger the buyer's obligations to pay the keel-laying instalments for hulls 5 and 6.

Perhaps unsurprisingly in the circumstances, the English courts declined to endorse this approach,[5] holding that the notices given in respect of the keel-laying instalments for hulls 1 and 2 were valid but that those given in respect of hulls 3–6 were of no legal effect. The judgments of the House of Lords rest principally upon the argument that the parties could not have intended that the buyer's contractual right to supervise the laying of each of the keels should be defeated by the appropriation of those for hulls 1 and 2 to each of the subsequent vessels. Although, on the facts of the case, this was rather a weak argument (because the buyer had had the opportunity to supervise the laying of the two keels), it seems logical and likely that the same approach will be applied by the English courts in other cases in which hulls or parts thereof built under one shipbuilding contract are, without the consent of the buyer, unilaterally redesignated by the builder for the purposes of performance of a subsequent contract.[6]

COMPLIANCE WITH PRINCIPAL PLANS AND DRAWINGS

The contract will also typically state that the vessel is to be built in accordance with the specifications and certain defined principal plans and drawings, including a General Arrangement Plan. These will usually be initialled by the parties for ease of subsequent identification.

The specifications and such plans and drawings are often stated to be "incorporated within" or to "form an integral part of" the contract, which will include detailed provisions for determining the order of precedence between them in the event of any ambiguity or conflict. Under the SAJ Form these provisions are contained in Article XX.2.

It should be noted in passing that Article I.1 of the SAJ Form defines "the Specifications" as comprising "the Specifications and the General Arrangement Plan", i.e., the term is delineated by reference to itself. It seems unlikely, however, that this will in practice cause any significant confusion.

DIMENSIONS AND CHARACTERISTICS

Apart from her hull number, the description of the vessel contained in the contract will usually encompass her length, breadth and depth as well as her gross tonnage, hold/tank

5 Described by Lord Lloyd of Berwick at page 628 as "an artifice to enable the plaintiffs to recover six keel-laying instalments when they had laid only two keels".

6 It is submitted that, in advance of keel-laying, the builder is in principle entitled to use sub-assembled blocks originally intended for one newbuilding in the construction of another vessel provided always that the purchaser of the latter vessel is given the opportunity to inspect and approve them. More difficult issues arise, however, where parts of an abandoned newbuilding are dismantled and then reused in a subsequent hull; the parties' rights in this situation will depend entirely on the contract terms and it may be open to the purchaser in this situation to argue that the vessel has not been built of "new" materials, which may be an express or implied requirement of the shipbuilding contract.

capacity, draught and method of propulsion. The vessel's dimensions will often be expressed on a "moulded" basis, i.e., measured to the inside of her steel plating.[7]

In *Yorkshire Equipment Co. Ltd* v. *Tweed Fishing Co. Ltd* (1948),[8] the term "draught two feet six inches", when used in specifications for the sale of a small passenger vessel, was held to refer to her maximum draught fully laden (which was aft of the vessel) rather than to her mean (midships) draught.[9]

This section of the contract will usually also include details of the operational capacity of the vessel's main engine, which will often be expressed in terms of a power output at a specified percentage of her maximum continuous rating.

In *Britain Steamship Co. Ltd* v. *Lithgows Ltd* (1975),[10] a Scottish case, the technical specification forming part of a contract for a bulk carrier included a reference to "Power:—continuous service output—16,800 b.h.p . . . r.p.m: continuous service output—110". Following repeated failures of her main engine after delivery, the purchasers sued the shipbuilders alleging, *inter alia*, that the words "continuous service output" related not merely to the capacity, but also to the reliability, of the engine in service. It was argued that the shipbuilders had failed to meet the condition implied by s. 13 of the 1979 Act that the vessel should comply with her description.

This contention was rejected, Lord Maxwell holding that the engine did not cease to conform with its technical description as to power and speed of operation simply because it had repeatedly broken down. In the judge's view, the words "16,800 b.h.p." and "110 r.p.m." were incapable of referring to the reliability of the engine and related only to its "normal or 'cruising' speed" capacity. The purchasers also failed to demonstrate that the vessel was not "reasonably fit" for the purpose required of it within the meaning of the condition implied by s. 14(3) of the 1979 Act.[11]

PERFORMANCE GUARANTEES

The vessel's description will also incorporate a number of so-called "guaranteed" standards of performance, typically relating to her speed, deadweight and fuel consumption. It will usually be agreed that a breach of these guaranteed standards will entitle the buyer to claim liquidated damages and, in extreme cases, to reject the vessel and rescind the contract.[12]

The guarantees offered by the builder will, however, vary in nature depending upon the type of newbuilding involved. It is, for example, standard practice for refrigerated vessels to be sold subject to a guarantee as to cubic capacity;[13] by the same token, a contract for

7 The vessel's moulded draft is measured from her baseline to summer loadline at the midship section.

8 (1948) 82 Ll.L.Rep. 89.

9 Applying what is now s. 53(3) of the 1979 Act, the court awarded damages based upon the difference between the vessel's value had the maximum draught been as warranted and the value based upon its actual characteristics.

10 1975 S.L.T. 20.

11 See pages 120–121, *infra*.

12 See pages 74–77, *infra*.

13 This is sometimes calculated on the basis of pallets of a standard size.

a container newbuilding will usually warrant the vessel's capacity to carry a given number of loaded containers of a certain size, assumed average weight and centre of gravity. The purchasers of cruise vessels and passenger ferries will often wish to incorporate in their contracts guaranteed maximum levels of noise and vibration in cabins and public areas. The NEWBUILDCON Form specifically provides for the possibility that the parties may agree upon further performance requirements for the vessel, providing in principle for the payment of liquidated damages and the accrual of termination rights in favour of the buyer for the builder's failure to achieve the same.[14]

In *Cenargo Ltd* v. *Empresa Nacional Bazan de Construcciones Navales Militares S.A.* (2001),[15] the High Court and the Court of Appeal both held, in the context of a contract for the construction of two ro-ro ferries, that an obligation to provide "actual trailer carrying capacity of . . . 146 Units of 13 metres" referred to 146 deck "slots" of 13 metres each, rather than 146 slots capable of fitting a trailer of 13 metres in length, i.e., with each slot incorporating an appropriate additional "allowance" for clearance and manoeuvring.[16] This decision turned upon the interpretation of numerous provisions of the contract and specifications but, in determining that no allowance was required to be given, the courts clearly took into account the practical difficulties which the builder would have experienced in determining the necessary extent of any such allowance.

CLASSIFICATION AND OTHER REGULATORY REQUIREMENTS

The vessel will also be required to meet the standards defined by a recognised classification society and the requirements of a number of national and international bodies (typically known as the "regulatory authorities") which will license her operations following delivery.

(i) Classification requirements

The world's leading classification societies[17] play a critically important role in almost all commercial shipbuilding projects. In addition to providing a detailed framework of rules concerning the structure of the vessel and the working methods to be used in her construction, the classification society selected by the buyer customarily undertakes day-to-day supervision of the contract works as these proceed; in fulfilling this task, the society's surveyors will co-operate closely with the buyer's representatives and the builder's yard management team. Prior to placing an order for a newbuilding, the buyer

14 See Boxes 4E and 17 and Clauses 2(b)(vi), 12 and 39(a)(viii).

15 QBD (Comm Ct), 30 January 2001, Andrew Smith J. and [2002] EWCA Civ 524.

16 Each slot needed on average 0.15 metres additional manoeuvring and clearance space.

17 The current membership of the International Association of Classification Societies (IACS) comprises Lloyd's Register of Shipping, Bureau Veritas, Germanischer Lloyd, Det norske Veritas, American Bureau of Shipping, RINA (previously Registro Italiano Navale), the Russian Maritime Register of Shipping, China Classification Society, the Korean Register of Shipping, the Indian Register of Shipping, Nippon Kaiji Kyokai (Japan), the Croatian Register of Shipping and the Polish Register of Shipping. It is estimated that the IACS' members collectively account for over 90% of global commercial tonnage involved in international trade.

will usually have decided not only upon her intended flag but also upon his preferred choice of classification society. The buyer will not, however, always enjoy an entirely free hand in this regard, as certain shipbuilders, accustomed to dealing with the representatives of one particular classification society, will either demand a financial premium to work with another society or will refuse to do so altogether. Where the vessel is to be built to a standard design prepared by the builder and pre-approved by a particular classification society, the builder is likely to be particularly reluctant to agree that another society should supervise its implementation.[18]

Whichever society is ultimately selected, it will always be of critical importance to the buyer that the vessel should achieve the classification status appropriate for her intended operations; this will be evidenced in the society's records by a "notation", indicating the vessel's type, the standards to which she has been built and the geographical and technical limits to which she has been approved for trading. The contract and specifications will normally require that the society's rules and requirements be strictly observed throughout the course of the vessel's construction and that the agreed notation be obtained prior to delivery.

Both objectives are achieved by imposing upon the builder an obligation to procure that construction of the vessel takes place subject to "special survey" by the chosen classification society. As indicated above, this involves the attendance of the society's surveyors at the shipyard and the premises of the builder's subcontractors and suppliers during the course of the vessel's construction to inspect and approve the contract works as these proceed. As prescribed by the society's rules or otherwise directed by its local surveyors, the builder will be required either to undertake or to permit inspections and tests of the contract works to ensure compliance with the society's standards; the contract will further expressly provide that the society's decisions on questions of compliance with such standards are to be final and binding upon the parties.

In practice, most international shipbuilders are very familiar with the requirements of the societies with whom they customarily work and include provision within their construction schedule for the tests and inspections they know will be required as a condition of class approval.

Except where appointed as an arbitrator to determine technical disputes between the parties,[19] the classification society is employed by, and acts solely on behalf of, the builder, who is customarily responsible for the society's fees and charges. Approval by the society of equipment and materials intended for the vessel is not therefore equivalent to approval by the buyer.[20] By the same token, it is clear that the classification society does not, in the absence of special circumstances, owe a contractual duty of care to the buyer

18 The risks to the buyer of engaging with an unfamiliar classification society are, however, to some extent mitigated by the trend towards the harmonisation of quality standards among the IACS' membership. In 2005 the IACS Council adopted so-called Common Structural Rules for Tankers and Bulk Carriers, which are a comprehensive set of minimum requirements for the classification of the hull structures of bulk carriers and double-hull oil tankers applicable to all shipbuilding contracts signed after 31 March 2006. The IACS is additionally committed to establishing further Harmonised Common Structural Rules for Oil Tankers and Bulk Carriers, which rules are expected to be submitted to the International Maritime Organisation for verification in 2013.

19 See pages 236–237, *infra*.

20 *Reid* v. *Macbeth and Gray* [1904] A.C. 223, H.L., *per* the Earl of Halsbury L.C. (who rather extravagantly described the contrary argument as "a most monstrous proposition").

to ensure that he is not prejudiced by defects in the vessel which should have been discovered by its surveyors.[21]

Whether, alternatively, the classification society can be held liable to the buyer in tort[22] is a matter which has given rise to a great deal of controversy in recent years. The clear tendency of both the English and American courts has, however, been to avoid the imposition of tortious liability upon classification societies for losses arising from defects in vessels they have classed.[23]

In *Marc Rich & Co. AG and Others* v. *Bishop Rock Marine Co. and Others (The "Nicholas H")* (1995),[24] a case in which cargo owners sued the Japanese classification society, NKK, for alleged negligence in respect of the loss of the carrying vessel, the House of Lords again declined to hold the society liable.

Adopting the views expressed by Saville L.J. in the Court of Appeal,[25] their Lordships held that, in order to determine a defendant's liability for negligence, the court had to consider not only the usual factors of foreseeability of loss and proximity of relationship between the parties, but also whether it was in all the circumstances "fair, just and reasonable" to impose a duty of care. Given the existence of a well-established international framework, based upon the Hague Rules, for the determination of liability for cargo claims, which regime would be seriously affected by a decision holding the classification society jointly liable for cargo loss or damage, Lord Steyn ruled that it would be "unfair, unjust and unreasonable" to impose a duty of care; the judge was further influenced in making this decision by the argument that the classification societies act for the "collective welfare" in ensuring the maintenance of proper safety standards in the maritime sector.

The position of the cargo owner seeking recovery from a classification society following a total loss is, of course, very different from that a newbuilding purchaser, who is likely to have chosen the society which is to class the vessel and who will have worked closely with the society throughout the course of her construction.[26] In light, however, of the endorsement by their Lordships of the public policy argument in the "*Nicholas H*", i.e., that classification societies should retain immunity from suit for the "common good", the prospects of a newbuilding purchaser succeeding in a tort claim against a classification society for negligence in the certification of the vessel seem, at least as a matter of English law, to be very limited. Such a claimant may be better advised to contend that English law

21 Even where a contractual duty arises, most classification societies seek to limit their exposure by incorporating within their rules (and including in all correspondence) a statement that their liability is limited to a relatively modest maximum level of damages. The extent to which such limitations of liability are legally effective will depend upon the precise wording used, whether proper and timely notice thereof was given to the party affected (i.e., the builder or the buyer) and the judicial forum in which the limitations are sought to be relied upon.

22 That is, for negligence in certification of the vessel.

23 See *The "Sundancer"* [1994] 1 Lloyd's Rep. 183; *Mariola Marine Corporation* v. *Lloyd's Register of Shipping (The "Morning Watch")* [1990] 1 Lloyd's Rep. 547; *Great American Insurance Co. and Others* v. *Bureau Veritas (The "Tradeways II")* [1973] 1 Lloyd's Rep. 273; and *The Shipping Corporation of India Ltd* v. *American Bureau of Shipping* [1990] A.M.C. 2882 (both U.S. District Court, Southern District of New York).

24 [1995] 2 Lloyd's Rep. 299, H.L.

25 [1994] 1 Lloyd's Rep. 492 at page 496.

26 In Lord Steyn's judgment in the *"Nicholas H"*, one of the factors leading him to deny the claim was that the cargo owners were entirely unaware that, prior to her last voyage, NKK had specifically approved the temporary repairs which had led to her subsequent total loss.

is not applicable to the issue of the classification society's liability[27] or even to bring proceedings in another jurisdiction, if this is possible.[28]

It should finally be noted that, in common with Article I.3 of the SAJ Form, most shipbuilding contracts expressly provide that the classification society should be the final arbiter of the vessel's compliance or non-compliance with its own rules and regulations. Such provisions are normally clear and rarely give rise to disputes, although issues may arise as to the correctness of the basis upon which the classification society in question has chosen to interpret its rules and requirements.

In *Riva Bella S.A.* v. *Tamsen Yachts GmbH* (2011),[29] the High Court was called upon to decide upon the correct interpretation of the class notation "RINA Charter Class (MCA)" in the context of a dispute concerning the sale and purchase of a "super yacht" newbuilding. It was common ground between the parties that the phrase "MCA" was intended by the parties to refer to the UK Maritime and Coastguard Agency Large Commercial Yacht Code ("LY2"), a UK regulatory code which had been adopted by various flag states, including that of the Isle of Man, where the yacht was to be registered; the parties differed, however, as to whether the RINA was entitled to apply the Code in accordance with its own (and the Isle of Man's) interpretation of its requirements or was obliged to apply a stricter interpretation adopted by the MCA. Perhaps unsurprisingly, the judge, Eder J., held that "the question was not whether the yacht was LY2 compliant in the abstract, but whether it was compliant with LY2 as it was going to be applied by the [Isle of Man] flag administration".

Finally, it should be noted that the SAJ Form provides that the classification (and other regulatory) requirements with which the vessel is required to be built should be those "in force as of the date of this Contract". This obviously imposes upon the buyer the risk of changes to such requirements entering into force in the period between contract signature and delivery of the vessel, and such wording is in practice often unacceptable to the buyer.

Recognising this, the NEWBUILDCON Form provides (at Clause 3(a)) that the vessel must comply with both the Class rules in force at the time of contract signing and those:

"... which are ratified and promulgated on or before the date of this Contract and which will be compulsory for the Vessel on or before ... delivery".

27 As a matter of English law, issues of the tortious liability of classification societies will normally fall to be determined in accordance with European Regulation (EC) No. 864/2007 on the Law Applicable to Non-Contractual Obligations. The general rule (Article 4(1)) is that the applicable law will be that of the country in which the damage caused by the breach of duty occurs (or is likely to occur).

28 For example, Italy: see in this context the decision of the Court of Genoa on 24 February 2010 in *Argos Shipping Agency S.r.l.* v. *Lloyd's Register of Shipping* (Il Diritto Marittimo, I/2011, pp. 230–251). However, in *Reino de Espana* v. *The American Bureau of Shipping Inc.*, 729 F.Supp.2d 635, 646 (S.D.N.Y., 2010) the Southern District Court of New York rejected Spain's attempt to establish liability on the part of American Bureau of Shipping in classifying the m.v. *"Prestige"*, whose sinking had led to major pollution damage, as fit to carry heavy fuel oil cargoes. The court held, *inter alia*, that the level of fees payable by the shipowner to ABS was inconsistent with an intention to allocate liability for pollution damage caused by the vessel. Furthermore, in a judgment rendered in March 2010 in proceedings also arising out of the "*Erika*" oil spill (Cour d'appel de Paris, pôle 4, 11 ch., 30 March 2010, RG No. 08/02278), the French Court of Appeal held that, in issuing statutory and safety certificates in respect of the vessel, the Italian classification society, RINA, had acted as an agent of the vessel's flag state, Malta, and, but for a procedural failure to take this point earlier in the proceedings, would have been entitled to assert a sovereign immunity defence; an appeal against the Court's findings of RINA's criminal and civil liability is currently on foot.

29 [2011] EWHC 1434 (Comm),

The builder therefore assumes the exclusive responsibility of ensuring that rules and regulations which enter into effect after contract execution are reflected in the design or construction of the vessel provided that these are in prospect at the time of signature as compulsorily applicable before delivery; where other changes take place in relation to the regulatory regime, these are normally dealt with by way of variations to the contract.[30]

(ii) Regulatory requirements

Apart from satisfying the requirements of the classification society, the vessel will need to comply with the rules for vessels of her type and size promulgated by a number of relevant regulatory authorities; these will usually comprise the maritime authorities of the vessel's country of registry and of the nations to which she is likely to trade. Thus, for example, it is common practice for ocean-going vessels to be built and equipped to the standards of the Panama and Suez Canal authorities; similarly, passenger cruise vessels will be constructed to meet the rules of the United States Coast Guard and US Public Health Service, particularly if they are to be operated to and from American ports, e.g., in the Caribbean cruise market.

The builder's task is, however, facilitated by international arrangements under which various IACS classification societies act on behalf of a number of flag and other authorities in issuing certain of the relevant approvals, in particular those evidenced by her SOLAS certificates. Furthermore, a significant proportion of international shipbuilding projects are undertaken on the basis of standardised specifications produced and marketed by the builder, which will have been prepared to ensure compliance with all the safety and trading regulations usually applicable to a newbuilding of the type in question. Subject to any changes in the relevant rules, specifications of this type will need to be revised only if the buyer considers that particular features of the vessel's intended trading pattern require her compliance with different or additional regulatory standards.

As part of, or in addition to, meeting the requirements of defined regulatory authorities, the contract will also provide that the vessel must comply with a number of International Conventions concluded under the auspices of the International Maritime Organisation (IMO). While these requirements will vary depending upon the type of vessel involved and the expected nature and range of her trading activities, most newbuildings will need at a minimum to comply with the following international conventions and protocols thereto (each as subsequently amended):

(1) the International Convention on Load Lines of Ships 1966 ("LL 1966") (and Protocol of 1988);
(2) the International Convention on Tonnage Measurement of Ships 1969;
(3) the International Convention for the Prevention of Collisions at Sea 1972 ("COLREG 1972") (including amendments in 1981, 1987, 1989, 1993, 2001 and 2007);
(4) the International Convention for the Prevention of Pollution from Ships 1973 (and Protocol of 1978) ("MARPOL 73/78");
(5) the International Convention for the Safety of Life at Sea 1974 ("SOLAS 1974") (and Protocols and amendments of 1978, 1981, 1983, 1988 and 1994); and

30 See pages 92–93, *infra*.

(6) the International Convention on the Control of Harmful Anti-Fouling Systems on Ships ("AFS 2001").

All newbuildings which are to trade internationally are also required to hold, among others, the following SOLAS certificates issued by or on behalf of their flag authorities:

(a) for cargo ships of 500 tons gross or more:
  (i) a Cargo Ship Safety Construction Certificate;
  (ii) a Cargo Ship Safety Equipment Certificate;
  (iii) a Cargo Ship Safety Radio Telegraphy (or Telephony) Certificate;
(b) for passenger vessels: a Passenger Ship Safety Certificate; and
(c) for all cargo ships of 500 tons gross or more (save as otherwise indicated below) and all passenger vessels:
  (i) an International Ship Security Certificate and a Ship Security Plan according to the ISPS Code;
  (ii) a Safety Management Certificate according to the ISM Code;
  (iii) a Continuous Synopsis Record;
  (iv) an International Air Pollution Prevention Certificate (for all ships of 400 tons gross or more);
  (v) an International Sewage Pollution Prevention Certificate (for all ships of 400 tons gross or more);
  (vi) an International Anti-fouling System Certificate;
  (vii) a Radio Station Licence; and
  (viii) (for all ships of 1,000 tons gross or more) a Bunker Convention Certificate pursuant to the 2001 International Convention on Civil Liability for Bunker Oil Pollution Damage.

It should also be noted that in May 2010 the IMO formally adopted so-called "Goal-based Ship Construction Standards for Bulk Carriers and Oil Tankers", which together with amendments to Chapter II-1 of SOLAS, will require all such vessels of 150 metres and above to be designed and constructed for a specified design life and to be safe and environmentally friendly, in intact and specified damage conditions, throughout such life. These new requirements (which apply to all such vessels for which the shipbuilding contract has been concluded on or after 1 July 2016, the keels have been laid on or after 1 July 2017, or the delivery of which has been effected on or after 1 July 2020) stipulate that, upon the delivery of a newbuilding, the shipbuilder must supply to the purchaser a Ship Construction File detailing "how the functional requirements of the Goal-based Ship Construction Standards for Bulk Carriers and Oil Tankers have been applied in the ship design and construction"; this must be kept on board the vessel and updated throughout her service life.

Furthermore, since 2003 the IMO has been pursuing extensive initiatives to limit "greenhouse gas" (GHG) emissions from ships. In July 2011, the IMO's Marine Environment Protection Committee (MEPC) agreed to add a new Chapter 4 to the MARPOL Annex VI (Regulations for the prevention of air pollution from ships) in order to make mandatory in respect of each newbuilding of 400 gross tonnes and above the provision of an Energy Efficiency Design Index (EEDI) and the Ship Energy Efficiency Management Plan; these requirements are expected to enter into force on 1 January 2013.

Depending on their ship type (namely, oil and gas tankers, bulk carriers, general cargo and container ships) the new MARPOL regulations essentially establish for newbuildings an energy efficiency benchmark defined in terms of grams of CO_2 per ship's capacity-mile. Pursuant to a set of guidelines adopted by MEPC in March 2012 to assist in the implementation of these regulations,[31] it is envisaged that the EEDI verification process will be conducted in two stages: namely, preliminary verification at the design stage and final verification of the actual EEDI at sea trial. If a newbuilding has an EEDI higher than the agreed mandatory benchmark, she will need either to have her engines de-rated or other design adaptations made by the builder before the flag state will agree to register her.

In contractual terms, responsibility for ensuring that the vessel's construction and outfitting comply with the agreed regulatory requirements will almost invariably rest with the builder. Thus, Article I.3 of the SAJ Form requires that, in addition to meeting class requirements, the vessel should on delivery comply with the "*rules, regulations and requirements of other regulatory bodies as described in the Specifications*", which (on the usual assumption that these encompass MARPOL) will implicitly provide for the provision of an EEDI and Ship Energy Efficiency Management Plan as soon as these become mandatory. Clause 3(a) of the NEWBUILDCON Form similarly requires that the vessel should be constructed in accordance with the rules and regulations of the "Regulatory Authorities", which are required to be defined by the parties in the Specification.[32]

(iii) Disputes

Under each of the SAJ, NEWBUILDCON and CMAC Forms, disputes between the parties as to whether or not the vessel complies with the rules and requirements of the classification society are exclusively to be determined by the society,[33] whose decision is binding upon them.[34] The NEWBUILDCON and CMAC Forms also apply this principle to decisions of the relevant regulatory authorities, who are empowered on an exclusive basis to determine the vessel's compliance or otherwise with their rules and requirements.

QUALITY STANDARDS AND QUALITY ASSURANCE

In addition to complying with classification and other regulatory requirements, the shipbuilding contract will often specifically provide for a generalised quality standard or standards to which the vessel is to be built. Such language must, however, be added as an adjunct to the SAJ Form, which makes no provision at all for any quality standard.

31 See the "2012 Guidelines on the method of calculation of the attained Energy Efficiency Design Index (EEDI) for new ships" (resolution MEPC.212(63)), the "2012 Guidelines on survey and certification of the Energy Efficiency Design Index (EEDI)" (resolution MEPC.214(63)), and the "Guidelines for calculation of reference lines for use with the Energy Efficiency Design Index (EEDI)" (resolution MEPC.215(63)).

32 For discussion of the requirement for so-called "Green Passports", see page 283, *infra*.

33 Article I.3 of the SAJ Form, Clause 42(a) of the NEWBUILDCON Form and Article XXVI of the CMAC Form.

34 In the case of the NEWBUILDCON Form, the stipulation applies only to "final" decisions of the classification society or regulatory authority; see Article 3(b) of Section 1. The term "final" is not defined.

In contrast, Clause 1 of the NEWBUILDCON Form provides that the shipbuilder:

"shall design, construct, test and survey, launch, equip, complete, sell and deliver the Vessel to the Buyer all in accordance with good international shipbuilding and marine engineering practice".

Given the enormous range in conditions and standards under which shipbuilding is conducted in dozens of countries worldwide, it is nevertheless questionable whether any real meaning can be attributed to the requirement to build in accordance with "good international . . . practice".

Alternatively, and more precisely, the quality standards stipulated by the contract may be defined as "highest" or "first-class" standards in the country or, more frequently, the continent of the vessel's construction, e.g., "highest West European shipbuilding standards".[35] It is also sometimes the case, particularly in relation to cruise vessels and super yachts, that the standards to be achieved by the builder are defined by reference to a named existing vessel, which will normally have been inspected by the builder prior to signature of the shipbuilding contract.

In an unreported arbitration award issued in 2011, London arbitrators held that an obligation to construct a series of vessels "in accordance with first-class shipbuilding practice in Europe for new vessels of similar type and characteristics as the vessel" imported more than an obligation to meet the agreed class standards under the contracts; the tribunal relied in part on a non-marine decision, *Rolls-Royce Power Engineering plc* v. *Ricardo Consulting Engineers Ltd* (2004)[36] in which, in the context of a contract for design services, the High Court held that the words "of first class quality" meant that the services would be provided "to a standard which would not be exceeded by anyone who might actually have been engaged to provide them".[37]

In addition to defining the quality standards which the completed vessel must meet, the contract will often also provide for the compulsory application in her construction of recognised Quality Assurance (QA) techniques. Although this is not reflected in any of the SAJ, CMAC and NEWBUILDCON Forms, some shipbuilding contracts stipulate, either in the body of the agreement itself or in the specifications, the specific QA standards which must be followed.

QA, which was first developed as a management tool in the US defence industries in the 1950s, involves the implementation and maintenance within an entire production process of approved systems and methods, usually conforming to recognised national or international standards. These systems, which are primarily geared to ensuring that the contractor's organisation and procedures will identify and eliminate defects in the manufactured article, rely heavily upon the use of computer or paper-based auditing techniques employed at each stage of the manufacturing process, from design to final completion.[38]

In the absence of a national standards organisation, American QA techniques originally developed on a company-by-company basis. In the UK, however, the British Standards Institution refined a number of common standards into the so-called British Standard

35 Article 1 of the Norwegian Standard Shipbuilding Contract of 1999 provides that: "The Vessel shall be designed and built in accordance with first-class shipbuilding practice in Western Europe for new vessels of similar type and characteristics as the Vessel."

36 [2004] 2 All E.R. (Comm) 129.

37 *Per* Judge Seymour Q.C. at paragraph 84 of his judgment.

38 QA should as such be distinguished from Quality Control, which is the application of defined quality standards to the physical items comprising the manufactured article, e.g., the vessel.

5750, which was in due course adopted throughout Europe and thereafter by the International Standards Organisation ("ISO") as its standard ISO 9000.

In order to achieve this standard the contractor is required to develop quality systems, which are defined in a quality manual, and to be assessed by an accredited assessor. In many countries, the assessors are themselves accredited by a governmental agency to ensure uniformity of standards.

The ISO 9000 standard applies at three principal levels, ISO 9001, 9002 and 9003, depending upon the type of activity in which the manufacturer or supplier is engaged. For most shipbuilders, the important standard is ISO 9001, which is intended for manufacturers and suppliers who can[39] undertake the complete process of design and construction of an engineered product. ISO 9002 is the relevant standard for contractors who do not undertake design and development, and may therefore be more appropriate for the builder's smaller subcontractors providing specific goods and materials for use in the project.

SUBCONTRACTING

The contract will normally contain specific provisions defining and limiting the extent of the builder's rights to subcontract the contract works. While the buyer will not be concerned with minor items of subcontracted work or supply, the right to approve major subcontractors and suppliers represents an important tool in ensuring full compliance with the quality standards stipulated in the contract. The buyer will also have in mind that the extent to which the works are subcontracted will affect his costs of supervision.

Normal shipbuilding practice is therefore to require that, at least in relation to substantial elements of construction and outfitting, the builder may delegate the contract works only with the buyer's prior approval in writing, the same not to be "unreasonably" withheld. In order to minimise the potential for delay in obtaining such consent, the contract or specifications will often incorporate a list of subcontractors and suppliers, usually known as the "Makers' List", which have been pre-approved by the buyer. This will frequently include a number of different subcontractors or suppliers for the same item, in which event the builder will usually be entitled to make the final selection; if his choice is subsequently overruled by the buyer, the latter will be obliged to pay any additional costs incurred by the builder as a result of such decision.[40]

Where the builder employs a subcontractor to undertake parts of the construction or outfitting of the vessel, the builder naturally remains liable in full for the performance of the works he has delegated.[41] It may, however, sometimes be agreed between the buyer and the builder that, in respect of the post-delivery period, the builder will, instead of providing his own warranty, either assign to the buyer the benefit of any guarantees provided to him by the subcontractor or procure that these are issued to the buyer directly. Even if this is not done, the buyer may in certain circumstances be entitled to claim in tort

39 Albeit with the assistance of subcontractors.

40 This may or may not be regarded as a formal modification of the specifications.

41 Where, as occasionally occurs in a shipbuilding contract, the builder lawfully delegates to a subcontractor performance of the entire contract, the builder is not thereby precluded from claiming the contract price or damages from the buyer; see *Bay Hotel & Resort Ltd* v. *Cavalier Construction Co. Ltd* [2001] UKPC 34, P.C.

directly against the subcontractor if the design or construction of a subcontracted item has been negligently undertaken.[42]

Furthermore, in certain circumstances falling within the scope of the Contract (Rights of Third Parties) Act 1999, the purchaser may be entitled to enforce directly against the builder's subcontractors claims for breach of the quality provisions of the relevant subcontracts.

Such rights arise (in the absence of agreement to the contrary) where either (i) the subcontract expressly provides that the buyer may exercise such rights or (ii) the builder and his subcontractor have intended by their subcontract to confer an entitlement upon the buyer to do so. The buyer must "be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into".[43] Clearly, the mere fact that the buyer has benefited from the work undertaken by the subcontractor will not in itself be sufficient to generate statutory rights in favour of the buyer; however, such rights would, for example, normally arise where the subcontractor had warranted the suitability or fitness for purpose of the subcontract works to each of the builder and "any purchaser" of the vessel whether or not specifically identified in the subcontract.[44] The fact that such third party rights have been granted does not prevent enforcement of the subcontract by the builder himself[45] and this will, of course, represent the normal course of events in the case of any quality failure on the part of his subcontractor.

Under Article I.4 of the SAJ Form the builder is permitted a general liberty to subcontract the contract works entirely without reference to the buyer. This is, however, contrary to modern shipbuilding practice and, where this form is used as the basis of the contract, Article I.4 is usually either deleted or substantially amended.

In contrast, Article X of the CMAC Form qualifies the builder's liberty to subcontract the contract works in two ways. First, it provides that such subcontracting shall be "to qualified and experienced subcontractors as set out in the Specifications of (sic) the Maker's List", which would, surprisingly, appear to prevent the builder from engaging subcontractors who are not so listed. Secondly, and in any event, the CMAC Form requires that "delivery and final assembly into the Vessel of any such work subcontracted shall be at the Builder's Shipyard".

The NEWBUILDCON Form is similarly favourable to the purchaser, committing the builder to employ "the Sub-contractors as set out in the Specification or Maker's List", and providing that "Except for minor work, the Builder shall not employ other subcontractors without the Buyer's approval, which shall not be unreasonably withheld".[46] The meaning of "minor work" is, however, left undefined.

42 See, e.g., *Diamante Sociedad de Transportes S.A.* v. *Todd Oil Burners Ltd (The "Diamantis Pateras")* [1966] 1 Lloyd's Rep. 179 where a duty of care was held to arise between a subcontractor and the purchaser of a newbuilding, although the claim failed on the facts. Where, however, the claim is for pure economic loss (e.g., the costs of replacing the defective part) the claim will succeed only if there is "sufficient proximity" between the buyer and the subcontractor. In *Hamble Fisheries* v. *L. Gardner & Sons (The "Rebecca Elaine")* [1999] 2 Lloyd's Rep. 1, the Court of Appeal held that no such special relationship of proximity imposing a duty to safeguard from pure economic loss existed between the manufacturer of marine engines and the owners of the vessels equipped with them; see also to the same effect the decision of the Singapore Court of Appeal in *Man B.W. Diesel S.E. Asia Pte Ltd and Another* v. *Bumi International Tankers* [2005] L.R.C. 1.

43 Section 1(5) of the Act.

44 See generally pages 250–251, *infra*.

45 That is, the statutory rights are additional to, and not in substitution for, the rights of the builder as the original contracting party to the subcontract.

46 Lines 326–328.

Finally, although it will be the builder, rather than the buyer who will usually seek the liberty to subcontract, the latter may wish to delegate the task of approving plans and supervising the construction of the vessel. The contract will usually contain no restriction upon the buyer's right in this respect, although it may sometimes be agreed that the use by the buyer of external consultants should be subject to the builder's prior approval.

REGISTRATION

Whether title to the vessel is to pass at the time of delivery or beforehand, it is customary for the buyer to bear all of the costs of registration under the chosen flag. The builder will nevertheless usually be required by the contract to provide on delivery, duly notarised and legalised, the bill of sale or builder's certificate upon which the buyer's application for registration will principally be based. Furthermore, if the terms of sale include a builder's credit secured by a mortgage on the vessel, it may sometimes be agreed that the costs of registration of the same should be for the builder's account.

Under Article I.5 of the SAJ Form, the buyer assumes a positive obligation upon delivery and acceptance of the vessel to enter her on the agreed register; similar commitments are provided for under Article XVIII of the CMAC Form and Clause 33 of the NEWBUILDCON Form. Unless the contract price incorporates a builder's credit to be secured by a mortgage in his favour, performance of this obligation is, however, unlikely to be a matter of great practical concern to the builder.

Article II—Contract price and terms of payment

1. Contract Price:

The purchase price of the VESSEL is ..... Japanese Yen (¥.....), net receivable by the BUILDER (herein called the "Contract Price"), which is exclusive of the BUYER's Supplies as provided in Article XVII hereof and shall be subject to upward or downward adjustment, if any, as hereinafter set forth in this Contract.

2. Currency

Any and all payments by the BUYER to the BUILDER under this Contract shall be made in non-resident convertible free Japanese Yen.

3. Terms of Payment

The Contract Price shall be paid by the BUYER to the BUILDER in instalments as follows:

(a) 1st Instalment:

The sum of ..... Japanese Yen (¥.....) shall be paid upon issuance by the Japanese Government of the Export License for the VESSEL.

(b) 2nd Instalment:

The sum of ..... Japanese Yen (¥.....) shall be paid upon keel-laying of the VESSEL.

(c) 3rd Instalment:

The sum of ..... Japanese Yen (¥.....) shall be paid upon launching of the VESSEL.

(d) 4th Instalment:

The sum of ..... Japanese Yen (¥.....)

plus any increase or minus any decrease due to adjustments of the Contract Price hereunder, shall be paid upon delivery of the VESSEL.

4. Method of Payment:

(a) 1st Instalment:

Upon receipt of a cable notice from the BUILDER of issuance by the Japanese Government of the Export License for the VESSEL, the BUYER shall remit the amount of this Instalment by telegraphic transfer to The ..... Bank, Ltd., Tokyo, Japan (herein called "..... Bank") for the account of the BUILDER.

(b) 2nd Instalment:

Upon receipt of a cable notice from the BUILDER of keel-laying of the VESSEL having been made, the BUYER shall remit the amount of this Instalment by telegraphic transfer to ..... Bank for the account of the BUILDER.

(c) 3rd Instalment:

Upon receipt of a cable notice from the BUILDER of launching of the VESSEL having been made, the BUYER shall remit the amount of this Instalment by telegraphic transfer to ..... Bank for the account of the BUILDER.

(d) 4th Instalment:

The BUYER shall, at least seven (7) days prior to the scheduled delivery date of the VESSEL, either cause a prime bank acceptable to the BUILDER to issue an irrevocable letter of credit in favour of the BUILDER through, or make cash deposit with, ... Bank, covering the amount of this Instalment as adjusted, available or releasable to the BUILDER against a signed copy of the Protocol of Delivery and Acceptance of the VESSEL as set forth in Paragraph 3 of Article VII hereof.

No payment under this Contract shall be delayed or withheld by the BUYER on account of any dispute or disagreement of whatever nature arising between the parties hereto.

5. Prepayment:

Prepayment of any Instalment due on or before delivery of the VESSEL shall be subject to mutual agreement between the parties hereto and also subject to approval of the Japanese Government.

Almost all large scale shipbuilding contracts are concluded on the basis of the buyer's acceptance of a fixed price quotation provided to him by the builder; a preliminary figure will usually have been agreed in principle at an early stage of the negotiations on the basis that this will be finalised when the precise scope of the specifications is agreed prior to signature of the contract. It is usual for the price to be paid in a number of instalments falling due before, upon and (where credit terms are extended to the buyer) after delivery of the vessel.

The contract will normally define those elements of the overall project cost which are included within the builder's quotation. In addition to the basic price of the completed vessel, the contract price will usually incorporate the costs of conducting all necessary tests and trials of the vessel and all charges levied by the classification society and the regulatory authorities in connection with their supervision of her construction and the issuance of relevant certificates; it will not normally include either the cost of the buyer's supplies or any expenses associated with the vessel's registration upon delivery.

The contract price having been finally agreed, this will normally be capable of adjustment only in the event of modifications to the specifications or to reflect any

liquidated damages payable by the builder as a result of delays in delivery or technical deficiencies in the vessel. It is relatively rare for international shipbuilding contracts to incorporate price escalation provisions of the type often seen in the context of non-marine construction projects,[1] and neither the SAJ nor NEWBUILDCON Forms make any reference to escalation of the price by reference to the builder's general costs. Where, exceptionally, an escalation clause is agreed in the context of either of these forms, this will typically be referenced to steel prices (and may, indeed, also provide for price reductions in the event that such prices fall between the effective date of the contract and the expected date of ordering by the builder). The clause will usually either be based upon an assumed price for a specified type and quantity of steel as quoted at the time of contracting by one or more specified steel mills or will use an established third-party index such as the MEPS International Steel Review.[2]

In contrast with the SAJ and NEWBUILDCON Forms, the CMAC Form seeks to allow the builder considerable theoretical scope for adjustment of the contract price both (i) by reason of increases in his costs of steel and main propulsive machinery for the vessel; and (ii) as a result of currency fluctuations between the Yuan and the US Dollar in the period between contract signature and delivery. These provisions[3] are, however, very loosely drafted and, given current international practice regarding the management of materials costs and currency risks, it seems unlikely that they would be accepted by most international purchasers of export newbuildings.

Apart from the fundamental issue of the price of the vessel, the buyer and the builder will each have a direct and substantial interest in questions of the timing and currency of payment for the vessel. These issues will themselves both influence, and be affected by, a key element in any major shipbuilding project, namely the source and terms of the financing required by the builder to meet the costs of construction and by the buyer to pay the contract price.

FINANCING THE NEWBUILDING

The substantial cost and time-scale of any major shipbuilding project combine to ensure that financing will almost always be required by one or both of the parties. This may be provided either on arm's length commercial terms or, depending upon the state or region in which the shipyard is located, as part of a government-funded subsidy programme designed to assist local shipbuilders in securing newbuilding orders.

(1) Financing for the builder

The buyer's instalments

In most shipbuilding projects, the primary source of financing for the builder lies in the pre-delivery instalments of the contract price payable by the buyer. In addition to assisting

1 But note the effect of clauses of the type considered in *Harland & Wolff Ltd* v. *Lakeport Navigation Co. Panama S.A.* [1974] 1 Lloyd's Rep. 301, see pages 72–73, *infra* and the escalation provisions referred to in the London arbitration proceedings reported at (2006) 707 L.M.L.N. 3; the arbitrators held in their award that the price escalation provisions of the shipbuilding contract in question applied in favour of the builder notwithstanding that his failure to deliver the vessel on time had triggered the contract price increase.

2 http://www.meps.co.uk/publications/international_steel_review.htm.

3 See Articles VI.6 and VI.7.

the builder in meeting the costs of construction, the practice of requiring the buyer to pay the contract price by instalments involves him in making a gradually increasing financial commitment to the project. This is perceived (sometimes erroneously) to reduce the risk that the buyer will attempt to resile from his contractual obligations should his own requirements or the newbuilding market generally change during the construction period.

The amount and timing of the pre-delivery instalments payable by the buyer will, however, vary significantly from project to project. Much will depend upon a variety of factors, including the contract price, the bargaining position of the parties, the buyer's financial strength, whether a builder's credit is to be provided[4] and in whom title to the vessel is to be vested during the construction period. If (as is usual) the builder is to retain title until delivery, his ability to provide a satisfactory and adequate refund guarantee will often be the critical factor in determining how much is paid for the vessel before the buyer takes delivery.

As a matter of English law, where the price of goods is payable by a series of instalments, the purchaser's failure to pay an instalment gives rise to a claim against him in debt rather than in damages; this is so even if title to the goods remains in the seller until the contract price has been paid in full. Section 49(2) of the 1979 Act provides that, "Where . . . the price is payable on a date certain irrespective of delivery, and the buyer wrongfully neglects or refuses to pay such price, the seller may maintain an action for the price, although the property in the goods has not passed . . . ".

In *Workman, Clark & Co. Ltd* v. *Lloyd Brazileno* (1908),[5] it was argued by the defendant purchasers of a newbuilding that s. 49(2) did not extend to a contract for sale of goods under which the price was payable by instalments.[6] It was therefore contended, on the basis of certain complex (and now discarded) English rules of pleading, that a claim for non-payment of the keel-laying instalment could be enforced only by an action for damages brought after the vessel had been sold consequent upon the purchasers' default.

The Court of Appeal held, however, that s. 49(2) was applicable to sale contracts in which the price was payable by instalments, whether or not title to the goods had passed. An instalment of the price was payable on a "date certain" for the purposes of the sub-section notwithstanding that this was defined by reference to an event (e.g., keel-laying) the occurrence of which depended upon the progress of the vessel's construction.[7]

Additional financing

The pre-delivery instalments of the contract price are nevertheless unlikely to represent a sufficient source of financing for the construction and outfitting of the vessel. Furthermore, the timing of the payments, which the buyer will usually wish to spread evenly over the construction period, will not normally coincide with the builder's funding requirements,

4 See pages 43–44, *infra*.

5 [1908] 1 K.B. 968.

6 The Court was considering identical wording in the 1893 Sale of Goods Act.

7 Section 49(2) nevertheless applies only where the price is payable "irrespective of delivery". Where (as is almost invariably agreed) the final instalment of the contract price falls due only upon delivery and acceptance of the vessel, the section will not avail the builder, whose remedy will be a claim in damages under s. 50(1) for non-acceptance.

which will often be heaviest at the outset of the project, when down payments and deposits are required to be made to suppliers and subcontractors. It is accordingly common for the builder to supplement the pre-delivery instalments of the contract price with construction financing obtained from his own sources.[8]

The precise terms of such financing will obviously depend upon the builder's financial position, the amount of funding needed and the period of time for which it is required. Particularly where the builder is to procure for him a satisfactory refund guarantee,[9] these issues are unlikely to be of direct concern to the buyer and will not therefore usually be reflected in the provisions of the contract itself.

The builder's financing requirements may, however, affect the project in two respects. First, the builder's financiers will often wish to take an assignment of the benefit of the contract, to which the buyer will usually be asked to consent. The contract may, however, expressly provide that the builder may assign its benefits without the consent of the buyer.

Secondly, in certain European shipbuilding jurisdictions,[10] it is possible for the builder to create and register a mortgage over the partly-built vessel to secure construction financing; such mortgage will obviously be redeemed prior to delivery in order to permit the buyer to take the vessel free of all encumbrances. During the construction period, however, the existence of the mortgage will usually ensure that it is the mortgagee, rather than the liquidator of the builder, who will be entitled to dispose of the vessel in the event of the builder's insolvency. Where the vessel's construction is to be financed on a mortgage basis, the buyer may therefore wish at the outset to reach a separate agreement with the mortgagee permitting him an option to purchase the vessel should the builder default and the mortgagee enter into legal possession.

(2) Financing for the buyer

Financing provided to the buyer to assist in the purchase of the vessel may take one of two forms:

(a) terms of sale under which the builder agrees to defer payment of part of the contract price for a period after delivery of the vessel (known as a builder's credit); and
(b) loan facilities provided directly to the buyer to permit him to pay the contract price in full before accepting delivery of the vessel (known as a buyer's credit).

8 The builder will sometimes seek to make the securing of construction finance a condition precedent to the effectiveness of the contract; see, e.g., *Gyllenhammar & Partners International Ltd* v. *Sour Brodogradevna Industrija* [1989] 2 Lloyd's Rep. 403.

9 That is, a guarantee that, if the contract is lawfully rescinded by the buyer consequent upon the builder's default, the pre-delivery instalments paid by the buyer will be refunded to him with interest thereon, see pages 289–293, *infra*.

10 Most significantly, Germany, Finland and Croatia. The 1967 Brussels Convention relating to the Registration of Rights in respect of Vessels under Construction (http://www.admiraltylawguide.com/conven/construction1967.html) has been ratified by only four states (Norway, Sweden, Greece and the former Yugoslavia) and is not yet in force.

(i) Builder's credits

It is relatively unusual in modern shipbuilding projects for the builder to offer credit terms to the buyer. The more common approach is for the buyer to secure his own financing, which will nevertheless frequently be provided, or supported, by government financing agencies in the builder's country of domicile.

Where a builder's credit is to be provided, the buyer will usually be required to pay only a small percentage (typically in the order of 20–30%) of the total contract price before taking delivery of the vessel; the balance of the price, together with interest at a fixed or floating rate on the deferred portion, will then be payable in annual or semi-annual instalments over an agreed period commencing upon the date of delivery and acceptance of the vessel.

In such circumstances, the buyer's payment obligations may be evidenced by promissory notes which he will be required under the contract to execute and furnish to the builder as a condition of taking delivery. Both the notes and the contract itself will typically include acceleration provisions rendering the balance of the contract price payable immediately and in full at the builder's option in the event that any note is dishonoured or another defined financial default occurs; such terms do not impose a penalty upon the buyer and are therefore legally enforceable.[11]

Where the builder agrees to extend credit terms, it is unusual for these to be financed from his own resources. When making a contract proposal to the buyer involving credit terms, the builder will normally arrange for either a bank or a government export credit agency to take over the provision of the facility on delivery of the vessel. In such cases the bank or government agency will pay to the builder the outstanding balance of the contract price and will assume, either by way of endorsement or assignment, the builder's rights under the promissory notes and any associated security instruments.

In this situation, the builder will seek in the pre-contract negotiations to ensure that the contract terms reflect the security requirements of the bank or government agency providing the financing. These will obviously vary depending upon the precise identity of the parties involved. Typically, however, the lender will wish to hold as security for payment of the promissory notes a bank guarantee issued on behalf of the buyer and/or a mortgage over the vessel and assignments of her insurance and earnings; it may also in certain circumstances require full or partial recourse to the builder in the event of the buyer's default in repayment.[12]

SAJ Form variations

The SAJ Form makes provision for the extension of a builder's credit on terms contained in three so-called "Variations" to the standard wording. The Variations comprise revised wordings of certain articles of the standard contract to reflect a sale on credit terms and draft forms of certain financial instruments to be executed in favour of the builder as

11 *Oresundsvarvet Aktiebolaget* v. *Marcos Diamantis Lemos* [1988] 1 Lloyd's Rep. 122.

12 See, e.g., the agreement reached between the shipbuilders and the Japanese trading house, Kanetmatsu-Gosho, in *Anangel Atlas Compania Naviera S.A. and others* v. *Ishikawajima-Harima Heavy Industries Co. Ltd (No. 2)* [1990] 2 Lloyd's Rep. 526 at page 540.

security for the buyer's post-delivery obligations. However, as these are no longer in general use in export newbuilding projects, they are not considered further here.

(ii) Buyer's credits

If, as is usually the case in modern shipbuilding, the builder wishes to contract on the basis that the contract price is paid in full by the time of delivery, the buyer will normally require financing to permit him to make payment. Depending upon the amounts involved, this requirement may extend not merely to the delivery instalment but also to some or all of the instalments payable during the construction period. Such financing may either be arranged by the builder, in which event it will be offered to the buyer as part of an overall contract package, or obtained by the buyer directly from his own sources.

As with a builder's credit, the loan made to the buyer will be repayable over an agreed period of time commencing from the vessel's delivery and acceptance under the contract. The terms of, and security for, the loan will usually be the subject of detailed negotiation between the buyer and the lender.

(3) Subsidies

Whichever of the above structures is employed, the shipbuilding project may, depending upon the type of vessel and the nationality of the parties, attract the application of governmental subsidies to reduce its true cost. These usually fall within one of three broad categories, namely:

(a) direct payments made to the builder to reduce the basic cost of the vessel's construction;
(b) the provision of guarantees and subsidy payments (the latter often called "interest makeups") to permit financing to be extended to the buyer on preferential terms[13]; and
(c) tax concessions (in particular capital and depreciation allowances) allowed to the buyer in connection with the financing or subsequent operation of the vessel.

The effect of subsidies in distorting world trade in shipbuilding is, however, widely recognised and various international attempts have been made to limit their availability and scope. These efforts have been led by the Organisation for Economic Co-operation and Development (OECD) and, in a European context, by the European Commission.

The OECD framework

The current global framework for the regulation of shipbuilding subsidies is contained in an OECD "Sector Understanding on Export Credits for Ships" (SSU) dated July 2008, which is documented as Annex 1 to an OECD "Arrangement on Officially Supported

13 That is, the subsidy generates financing terms for the buyer which are more attractive than those which would be offered to him without such support. This may involve either a rate of interest lower than the market rate or a repayment period longer than that normally granted by a commercial lender.

Export Credits".[14] This essentially requires that subsidised credit schemes for new-buildings (and conversions) should meet the following criteria:

(a) the maximum amount of the contract price to be deferred beyond delivery must not exceed 80% of the total;
(b) the maximum repayment period for such deferred portion of the price is 12 years from delivery of the vessel;
(c) the principal amount of the loan must be repaid in equal instalments at regular intervals, which should normally be six months, with a maximum interval of 12 months; and
(d) interest may not be capitalised and must be paid no less frequently than every six months on the basis that the first payment must made no later than six months from the date of commencement of the loan.

It is also agreed that any participant to the SSU intending to provide an interest subsidy on different terms to those set out in (d) must, at least 10 calendar days before issuing any commitment, notify the other SSU participants and the OECD Secretariat in the form set out as Annex V to the Arrangement. There do not, however, appear to exist any sanctions for breach of such obligation or of the underlying commitment given by each Participant, Clause 2 of the Arrangement providing that

"The Arrangement is a Gentlemen's Agreement among the Participants; it is not an OECD Act although it receives the administrative support of the OECD Secretariat."

Contract subsidy provisions

Although frequently essential to the viability of the entire project, subsidies for newbuildings are almost always either not disclosed to the buyer or documented separately from the shipbuilding contract itself. It is therefore only where the effectiveness of the shipbuilding contract is dependent upon the provision of a subsidy or where the conditions upon which it has been granted impose upon the parties a specific method of contracting that the existence of a subsidy will normally be apparent from the terms of the contract itself. It will frequently be provided, for example, that the shipbuilding contract will not enter into effect until the granting of the buyer's export credit facility, incorporating the subsidy structure, has been confirmed by the relevant governmental agency or the commercial bank acting on its behalf.

TERMS OF PAYMENT

(a) Bank charges

In any major shipbuilding project, the amount of each instalment to be paid by the buyer is likely to be substantial; furthermore, depending upon the identity of the parties and the currency of payment, this may pass through the hands of a number of banks before reaching the builder. The charges thereby incurred customarily fall to the account of the

14 See http://www.oecd.org/officialdocuments/displaydocumentpdf?cote=tad/pg(2010)2&doclanguage=en. The Participants to the Sector Understanding are Australia and New Zealand, the European Community, Norway, Japan and Korea.

buyer, who is obliged to remit sufficient funds to permit the builder to receive the full amount of each instalment. Thus, Article II.1 of the SAJ Form defines the contract price as an amount of Yen "net receivable by the builder".

(b) Currency

The contract will usually stipulate a single currency[15] in which the contract price is to be paid, which will normally be United States dollars, Euros or (more rarely) another currency of the builder's domicile. It will usually also be agreed that the builder's obligations upon rescission to refund the buyer's pre-delivery instalments must be settled in the same currency as the payments made to him.

The SAJ Form provides that all payments by the buyer under the contract are to be made in "non-resident convertible free Japanese Yen"; this wording was drafted prior to the relaxation of Japanese Government exchange controls in 1980 and is now redundant. The NEWBUILDCON Form permits the contracting parties to specify the currency of the contract.[16] while the CMAC Form, although also leaving this issue to the parties, then provides that the instalments of the purchase price will be payable in United States dollars.[17]

(c) Timing

In the majority of shipbuilding contracts the buyer's obligations to pay the various pre-delivery instalments are triggered by events constituting part of the construction process. The parties agree that payment must be made within a specified number of days of the builder's written notification that the event in question has occurred. Where, unusually, it is agreed that the pre-delivery instalments shall be paid on specific calendar dates, the buyer is obviously exposed to the possibility that the level of his investment in the project may outstrip the progress made in the vessel's construction. This may not matter greatly if he is secured by a refund guarantee,[18] but he will be seriously exposed if his only security is the vessel itself.[19]

The unamended SAJ Form provides for three pre-delivery instalments, payable upon granting of an export licence, upon keel-laying and upon launching. This does not, however, reflect modern shipbuilding practice which, as indicated in the NEWBUILDCON Form,[20] is to require the buyer to make at least four pre-delivery payments, typically upon the occurrence of the following "milestone" events:

- effectiveness of the contract or (where different) receipt of a valid refund guarantee;
- commencement of steel cutting;

15 Multi-currency options are unusual in shipbuilding contracts, although these are not unknown. Where the currency of the contract is different from the buyer's operating currency, he will often seek to "hedge" his risk by entering into a swap or other forward exchange arrangement.

16 In Box 9.

17 Articles 5.2 and 5.3.

18 There may, however, be a substantial interest cost to the buyer if he is required to make "early" payment of an instalment of the contract price.

19 See pages 139–143, *infra*.

20 See Box 11.

- keel-laying; and
- launching.

"Keel-laying", which is not defined in any of the SAJ, NEWBUILDCON or CMAC Forms, is a somewhat flexible concept in modern shipbuilding. Where, as is usual in large scale projects, the keel is constructed of pre-fabricated blocks which are thereafter assembled in the building dock, the standard form will sometimes be amended to define "keel-laying" as occurring when the first block is laid down. This may, however, be regarded by the buyer as too limited a "milestone" to justify payment of a further instalment of the contract price, in which event the contract may require the builder to make specific progress in the construction and assembly of a number of blocks before the keel-laying instalment falls due.

It should be noted in this context that the 1974 SOLAS Convention envisaged that future amendments to its rules would be applied to newbuildings whose keels had been laid or "which were at a similar stage of construction" as at the date of introduction of such amendments. Thereafter, in the 1981 amendments to the Convention, a "similar stage of construction" was defined as:

(a) the "commencement of construction identifiable with a specific ship"; and
(b) the "assembly of . . . at least 50 tonnes or 1 per cent of the estimated mass of all structural material, whichever is the less".[21]

In *Stocznia Gdanska S.A.* v. *Latvian Shipping Co., Latreefer Inc. and Others* (1998),[22] the plaintiff shipbuilder agreed to build six reefer vessels for a Liberian purchasing company. The shipbuilding contracts provided that the second instalment of the contract price should be paid within five banking days of shipbuilder's notice of "keel-laying of the Vessel (meaning that the first and second sections of the Vessel's hull have been joined on the berth where the vessel is being constructed), such notice to be confirmed simultaneously by the Classification Society". The purchaser failed to pay the keel-laying instalments of the contract price for hulls 1 and 2 in the series, whereupon the shipbuilder exercised an express right to rescind the shipbuilding contracts.

Having done so, the shipbuilder then decided to "use" the two sections which had been joined for hulls 1 and 2 to trigger the purchaser's obligations to pay the equivalent keel-laying instalments for hulls 3–6 in the series. Notices were given to the purchaser demanding payment of keel-laying instalments for hulls 3 and 4 and, after these had been rejected, the shipbuilder rescinded the contracts. The process was furthermore repeated in respect of hulls 5 and 6.

However, in proceedings brought by the shipbuilder for judgment in respect of all six keel-laying instalments, the House of Lords rejected the claims in respect of hulls 3–6, holding that the shipbuilder's notices demanding payment were ineffective. Their Lordships' decision, although plainly just,[23] is nevertheless hard to justify on purely rational grounds, being largely founded upon the argument that, in circumstances in which the purchaser was contractually entitled to supervise each vessel's construction, it could not have been intended that hull sections joined together under one contract, albeit under

21 Chapter 2, Part A, Regulation 1.3.

22 [1998] 1 Lloyd's Rep. 609, H.L., see generally pages 199–201, *infra*.

23 This was described by Lord Lloyd as being the " . . . instinctive answer, and that which would . . . be given by any fair-minded man", see page 628.

the buyer's supervision, could subsequently be used for the purposes of a different contract.[24]

However, although this approach has some merit in circumstances in which previously joined hull sections are used to perform a contract for a different purchaser, it appears artificial in the context of a series of newbuildings for the same purchaser. The approach is further weakened by the fact that (unless the contract specifically states that the vessel should be made of "new" materials) there would be appear to be no good reason why in such circumstances the builder should not be entitled to separate previously joined hull sections under a cancelled contract and rejoin them under the buyer's supervision specifically in order to "trigger" a keel-laying payment obligation under a subsequent contract.[25]

In addition to the pre-delivery instalments defined in the SAJ Form, the contract may also provide for instalments to fall due at other points in the construction process, e.g., the commencement of steel-cutting or the installation of the vessel's main engine. Where a number of vessels are to be built for him in series, the buyer may, in order to "stagger" the payments he has to make, insist that certain instalments should not be payable before specific calendar dates regardless of the progress of construction.

The contract may also state that the builder's notification must be countersigned or otherwise confirmed by either the classification society or the buyer's representative at the shipyard. This affords the buyer a right to verify that the relevant stage of the construction process has been reached before his obligation to make payment accrues.

Where the contract states that the confirmation must come from the buyer's representative, the builder is obviously exposed to the risk of his unwarranted refusal to provide the same. Such provisions are unlikely in practice to cause problems where the event triggering payment is well defined (e.g., launching[26]), but the position may be very different where the process of certification involves an exercise of subjective judgement as to the progress of the vessel's construction. This situation typically arises where the buyer's obligation to make payment is subject to "satisfactory" completion of certain elements of the contract works.

In such circumstances the buyer's representative will obviously enjoy a measure of discretion as to the timing of the payments made to the builder. The English courts have, however, traditionally displayed considerable willingness to intervene in order to ensure that the builder is not prejudiced by unfair or improper conduct on the part of the buyer's representative.

Thus, in *Frederick Leyland & Co. Ltd (J. Russell & Co.)* v. *Compania Panamena Europea Navegacion Ltda* (1943),[27] the Ministry of War Transport sold a damaged vessel to certain shipowners on the basis that the latter would take over a ship repair contract concluded between the Ministry and Leyland. The repair contract provided that the owners' surveyor should be entitled "to exercise reasonable supervision of the repairs during the progress thereof" and further that payment should be made " . . . after the issue

24 See *per* Lord Goff at page 616 and Lord Lloyd at page 629.

25 The contract may, of course, prevent this by requiring all materials to be unused or "new".

26 Depending upon the level of his confidence in the builder, the buyer may, however, wish to ensure that launching is permitted to take place only when his supervisors are satisfied that the vessel is ready in all respects to take to the water.

27 (1943) 76 Ll.L.Rep. 113.

of a certificate by the owners' surveyor that the work has been satisfactorily carried out and upon receipt of a certificate of the amount due issued by the . . . Ministry".

Following completion of the works, the surveyor refused to certify the works as satisfactorily completed until he had received detailed information from Leyland concerning their labour, material, dock and cranage charges. Leyland contended that his duty of certification was confined to questions of the quality of the work carried out and that he was not therefore entitled to the information he sought.

Against this background, the House of Lords held that the surveyor's jurisdiction was indeed limited to consideration of the quality of the works and that his wrongful refusal to issue the certificate did not prevent Leyland from recovering the cost of the repairs in an amount certified by the Ministry to be correct. In reaching this decision, their Lordships expressed the view that there was no necessary conflict between the surveyor's role in acting as the owners' superintendent and his duty to act independently as a certifying authority for the purposes of confirming that the works had been properly completed. Where he breached this latter obligation, the repairers were entitled to sue for the value of the work done without furnishing a certificate of satisfactory completion issued by him.

(d) Security for payment

Particularly where the contract has been entered into by a "single purpose" subsidiary of the buyer, the builder may be exposed to a significant credit risk in respect of non-payment of the contract price. It is therefore normal in such a situation for the builder to insist upon the provision of a guarantee of the purchasing company's payment obligations. Such a guarantee may, depending upon the circumstances, be furnished by the purchaser's parent company or by a third party, often a bank.

The SAJ Form includes a specimen of the former type of guarantee, the CMAC Form provides for the latter type of guarantee. The NEWBUILDCON Form includes specimens of both types of guarantee.[28] Whether parent or bank guarantees are to be provided, the form of the same is usually agreed at the time the contract is concluded and appended in draft to the agreement itself.

(e) Prepayments

Where, unusually, the contract incorporates a builder's credit, limitations may be placed upon the buyer's right to pre-pay the post-delivery instalments of the contract price.

Under Article II.5 of the SAJ Form the buyer is permitted to make pre-payments of the contract price only by agreement with the builder and subject to the prior approval of the Japanese Government. This wording is again the legacy of an era when Japanese exchange controls applied to export shipbuilding contracts and is now redundant. In practice, the parties are unlikely to agree upon early payment of any pre-delivery instalment unless the buyer wishes to take advantage of interest rate differentials by financing payment of the instalments in a different currency and the builder agrees to reduce the contract price to a level sufficient to justify the buyer's increased costs of financing the accelerated instalments.

28 See Annexes A(i) and A(ii) of the NEWBUILDCON Form.

(f) Rights of set-off and deduction

In light of his own financial commitments during the course of the construction period, it is usually of vital importance to the builder that the pre-delivery instalments of the contract price are paid on their due dates and are not the subject of any alleged right of set-off or withholding on account of cross-claims or disputes existing at that time. Such action not only increases the builder's financing costs of the project but, often more importantly, exposes him to the risk of exchange rate fluctuations if the currency of the contract is different from his own.[29]

In common with other standard forms, Article II.4 of the SAJ Form accordingly provides that the buyer should have no right to delay or withhold the amount of any instalments of the contract price on account of "any dispute or disagreement of whatever nature arising between the parties".[30]

There is, however, some uncertainty as to whether this wording is fully effective in achieving its intended objective. Although there is no doubt[31] that A and B can validly agree to exclude any rights A might otherwise have to set-off, withhold or deduct the amount of its claims against B from monies due and owing to B,[32] it is well established that clear words are required for such an agreement to be effective.[33]

In *Foster Wheeler Wood Group Engineering Ltd* v. *Chevron UK Ltd* (1996),[34] which concerned a contract for the design and installation of modifications to two oil production platforms, the oil company employer sought to set off against the unpaid balance of the contract price claims arising both from alleged overpayments to the contractor and loss and damage resulting from the contractor's alleged design errors. The contract contained various provisions entitling the employer to make specific deductions from sums due to the contractor, but did not state that these provisions were exclusive, i.e., that they replaced the employer's usual set-off rights.[35] In such circumstances, the court held that the employer was not prevented from asserting an equitable set-off against the contract price in respect of his own claims.[36]

Given that Article II.4 of the SAJ and Article V of the CMAC Form do not expressly exclude the buyer's rights of set-off, it appears arguable that such rights survive under those forms, although it must be said that the issue remains unclear. In contrast, Clause 17 of the NEWBUILDCON Form excludes the buyer's right of set-off in relation to the pre-delivery instalments, but expressly preserves the same with respect to the final (delivery) instalment, against which the buyer is entitled to set-off claims for liquidated damages for delay and deficiencies in the vessel's performance. It should, however, be noted that, in the limited category of cases in which the Unfair Contract Terms Act 1977 (UCTA)

29 The builder may, in anticipation of payment, have arranged to sell the instalment forward into his own currency, in which event he may be unable to complete the transaction if this is paid late.

30 See in this regard Article V.4(5) of the CMAC Form and Clause 17 of the NEWBUILDCON Form.

31 Subject to the potential application of the Unfair Contract Terms Act 1977, see further below.

32 See *Continental Illinois National Bank & Trust Company of Chicago* v. *Papanicolaou* [1986] 2 Lloyd's Rep. 441; *Coca-Cola Financial Corporation* v. *Finsat International Ltd. & Others* [1996] 3 W.L.R. 849; and *Kaupthing Singer & Friedlander* v. *Mill and Others* [2009] 2 Lloyd's Rep. 154.

33 *Gilbert-Ash Northern Ltd* v. *Modern Engineering (Bristol) Ltd* [1974] A.C. 689.

34 QBD, Official Referees' Business, 29 February 1996.

35 Such rights can arise at common law or by the application of equitable principles.

36 See also *Connaught Restaurants Ltd* v. *Indoor Leisure Ltd* [1994] 1 W.L.R. 501, *per* Waite, L.J. (at page 510) "the simple expression 'without any deduction' is insufficient by itself, in the absence of any context suggesting the contrary, to operate by implication as an exclusion of the lessee's equitable right to set-off", and *BOC Group plc* v. *Centeon LLC and anr* (1999) 63 Con. L.R. 104.

applies,[37] provisions of a contract for the sale of goods which seek to restrict or exclude the purchaser's right to assert a set-off or counterclaim against the price may, depending upon their precise terms, be unenforceable in English law.

In *Stewart Gill Ltd* v. *Horatio Myer & Co. Ltd* (1992),[38] the plaintiff contractor agreed to construct and install in the defendant's factory a conveyor system, the price of which was payable by instalments during the course of the works. The contract provided (at Clause 12.4) that the defendant should not be entitled to:

"... withhold payment of any amount due to the [Plaintiff] under the Contract by reason of any payment credit, set off, counterclaim, allegation of incorrect or defective goods or for any other reason whatsoever which the [defendant] may allege excuses him from performing his obligations thereunder."

The defendant alleged that this provision offended against UCTA[39] and this contention was upheld by the Court of Appeal. The court held that, to the extent that Clause 12.4 sought to prevent the defendant from setting off against the price any "payment [or] credit" of any description (and whether or not arising under the contract itself) it was unreasonable and unenforceable in its entirety.[40] The fact that parts of the clause, when read in isolation, might well be deemed unobjectionable was irrelevant, i.e., the "offending" parts could not be severed to save the provision as a whole.[41]

Finally, it should be noted that wording of the type contained in Article II.4 of the SAJ Form will not preclude the buyer from asserting that the specific event which triggers his obligation to make payment under the contract has not yet occurred. Where, for example, an instalment is payable upon the completion of assembly of an agreed percentage of the vessel's steelwork, it remains open to him to contend that such percentage has not yet been achieved. In the context of the delivery instalment, it may equally be open to the buyer to argue that the vessel is not in a "deliverable" condition.[42]

Equally, where a builder's credit forms part of the contract price, the instalments payable in the period after delivery will normally be secured by promissory notes and no question of any right of set-off or deduction will arise.[43]

(g) Common law rights of abatement

In addition to rights of set-off, English law has historically permitted the purchaser under contracts for the sale of goods or "work and labour" a right of abatement, i.e. a right to set against claims for the contract price the value of any diminution in the worth of the goods or services provided which results from the supplier's breach of contract.

37 See pages 188–191, *infra*.

38 [1992] 2 All E.R. 257.

39 Specifically, s. 13(1)(b) which prevents the contractual exclusion or restriction of any "right or remedy" arising in respect of any liability which cannot itself be excluded or restricted by reason of the Act.

40 See also *Esso Petroleum Ltd* v. *Milton* [1997] 1 W.L.R. 938.

41 But see *Schenkers Ltd* v. *Overland Shoes Ltd* [1998] 1 Lloyd's Rep. 498, where the Court of Appeal held on the facts that an exclusion of the right of set-off was "reasonable" for the purposes of UCTA in circumstances in which this was in widespread use in the industry in question and the plaintiff, seeking to uphold the exclusion, was known to require an uninterrupted income stream to permit him to finance the performance of his contractual obligations. It is strongly arguable that these considerations equally apply to most international shipbuilding projects.

42 See pages 107–121, *infra*.

43 See *Montecchi* v. *Shimco (U.K.) Ltd* [1980] 1 Lloyd's Rep. 50, *per* Bridge L.J. at page 51.

This principle, which is now enshrined in s. 53(1)(a) of the 1979 Act,[44] derives its modern authority from *Mondel* v. *Steel* (1841),[45] a shipbuilding case in which the vessel was to be built according to a detailed specification at a certain contract price per ton. In answer to a claim by the shipbuilder for the balance of the price, the purchaser asserted a defence based upon the cost of repairs he had been obliged to undertake consequent upon the discovery of defects following the vessel's delivery. The defence succeeded, Parke B. holding that "it is competent for the (shipowner) . . . simply to defend himself by showing how much less the subject of the action was worth by reason of the breach of contract". This principle was applied in *Gilbert-Ash Northern Ltd* v. *Modern Engineering (Bristol) Ltd* (1973)[46] in which it was described as a remedy "independent of the doctrine of 'equitable set-off'" and "no mere procedural rule . . . but a substantive defence at common law".[47] The defence applies, however, only in respect of circumstances which reduce the value of the work performed or the goods sold and does not, for example, entitle the buyer to seek a reduction of the contract price by reason of his claims in damages for delay in delivery.[48] The measure of abatement is "how much less the subject-matter of the action [is] worth by reason of the breach".[49]

It is again possible for the parties to exclude by agreement the potential application of the defence of abatement. It is, however, clear from the decision of the House of Lords in *Gilbert-Ash*[50] that the defence will be presumed not to have been excluded unless "clear express words" have been used.[51]

In the context of the SAJ Form, the terms of Article II.4 are probably sufficient to constitute an agreement to exclude the buyer's common law right of abatement.[52] In the absence of such wording, it is, however, open to the buyer to set against the delivery instalment an amount reflecting the diminution in value of the vessel resulting from defects existing on delivery. The fact that the builder extends a twelve-month warranty of parts and labour does not affect the position, as this only embraces defects discovered after the vessel has been delivered.

METHOD OF PAYMENT

The contract will typically also incorporate provisions stipulating how and where the instalments of the price are to be paid. In most modern shipbuilding projects these are

44 The subsection provides that, where there has been a breach of warranty by the seller, the purchaser may: "set up against the seller the breach . . . in diminution or extinction of the price".

45 (1841) 8 M. & W. 858 at pages 871–872.

46 [1974] A.C. 689.

47 *Per* Lord Diplock at page 717 see also *Henriksens Rederi A/S* v. *T.H.Z. Rolimpex (The "Brede")* [1973] 2 Lloyd's Rep. 333, and the more recent Court of Appeal decision in *Acsim (Southern)* v. *Danish Contracting and Development Co.* (1992) 47 B.L.R. 55.

48 *Mellowes Archital Ltd* v. *Bell Projects Ltd* (1998) 87 B.L.R. 26, where the Court of Appeal held that a party relying on the defence of abatement must demonstrate that the breach of contract has directly affected or reduced the actual value of the goods supplied or work performed. Claims for other loss or damage, e.g., by reason of delay, can only be asserted by way of set-off (assuming such right has not been excluded by agreement).

49 *Mondel* v. *Steel*, *supra* at n. 45.

50 *Supra*.

51 See also *Ellis Tylin Ltd* v. *Co-operative Retail Services Ltd* [1999] B.L.R. 205.

52 Article V.4(5) of the CMAC Form and Clause 17 of the NEWBUILDCON Form are to the same effect: the latter permits deductions from the delivery instalment, but only to the extent expressly permitted under the contract, rather than pursuant to the common law abatement principles.

remitted by means of an electronic transfer which, in the case of payments in United States dollars, will normally be effected via New York. It is customary, however, for the delivery instalment to be deposited with the builder's bank in advance of the vessel's handover and released against presentation by the builder of an original signed copy of the protocol of delivery and acceptance.

Under the SAJ Form the buyer is obliged, seven days before the "scheduled delivery date", either to make such a deposit with the builder's bank or to procure the issuance of a letter of credit from a "prime bank acceptable to the Builder". The term "scheduled delivery date" is not defined but probably means the date on which the builder anticipates actual delivery of the vessel will take place.[53] The security required to be provided by the buyer is limited to the amount of the delivery instalment as adjusted to reflect the cost of modifications and any liquidated damages payable by the builder as a consequence of delay in delivery or technical deficiencies in the vessel.

The CMAC Form, at Article V.4(5), requires the buyer to make a cash deposit covering the amount of the final instalment with the builder's bank at least three banking days prior to delivery, with an irrevocable instruction to release the same to the builder upon the builder's presentation to the bank of the Protocol of Delivery and Acceptance signed by both parties. This more accurately reflects modern practice, under which the buyer will normally remit the funds to the builder's bank under a SWIFT[54] message, together with accompanying SWIFT instructions to the receiving bank authorising their release against presentation of the signed Protocol. The NEWBUILDCON Form[55] is in similar terms, but permits the buyer to demand the return of the delivery instalment if the Protocol of Delivery and Acceptance has not been signed by the parties within seven days of the date nominated by the builder for delivery of the vessel.

It should be noted that this arrangement can often cause considerable practical difficulties if payment of the delivery instalment is to be financed by the buyer's bank against the security of a mortgage on the vessel. In the normal course, the bank will pay over the amount of the instalment concurrently with execution of the Protocol of Delivery and Acceptance and registration both of the buyer's title to the vessel and of its mortgage. If, however, the delivery instalment must be advanced by the bank before the vessel is delivered, the bank may require assurances that the instalment, plus accrued interest, will be returned if delivery does not for any reason take place and that the buyer will not accept delivery, thereby releasing the instalment to the builder, unless the vessel is fully in class and otherwise complies with the conditions and warranties contained in the relevant loan agreement. This may involve the need for the bank, the buyer and the builder to reach specific agreement on these issues and the wording of the SWIFT instructions referred to above, before the instalment is paid to the builder's bank.

BUYER'S ALLOWANCES

Although this practice has declined in recent years, where subsidised finance is available to assist the buyer in the purchase of the vessel, the contract price may, depending upon

53 There is, however, no provision in the SAJ Form requiring the builder to notify this date to the buyer.

54 The Society for Worldwide Interbank Financial Telecommunication (SWIFT) provides an international network under which banks and other financial institutions can securely communicate as well as effect payments.

55 Article 30.

the attitude of the bank or government agency providing the credit, be increased to include a "buyer's allowance". This is a fund constituted by the builder, equivalent in value to the amount of the increase in price, upon which the buyer is entitled to draw during the life of the contract to meet his own costs of the newbuilding project; these typically comprise supervision expenses and the cost of buyer's supplies.

The existence of a buyer's allowance will often be documented in a side letter to the contract which will provide that, to the extent that any part is not drawn down, the contract price will be reduced in like amount. Where a builder's credit has been extended, any such reduction will either be effected via the delivery instalment or be pro-rated between the pre- and post-delivery instalments. Because of the relative complexity of these arrangements, considerable difficulties can arise if they are not properly documented.

In *Helmsing Schiffahrts GmbH & Co. K.G.* v. *Malta Drydocks Corporation and Others* (1977),[56] German purchasers placed an order with Maltese shipbuilders for the construction of two vessels at a price of Maltese pounds 575,000 each. However, by a side letter to the contract it was agreed that this figure included a buyer's allowance, described as a "plus-up", of M£52,500 per vessel to cover certain equipment to be procured by the purchasers directly. To the extent that the allowance was unused, this was to be repaid by the shipbuilders, although neither the contract nor the side letter indicated when this was to occur.

As a further part of the contract package, the shipbuilders arranged for The Investment Bank of Malta (IBM) to provide a buyers' credit in respect of 50% of the contract price at a fixed rate repayable over eight years; the loan was to be drawn down by the builder directly upon delivery. The purchasers were, however, unwilling to accept these terms and insisted (*inter alia*) upon a loan equivalent to 60% of the price. Anxious to secure the contract, the shipbuilders agreed with IBM to leave an amount of the loan equivalent to 10% of the price undrawn for four years, on which basis IBM increased the loan to 60% of the price.[57]

In the event, the purchasers made no drawings in respect of their allowance and in due course claimed repayment of M£105,000. In response, the shipbuilders initially refused to make payment, contending (*inter alia*) that it had been orally agreed that their repayment obligation would be postponed for the four-year period during which they had undertaken to IBM to leave 10% of the price undrawn.[58]

This contention failed on the facts, Kerr J. holding that an agreement in these terms, although discussed at length between the parties, had never been concluded. He accordingly decided that interest was payable from a mid-point between the delivery dates of the two vessels until repayment of the principal sum outstanding. Furthermore, although the shipbuilders' reimbursement obligations arose in Maltese Pounds, the court held that interest payable on the principal sum should be calculated at the (higher) rate applicable to borrowings in Deutsche Marks, this being the purchasers' currency of account.

It is not clear from the judgment whether IBM was advised at the outset that the contract price had effectively been inflated to reflect the amount of the purchasers' allowance.

56 [1977] 2 Lloyd's Rep. 441.

57 This effectively made the shipbuilders the guarantors in part of the purchasers' repayment obligations during the first four years of the loan.

58 The parties reached a settlement during the hearing as to the principal sum claimed and the judgment was limited to the issue of the interest payable thereon.

Given that this represented a significant proportion of the basic price (10%) and that IBM were obviously closely involved in the pre-contract negotiations, it nevertheless seems unlikely that they were not told. Where, however, the incorporation with the contract price of a buyer's allowance is not disclosed to the bank or government agency providing the credit, serious legal problems can arise affecting the legality of the entire transaction.

These problems were highlighted by the decision of the High Court in *Mitsubishi Corporation* v. *Aristidis I. Alafouzos* (1988).[59] In that case the plaintiff shipbuilders agreed with a company connected with a Greek national, Mr Alafouzos, to build and deliver a bulk carrier under a contract governed by English law and subject to London arbitration. The price of the vessel was expressed in the contract to be four billion Yen, payable in instalments. Mr Alafouzos agreed to provide a personal guarantee of the purchasers' contractual obligations.

Following default in the payment of the second and third instalments of the price, Mitsubishi commenced proceedings under the guarantee. These were defended and, in the course of interlocutory proceedings, Mr Alafouzos asserted that enforcement of the contract would be contrary to English public policy because it contained a deliberate misdescription of the vessel's true price. Specifically, he alleged that the parties to the shipbuilding contract had simultaneously executed a side letter agreeing to reduce the price of the vessel as described in the contract, the purpose of such arrangement being to effect a deception upon the Japanese government. Although the evidence as to the effect of the alleged deception was unclear, it was conceded by the shipbuilders that, by inflating the price of the vessel as described in the contract, the parties had sought to facilitate the granting of a government licence for her construction and export.

Against this background, Mr Alafouzos relied upon *Alexander* v. *Rayson* (1937),[60] a case in which a landlord had persuaded his tenant to sign two documents, one containing a figure expressed as "rent" for the property and the other a figure for fictitious services to be rendered by the landlord during the course of the lease. The latter's motive in making such arrangements was to allow him to present only the first document to his local authorities for the purposes of fixing the rental, and therefore the taxable, value of the property. The Court of Appeal unanimously refused to allow the landlord's claim for rent on the grounds that this was founded upon documentation prepared for a wholly illegal purpose.

The judge in *Mitsubishi* (Steyn J.) strongly reaffirmed the principles applied in *Alexander* v. *Rayson*, stating that:

> " . . . in an age in which commercial fraud is increasing, it seems imperative that the Court should refuse to allow a party to rely on a contract which was drafted or structured to deceive third parties . . . the fact that what is alleged to have happened in this case is by no means unknown in the shipbuilding trade makes the stringent application of that policy [i.e., as enunciated in *Alexander* v. *Rayson*] in this area a matter of the first importance."[61]

Furthermore, the fact that the alleged deception took place abroad (and did not constitute a crime or civil wrong under English law) was in the judge's view immaterial to the question of its enforceability.

59 [1988] 1 Lloyd's Rep. 191.
60 [1936] 1 K.B. 169.
61 *Ibid.*, at page 194.

The judgment in *Mitsubishi* was rendered at an interlocutory stage and the shipbuilders' claim, although permitted to proceed in England, was thereafter settled before detailed evidence and legal submissions could be heard. Furthermore, the judge was keen to emphasise that the application of principles of public policy is always a matter of the court's discretion to be considered on the precise facts of each case. That said, however, the judgment represents the clearest indication that commercial arrangements made and documented in a manner intended to deceive third parties will not normally be enforced by the English courts.[62] Furthermore, according to the majority decision of the Court of Appeal in *Brown Jenkinson & Co. Ltd* v. *Percy Dalton (London) Ltd* (1957)[63] it is irrelevant to the application of the principle that the parties' intentions were not fraudulent or otherwise dishonest. In *Standard Chartered Bank* v. *Pakistan National Shipping Corporation (No. 2)* (2000)[64] Evans L.J., citing *Brown Jenkinson*, said:[65]

" . . . the requirement of honest commerce is stringently enforced by the English courts . . . it is no defence to a charge of knowingly making a false statement that the [maker] believed he was justified in doing so or that in the circumstances no harm would result."

Where, therefore, the price of a newbuilding is artificially inflated to reflect the amount of a buyer's allowance and such arrangement is not disclosed to a third party providing financing for the project, doubts will arise as to the enforceability of the shipbuilding contract itself. The risk will be particularly acute where such financing is to be provided on a subsidised basis and the purpose of the arrangement is to extend the subsidy to items of the buyer's project costs for which it could not (or would not normally) be made available.

PRICE RENEGOTIATIONS

After the contract has entered into effect, the builder may sometimes seek to renegotiate the contract price upwards to reflect increases in his costs or simply changed market conditions. While the commercial consequences of such conduct may be very damaging to the builder in the long term, such considerations have not always prevailed in difficult newbuilding markets.

It is, of course, perfectly open to the builder at any stage to seek to persuade the buyer to increase the contract price. Unless carefully structured, an agreement to this effect may nevertheless be legally unenforceable on the grounds that, by undertaking to render for an increased price contractual performance he was in any event obliged to provide, the builder furnishes no consideration.[66] Furthermore, where the builder threatens not to perform the contract unless his demands are met, the buyer's agreement to an increase in

62 For an example of the application of this principle in a slightly different, but analogous, context see *Far Eastern Shipping Co. plc* v. *Scales Trading Ltd* [2001] Lloyd's Rep. Bank. 29, where a guarantor was discharged from liability in circumstances in which the contract for which he had provided security in respect of one party's performance involved the commission of an exchange control fraud on the Russian Government.

63 [1957] 1 Q.B. 621.

64 [2000] 1 Lloyd's Rep. 218; see also *GE Commercial Finance Ltd* v. *Gee and others* [2006] 1 Lloyds's Rep. 337.

65 At paragraph 3 of his judgment.

66 But see *Williams* v. *Roffey Bros and Nicholls (Contractors) Ltd* (1990), *infra*; as to the requirement of consideration generally, see pages 5–6, *supra*.

the price may in certain circumstances be set aside on the grounds that this was induced by economic duress.

Both these issues arose in *North Ocean Shipping Co. Ltd* v. *Hyundai Construction Co. Ltd and Others (The "Atlantic Baron")* (1979),[67] which involved a US dollar contract for the construction in Korea of a large tanker. After the first instalment had been paid, the shipbuilders demanded that the price be increased by 10% to compensate them for the effects of a devaluation of the Korean Won. Following the shipbuilders' threat to terminate the contract, the purchasers agreed to their demands on the understanding that the refund guarantee would be amended to reflect the increased payments. After delivery of the vessel, the purchasers commenced arbitration proceedings to recover the additional amounts they had paid.

Relying upon *Stilk* v. *Myrick* (1809),[68] the purchasers argued that the agreement to increase the price had been made without consideration because the shipbuilders were already obliged by their contract to construct the vessel. The purchasers also contended that the shipbuilders' conduct amounted to duress and that this permitted them to set aside the agreement.

On the first point Mocatta J., although approving *Stilk* v. *Myrick*, held that the consideration for the increase lay in the shipbuilders' undertaking to increase the refund guarantee, which in his view rendered them "liable to an increased detriment".[69] As to the second issue, however, the judge held that the agreement was induced by "duress in the form of economic pressure", which rendered it voidable at the option of the buyer. The purchasers would therefore have been entitled to recover their overpayments had their subsequent conduct not affirmed the agreement.

The rule in *Stilk* v. *Myrick* that performance of an existing contractual duty cannot constitute good consideration was, however, reconsidered by the Court of Appeal in *Williams* v. *Roffey Bros and Nicholls (Contractors) Ltd* (1990).[70] In that case the head contractor in a non-marine construction project faced the prospect of incurring a liability in liquidated damages to the employer as a result of his subcontractor's delays; the latter, a carpenter, was in financial difficulties because the lump sum price agreed for the works was too low to allow him to undertake the same profitably. In these circumstances the head contractor agreed to increase his price but, after further works had been completed, failed to make payment in full. In answer to the subcontractor's claim, it was contended that the agreement reached was unenforceable for want of consideration.

This argument was, however, rejected by the Court of Appeal who held that, provided that the same was not secured by economic duress or fraud, the promise of one party to a contract, A, to make an additional payment in return for the promise of the other, B, to perform an existing contractual obligation could constitute consideration where A as a result secured a benefit or avoided a detriment.[71] By assisting the contractor in avoiding

67 [1979] 1 Lloyd's Rep. 89.

68 (1809) 2 Camp. 317 in which the Court refused to enforce an agreement between a ship's master and his crew to divide amongst the latter the wages of deserting sailors if those remaining worked the passage home shorthanded. The sailors had furnished no consideration for such agreement as they were already bound by their contracts of employment to take the ship home.

69 This aspect of the decision has been heavily criticised see Clarke [1981] 2 L.M.C.L.Q. 234.

70 [1990] 2 W.L.R. 1153; see also *In re Selectmove Ltd* [1995] 1 W.L.R. 474 and *Compagnie Noga d'Importation et d'Exportation S.A.* v. *Abacha and Anr* [2001] All E.R. (D) 48.

71 *Per* Glidewell L.J. at page 1165.

a liability in liquidated damages, the subcontractor furnished good consideration and the agreement was enforceable.

In *Anangel Atlas Compania Naviera S.A. and Others* v. *Ishikawajima-Harima Heavy Industries Co. Ltd (No. 2)* (1990)[72] the purchasers sought to contend that their acceptance of delivery of the vessel on a particular date constituted good consideration for an agreement (*inter alia*) that the shipbuilders would grant them "most favoured customer" treatment.[73] In reply, the shipbuilders argued that *Williams* v. *Roffey* had not altered the rule in *Stilk* v. *Myrick* in circumstances in which the services rendered in return for the increased price (i.e., the carpentry works) had been furnished by the defendants rather than the plaintiffs. Unsurprisingly, this argument was unsuccessful, Hirst J. holding that:

" . . . where there is a practical confirmation of benefit or a practical avoidance of disbenefit for the promisee, there is good consideration and it is no answer to say that the promisor is already bound; where on the other hand, there is a wholly gratuitous promise *Stilk*'s case still remains good law."

The judge further held that, as "core" customers, the purchasers' agreement to accept delivery of the vessel on a particular date conferred a benefit on the shipbuilders by encouraging their other customers with vessels nearing completion to take delivery in what was clearly a very depressed market.[74]

In light of *Williams* v. *Roffey* and *Anangel* it seems that an agreement between the buyer and builder to increase the contract price of the vessel can be legally effective notwithstanding that the parties are already contractually bound, provided that such an agreement confers either a commercial benefit or "the avoidance of a disbenefit" on the buyer. This does not, however, affect the principle that an agreement to increase the price founded upon economic duress or fraud may be set aside by the buyer at his option.[75]

72 [1990] 2 Lloyd's Rep. 526.

73 That is, would not extend to other customers better terms as to payment and price for equivalent vessels.

74 But see Clarke [1991] 3 L.M.C.L.Q. 305.

75 The party claiming economic duress (i.e., the buyer) must usually show that "illegitimate pressure" has been exerted upon him by the other party (i.e., the builder) and that this constituted a significant cause inducing him to enter into the amendment; *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation* [1982] 2 All E.R. 67. Lawful pressure can nevertheless in certain circumstances amount to economic duress; see *Progress Bulk Carriers Ltd* v. *Tube City IMS* [2012] EWHC 273.

Article III—Adjustment of contract price

The Contract Price shall be subject to adjustment, as hereinafter set forth, in the event of the following contingencies (it being understood by both parties that any reduction of the Contract Price is by way of liquidated damages and not by way of penalty):

1. Delivery:

(a) No adjustment shall be made and the Contract Price shall remain unchanged for the first thirty (30) days of delay in delivery of the VESSEL beyond the Delivery Date as defined in Article VII hereof (ending as of twelve o'clock midnight of the thirtieth (30th) day of delay).

(b) If the delivery of the VESSEL is delayed more than thirty (30) days after the Delivery Date, then, in such event, beginning at twelve o'clock midnight of the thirtieth (30th) day after the Delivery Date, the Contract Price shall be reduced by deducting therefrom as follows:

31st– 60th day	¥.....	per diem
61st– 90th day	¥.....	per diem
91st–120th day	¥.....	per diem
121st–150th day	¥.....	per diem
151st–180th day	¥.....	per diem
181st–210th day	¥.....	per diem

However, the total reduction in the Contract Price shall not be more than as would be the case for a delay of hundred and eighty (180) days, counting from midnight of the thirtieth (30th) day after the Delivery Date at the above specified rate of reduction.

(c) But, if the delay in delivery of the VESSEL should continue for a period of hundred and eighty days from the thirty-first (31st) day after the Delivery Date, then in such event, and after such period has expired, the BUYER may at its option rescind this Contract in accordance with the provisions of Article X hereof. The BUILDER may, at any time after the expiration of the aforementioned hundred and eighty (180) days of delay in delivery, if the BUYER has not served notice of rescission as provided in Article X hereof, demand in writing that the BUYER shall make an election, in which case the BUYER shall, within fifteen (15) days after such demand is received by the BUYER, notify the BUILDER of its intention either to rescind this Contract or to consent to the acceptance of the VESSEL at an agreed future date it being understood by the parties hereto that, if the VESSEL is not delivered by such future date, the BUYER shall have the same right of rescission upon the same terms and conditions as herein above provided.

(d) If the BUYER requests in writing that the delivery of the VESSEL be made earlier than the Delivery Date, and if the delivery of the VESSEL is made, in response to such request of the BUYER, more than thirty (30) days earlier than the Delivery Date, then, in such event, beginning with the thirty-first (31st) day prior to the Delivery Date, the Contract Price of the VESSEL shall be increased by adding thereto ..... for each full day (it being understood that the BUILDER'S acceptance of such BUYER'S request for early delivery shall be in no way be construed as change or alteration of the Delivery Date under this Contract).

(e) For the purpose of this Article, the delivery of the VESSEL shall be deemed to be delayed when and if the VESSEL, after taking into full account all postponements of the Delivery Date by reason of permissible delays as defined in Article VIII and/or any other reasons under this Contract, is not delivered by the date upon which delivery is required under the terms of this Contract.

2. Speed:

(a) The Contract Price shall not be affected or changed by reason of the actual speed, as determined by the trial run, being less than three-tenths (3/10) of one (1) knot below the guaranteed speed of the VESSEL.

(b) However, commencing with and including such deficiency of three-tenths (3/10) of one (1) knot in actual speed below the guaranteed speed of the VESSEL, the Contract Price shall be reduced as follows (but disregarding fractions of one-tenth (1/10) of a knot).

For Three-tenths	(3/10) of a knot	a total sum of ¥ .....
For Four-tenths	(4/10) of a knot	a total sum of ¥ .....
For Five-tenths	(5/10) of a knot	a total sum of ¥ .....
For Six-tenths	(6/10) of a knot	a total sum of ¥ .....
For Seven-tenths	(7/10) of a knot	a total sum of ¥ .....
For Eight-tenths	(8/10) of a knot	a total sum of ¥ .....
For Nine-tenths	(9/10) of a knot	a total sum of ¥ .....
For One (1) knot	(3/10) of a knot	a total sum of ¥ .....

(c) If the deficiency in actual speed of the VESSEL upon trial run is more than one (1) full knot below the guaranteed speed of the VESSEL, then the BUYER may, at its option, reject the VESSEL and rescind this Contract in accordance with the provisions of Article X hereof, or may accept the VESSEL at a reduction in the Contract Price as above provided for one (1) full knot only, that is, at a total reduction of .....

3. Fuel Consumption:

(a) The Contract Price shall not be affected or changed by reason of the fuel consumption of the VESSEL, as determined by.....trial as per the Specifications, being more than the guaranteed fuel consumption of the VESSEL, if such excess is not more than.....percent (.....%) over the guaranteed fuel consumption.

(b) However, commencing with and including an excess of.....percent (.....%) in the actual fuel consumption over the guaranteed fuel consumption of the VESSEL, the Contract Price shall be reduced by the sum of .....for each full one percent (1%) increase in fuel consumption above said.....percent (.....%) (fractions of one percent (1%) to be prorated), up to a maximum of.....percent (.....%) over the guaranteed fuel consumption of the VESSEL.

(c) If such actual fuel consumption exceeds.....percent (.....%) of the guaranteed fuel consumption of the VESSEL, the BUYER may, at its option, reject the VESSEL and rescind this Contract in accordance with the provisions of Article X hereof, or may accept the VESSEL at a reduction in the Contract Price as above specified for.....percent (.....%) only, that is, at a total reduction of.....

4. Deadweight:

(a) In the event that the actual deadweight of the VESSEL as determined in accordance with the Specifications is less than or in excess of the guaranteed deadweight of the VESSEL, the Contract Price shall be either reduced by the sum of ..... for each full long ton of such deficiency being more than.....(.....) long tons, up to a maximum reduction of....., or increased by the sum of.....for each full long ton of such excess being more than.....(.....) long tons, as the case may be (in both cases disregarding fractions of one (1) long ton).

(b) In the event of such deficiency in the actual deadweight of the VESSEL being..... (.....) long tons or more, then, the BUYER may, at its option, reject the VESSEL and rescind this Contract in accordance with the provisions of Article X hereof or accept the VESSEL at a reduction in the Contract Price as above provided for..... (.....) long tons only, that is, at a total reduction of.....

5. Effect of Rescission:

It is expressly understood and agreed by the parties hereto that in any case, if the BUYER rescinds this Contract under this Article, the BUYER shall not be entitled to any liquidated damages.

It is the almost invariable practice in modern shipbuilding projects for the builder to promise that the vessel will be completed within a defined timescale and that she will at the time of delivery meet certain agreed minimum performance standards, usually relating to her speed, fuel consumption and deadweight.[1]

Where the builder is unable to fulfil his promise, the buyer may suffer significant losses in terms of the use or value of the vessel. The buyer may nevertheless find it difficult to prove the precise extent of such losses, particularly where the delay or the deficiency in the vessel is limited in extent. If, for example, the vessel's actual speed or deadweight is less than the figure warranted by the builder, her earnings potential is theoretically bound to be reduced. The degree to which the buyer is actually affected by the builder's breach of contract depends, however, upon a large number of factors, including the vessel's expected working life, the terms of trade in the markets for which she has been built and her potential for alternative employment. Furthermore, the effect of these various factors cannot usually be evaluated until after the vessel has entered into service.

These problems were highlighted in *Australian Steamship Proprietary Ltd* v. *John Lewis & Sons Ltd* (1933)[2] where (in addition to a deadweight deficiency) the vessel's draught exceeded the guaranteed figure. The arbitrator held in an interim award that the owners were entitled to " . . . the costs of reducing such excess draught to the said guaranteed draught for the estimated effective life of the vessel, with suitable discount for such contingencies as loss of the vessel or her sale, or lack of employment"; the shipbuilders were thereafter permitted to adduce evidence of the vessel's trading pattern following delivery to show that no loss had in fact been sustained.[3]

The buyer's problems in seeking to prove the extent of his losses pale into insignificance, however, when compared with those of the builder in attempting to manage the risks associated with the vessel's construction; because delay in delivery or technical deficiencies in the vessel may have a very considerable effect upon her employment and earnings, these risks are substantial. For this reason most shipbuilders are unwilling to contract on terms that involve assuming an unlimited liability in damages for the buyer's loss of use or value in the vessel.

It is therefore usual for the parties to agree expressly upon the level of compensation due to the buyer for delays in delivery and non-compliance with the vessel's principal

1 Other criteria may also be important; see pages 76–77, *infra*.

2 (1933) 47 Ll.L.Rep. 132.

3 It is submitted, however, that a more appropriate approach to the assessment of damages is to establish whether there has been any reduction in the market value of the newbuilding at the time of delivery and to award the purchaser the amount of such reduction; this eliminates any argument as to the length and profitability of the vessel's future employment by the purchaser. See n. 59, *infra.*

performance criteria. This is typically achieved by the incorporation within the contract of agreed or "liquidated" damages provisions.

LIQUIDATED DAMAGES

Liquidated damages clauses are employed in a wide range of commercial contracts and English law has as a result developed a substantial body of case law to regulate their use; certain generally applicable principles are of particular relevance to shipbuilding projects.

First, it is well established under English law that the effectiveness of such a clause is subject to a general requirement that it should be commercially justifiable in the sense that it should not represent an unreasonable remedy for the breach to which it relates.

Formerly, this principle was expressed by the English courts in terms of a requirement that the level of liquidated damages agreed to be payable should represent a genuine pre-estimate of the losses arising from the breach in question. Where, judged by this standard, the compensation to the victim of the breach was "extravagant or unconscionable",[4] the clause would be categorised as a penalty and as such legally unenforceable.

That the losses flowing from the breach were exceptionally difficult to quantify would not, however, prevent the enforcement of a liquidated damages clause, as these are precisely the circumstances for which such provisions are usually designed. In the leading case of *Clydebank Engineering & Shipbuilding Co. Ltd* v. *Don Jose Ramos Izquierdo y Castaneda* (1905),[5] four torpedo boats were ordered from a Scottish shipbuilder by the Spanish government, which had intended to employ them in the Hispano-American war of 1898. The vessels were delivered too late to be used. The House of Lords held in these circumstances that the fact that the vessels were intended to be used in a military, rather than commercial, purpose (and that it was therefore virtually impossible to place a value upon the loss of their use) did not in itself render the liquidated damages provisions of the contract unenforceable.[6]

In the same vein, it was also clear from a decision of the Privy Council, *Philips Hong Kong Ltd* v. *The Attorney-General of Hong Kong* (1993)[7] that a liquidated damages provision would not be construed as a penalty merely because in certain hypothetical situations its application might result in the damages payable being in excess of the loss suffered. In the words of Lord Woolf:

> "... so long as the sum payable in the event of non-compliance with the contract is not extravagant, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time the contract was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damage provision. The use in argument of unlikely illustrations should not therefore assist a party to defeat a provision as to liquidated damages. ... "[8]

4 *Per* the Earl of Halsbury L.C in *Clydebank Engineering & Shipbuilding Co. Ltd* v. *Don Jose Ramos Izquierdo y Castaneda* [1905] A.C. 6.

5 *Supra*.

6 Their Lordships also dismissed the shipbuilders' argument that the delay had actually benefited the purchasers by preventing the warships from being lost in the war. This must rank amongst the weakest submissions ever made to the House of Lords.

7 (1993) 61 B.L.R. 41, P.C.

8 At page 59.

However, certain more recent English decisions have indicated that a broader approach should be taken to the categorisation of such clauses and that the relevant test is whether the liquidated damages provision is "commercially justifiable". In *Lordsvale Finance plc* v. *Bank of Zambia* (1996)[9] the High Court held that:

"whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time the contract was entered into the predominant contractual function of the provision was to deter a party from breaking the contract or to compensate the innocent party for breach. That the contractual function is deterrent rather than compensatory can be deduced by comparing the amount that would be payable on breach with the loss that might be sustained if the breach occurred."[10]

Where the amount of the agreed damages payable by the contract breaker is "extravagant or unconscionable" compared with the damages which would be recoverable at common law for the breach in question, it is unlikely that the liquidated damages clause will be enforced in English law.[11] Other factors may, however, be of relevance in the legal analysis[12] and can lead to such a clause being upheld notwithstanding that the agreed level of compensation is greater than that which would have been generated by the application of common law principles.

Thus, in *Azimutt-Benetti SpA (Benetti Division)* v. *Darrell Marcus Healey* (2010),[13] a contract for the construction of a "super yacht" provided that upon lawful termination by the builder for the buyer's failure to pay any instalment of the price, the builder would be entitled to retain from previously paid instalments an amount of 20% of the price as compensation for its estimated losses. This appeared to represent a significant premium to the builder in terms of its actual losses, but was arguably counterbalanced by a further provision providing that the buyer would on termination be entitled to receive an immediate refund of any amounts paid by him in excess of 20% of the contract price, i.e., he was not (as usual practice would have dictated) required to wait for the builder to complete and sell the yacht to a third party before receiving a partial refund of his instalments. Against this background, the High Court upheld the liquidated damages clause on the grounds that it was "commercially justifiable as providing a balance between the parties upon lawful termination by the builder".[14]

Secondly, there is some authority to indicate, that the courts will seek to interpret liquidated damages clauses so as to prevent their application where the breach of contract in question is relatively minor in nature.

In *Cenargo Ltd* v. *Empresa Nacional Bazan de Construcciones Navales Militares S.A.* (2002),[15] two shipbuilding contracts provided that liquidated damages should be payable

9 [1996] Q.B. 752.

10 *Per* Colman J. at page 762; see also *Cine Bes Filmcilik VE Yapimcilik* v. *United International Pictures* [2003] EWCA Civ 1669; *Murray* v. *Leisureplay plc* [2005] EWCA Civ 963 and *Euro London Appointments Ltd* v. *Claessens International Ltd* [2006] EWCA Civ 385.

11 *Murray* v. *Leisureplay plc*, *supra*, applying *Dunlop Pneumatic Tyre* v. *New Garage and Motor Co.* [1915] A.C. 79, H.L.

12 See *per* Mance L.J. in *Cine Bes Filmcilik*, *ibid*., at paragraph 15 of his judgment.

13 [2010] EWHC 2234.

14 *Per* Blair J at paragraph 29 of his judgment, it was relevant also that the contract had been negotiated with the benefit of experienced legal advice on both sides. In this context, see also *Tandrin Aviation Holdings Ltd* v. *Aero Toy Store LLC and another* [2010] EWHC 40 (Comm), an aircraft sale and purchase case in which the High Court upheld a liquidated damages provision entitling the seller to retain a 10% deposit in circumstances of the buyer's failure to take delivery.

15 [2002] EWCA Civ 524.

for deficiencies in the trailer-carrying capacity of two ro-ro ferry newbuildings. The required capacity was not provided but it was accepted that the configuration of the vessels' lorry decks could be altered easily and cheaply to meet the contract requirements. The builder argued in these circumstances that the court should construe the liquidated damages clause as intended to apply only to "major" breaches of contract and not to a factual situation in which the cost of the modifications (about $11,000) was substantially less than the liquidated damages claim ($750,000) generated by the deficiency in capacity.

This argument was rejected by the Commercial Court but upheld by the Court of Appeal, which confirmed[16] that liquidated damages clauses which are capable of application in a range of factual situations should be interpreted as intended to apply only to "major" breaches of contract. In the view of Longmore L.J., giving the only judgment, such breaches meant those "giving rise to substantial loss of the kind contemplated by the liquidated damages clause".[17] He furthermore held on the facts of the case that "the parties . . . when agreeing liquidated damages in relation to trailer-carrying capacity, could [not] have had in mind defects in design or workmanship which could be rectified without incurring major expense. . . . "

The scope of the general principle espoused by Longmore L.J. in *Cenargo* is not explained further in the judgment and is likely to give rise to considerable uncertainty in practice. It would appear, however, that if a defect or shortcoming in a newbuilding (i) would generate a substantial contractual liability in liquidated damages, but (ii) can be remedied at a significantly lower cost than the damages agreed to be payable, the builder will normally be entitled to argue that his liability should be limited to the costs of the remedy rather than to payment of the damages. It can nevertheless legitimately be argued that the need to undertake such an analysis defeats the entire purpose of a liquidated damages clause, which is to provide certainty for *both* parties regarding the extent of one party's liability for a specific breach of contract.

The third principle of general application to liquidated damages provisions is that the burden of proving that these are penal in operation and therefore unenforceable lies upon the party to the contract who is seeking to escape from their operation.[18] In the context of a shipbuilding contract, this will, of course, invariably be the builder, rather than the buyer. It should be noted that the fact that (as is customary in shipbuilding contracts) the clause describes itself as providing for liquidated damages rather than a penalty is irrelevant to the question of its enforceability because the court or arbitration tribunal must "proceed according to what is the real nature of the transaction".[19]

Fourthly, where the sums payable increase by reference to the seriousness of the breach to which they relate, it will be presumed that the parties have provided for liquidated damages rather than a penalty.[20] Such clauses are widely employed in modern shipbuilding contracts, which usually stipulate for graduated levels of compensation payable to the buyer depending upon the extent of the delay in delivery or of the technical deficiencies in the vessel. The presumption that a graduated damages clause is enforceable can

16 Relying upon *Webster* v. *Bosanquet* [1912] A.C. 394 and the views expressed by a leading academic.

17 At paragraph 32 of the judgment.

18 *Robophone Facilities Ltd* v. *Blank* [1966] 1 W.L.R. 1428. See also *Murray* v. *Leisureplay plc*, *ibid*., *per* Clarke L.J. at paragraphs 106(vii) and (xi).

19 *Clydebank Engineering* (*ibid*..), *per* the Earl of Halsbury L.C. at page 9.

20 *Lord Elphinstone* v. *Monkland Iron and Coal Co.* (1886) 11 App. Cas. 332.

nevertheless still be rebutted by the builder if the level of the agreed damages is exorbitant or extravagant.[21]

Fifthly, if the parties have agreed upon the damages payable for a particular breach of contract, their bargain will be upheld even if the loss actually sustained by reason of the breach proves to be significantly greater than the agreed figure.[22] Liquidated damages clauses thus effectively limit to the agreed amount the liability of the party in breach; the innocent party may circumvent the limitation and sue for his actual losses only if he can establish an alternative or additional breach of contract which is not subject to the liquidated damages clause.[23] Where, for example, the builder fails to deliver the vessel by the Delivery Date, the buyer's exclusive remedy will (in the absence of agreement to the contrary) normally lie within the liquidated damages provisions of the contract dealing with delay in delivery.

By the same token, however, where a clause providing for the payment of agreed damages is penal in nature and thus legally unenforceable, both parties are precluded from relying on its terms. In such circumstances the innocent party is entitled to attempt to prove his actual losses and (subject to the usual rules of causation and remoteness) the party in breach is liable to the extent that the loss is proven.[24]

The sixth, often overlooked, principle relevant to liquidated damages clauses in building contracts is that these are subject to rules protecting the builder/contractor from the consequences of delay caused by the buyer/employer. Unless the contract provides, expressly or impliedly, that time for completion will be extended in such circumstances, a long line of English decisions commencing with *Holme* v. *Guppy* (1838)[25] holds that the buyer/employer is precluded from claiming any liquidated damages whatsoever where his conduct has in fact delayed the completion of the contract works.[26] Thus, in *Peak Construction (Liverpool) Ltd* v. *McKinney Foundations Ltd* (1971),[27] a non-marine construction case, Salmon L.J. held that:

21 *Clydebank Engineering* (*ibid.*) *per* Lord Davey at page 10. In the light of the authorities cited above, it may arguably assist the buyer in seeking to enforce such a clause if the contract permits the builder an equivalent bonus for performance in excess of the contract requirements calculated on the same graduated basis as the liquidated damages payable for its breach.

22 *Cellulose Acetate Silk Co.* v. *Widnes Foundry (1925) Ltd* [1933] A.C. 20; see also *Suisse Atlantique Société d'Armement Maritime S.A.* v. *N.V. Rotterdamsche Kolen Centrale* [1966] 1 Lloyd's Rep. 529, *per* Lord Upjohn at page 556: "An agreed damages clause is for the benefit of both [parties]. The party establishing breach by the other need prove no damage in fact; the other must pay that, no less but no more." It is also clear that the beneficiary of a liquidated damages clause is unaffected by the usual principles of mitigation of loss; see *Robert Abrahams* v. *The Performing Right Society* [1995] I.C.R. 1028, C.A. He is accordingly entitled to recover the agreed level of damages whether or not he could reasonably have reduced his actual losses flowing from the breach of contract in question.

23 *Aktieselskabet Reidar* v. *Arcos Ltd.* [1927] 1 K.B. 352. In *Royal Coast Maritime S.A.* v. *Malta Drydocks Ltd*, an unreported decision in 1993, it was held that a liquidated damages clause in a ship repair contract operated to limit the repairer's liability for delay in delivery whilst the contract was subsisting but not thereafter, i.e., it did not present an obstacle to the shipowner's further claims for the additional costs of completing the vessel following his acceptance of the repairer's repudiatory breach of the contract. See also *Pacific Ocean Shipping Corporation & anr* v. *Sembawang Corporation Ltd (The "Solitaire")*, Commercial Court, 4 June 1998, *per* Tuckey J.: "The contract gives owners the option of terminating or keeping the contract alive. If they keep it alive, the liquidated damages provision quantifies the loss which they can recover; if they terminate, the liquidated damages provision is irrelevant".

24 *Jobson* v. *Johnson* [1989] 1 All E.R. 621.

25 (1838) 3 M. & W. 387.

26 Many of the authorities are cited in *Astilleros Canarios S.A.* v. *Cape Hatteras Shipping Co. Inc. (The "Cape Hatteras")* [1982] 1 Lloyd's Rep. 518. See also *Percy Bilton Ltd* v. *Greater London Council* (1982) 20 B.L.R. 1 at 13, *per* Lord Fraser.

27 (1971) 69 L.G.R. 1.

"If the employer wishes to recover liquidated damages for failure by the contractors to complete on time in spite of the fact that some of the delay is due to the employer's own breach of contract, then the extension of time clause should provide, expressly or by necessary inference, for an extension of time on account of such a fault or breach on the part of the employer."[28]

It is, however, also clear that it is not necessary that the employer's conduct should constitute a breach of contract. The principle will equally come into play where, for example, he exercises a right to order extra works without permitting further time for the completion of the contract.[29]

The rule in *Holme* v. *Guppy* was applied in a ship repair context in *Astilleros Canarios S.A.* v. *Cape Hatteras Shipping Co. Inc. (The "Cape Hatteras")* (1982),[30] and, more recently, in relation to a shipbuilding project in the important case of *Adyard Abu Dhabi* v. *S.D. Marine Services* (2011).[31]

In *The "Cape Hatteras"* the repair contract provided for liquidated damages in the event of delay in redelivery of the vessel beyond a specified date. The completion of the works was in part held up by the shipowners' decision not to permit the repairer to deliver the vessel's crankshaft to a subcontractor for grinding and polishing.

Although describing the proposition as "at first sight somewhat implausible", Staughton J. held that repairers were in these circumstances wholly discharged from any liability in liquidated damages for delay; in the judge's view it was unnecessary to undertake any investigation of the delay to establish how far this had been caused by the shipowners' conduct because:

"... the principle established by the authorities, that no liquidated damages for delay can be claimed if completion was in part delayed by conduct of the employer, is applicable in the present case. Had the parties wished to avoid that result, they could and should have inserted in the contract a term that the agreed date for completion should be extended in the event of delay caused by [the shipowners]."[32]

In *Adyard* the purchaser of two newbuildings had cancelled the relevant shipbuilding contracts pursuant to their express terms for delay in achieving the vessels' readiness for sea trials. The shipbuilder did not dispute that the vessels were incomplete, but argued, *inter alia*, that the purchaser was not entitled to cancel on the grounds that its acts had prevented their completion.

The contracts provided that each vessel should be built for registration under the UK flag and included a detailed mechanism under which changes in the regulatory regime relevant to such flag would be addressed. In essence, if such a change occurred during the construction period, the purchaser could choose either (i) to agree to "reasonable adjustments" required by the shipbuilder to the contract price, completion date and other terms of the contract, in which case the relevant modification would be implemented, or

28 At page 11. See also *Multiplex Constructions (U.K.) Ltd* v. *Honeywell Control Systems Ltd* [2007] EWHC 447 (TCC) where (at paragraph 47 of his judgment) Jackson J stated that: "... one consequence of the prevention principle is that the employer cannot hold the contractor to a specified completion date, if the employer has by act or omission prevented the contractor from completing by that date. Instead, time becomes at large and the obligation to complete by the specified date is replaced by an implied obligation to complete within a reasonable time."

29 *Dodd* v. *Churton* [1897] 1 Q.B. 562, but see also *Balfour Beatty Building Ltd* v. *Chestermount Properties Ltd* (1993) 62 B.L.R. 1.

30 *Supra*.

31 [2011] EWHC 848 (Comm).

32 At page 526.

(ii) to instruct the shipbuilder "otherwise", i.e., not to effect the modification. However, the contracts made no specific provision for the situation in which, because it disagreed with the shipbuilder's request for an extension of time, the purchaser did nothing at all. It was these circumstances, i.e., the purchaser's failure to decide promptly whether or not to implement the modification, that the shipbuilder contended had delayed the completion of the vessels and had brought the "prevention principle" into play; on this basis the shipbuilder contended that the purchasers' cancellations were premature and unlawful.

Against this background, the purchaser argued, and the High Court accepted, that the contracts did in fact contain provisions entitling the shipbuilder to an extension of time and that the prevention principle could not therefore apply. Surprisingly, however, Hamblen J. based his decision not upon the terms of the contracts dealing with modifications, but on its Permissible Delay provisions, which contained customary language allowing the shipbuilder to claim extensions of time for *force majeure* events such as wars, strikes "and any other delays of a nature which under the terms of this contract permits (*sic*) postponement of the Delivery Date". In these circumstances, the judge held that, subject to providing to the purchaser timely notices of delay (which the shipbuilder had failed to do), the shipbuilder would in principle have been entitled to an extension of time to cover the period of the purchaser's "indecision"; the existence of this potential remedy displaced the operation of the prevention principle.

This is a surprising conclusion. As Hamblen J. accepted, the provisions of most shipbuilding contracts dealing with modifications and *force majeure* delay "generally operate separately" and any linkage between the two is not obvious. Furthermore, other than *force majeure* circumstances, Permissible Delay meant (as in most shipbuilding contracts) delays which "under the terms of th[e] Contract" permit extension of time, and the modifications clause did not contain provisions permitting an extension of time in such circumstances—the fact that, as the judge noted, "[the modification clause] permits the parties to agree adjustments to the Delivery Date", clearly did not generate any express right to an extension of time in circumstances in which agreement had *not* been reached. Finally, while there is obvious logic in requiring that "true" *force majeure* notices should promptly be given by the shipbuilder to the purchaser, it is submitted that there is no good commercial reason why the shipbuilder should be required to give notices of both the commencement and cessation of a delay which results from the parties' joint failure to conclude ongoing negotiations between them.

In reaching his decision, the judge was clearly worried that the wholesale importation of the "prevention principle" into English shipbuilding contract law might upset a long established commercial balance between shipowners and shipbuilders—he referred in particular to concerns expressed by Colman J. in *Balfour Beatty Building Ltd* v. *Chestermount Properties Ltd* (1993)[33] that the operation of the principle might mean that the existence of a "trivial variation" could cause the employer (or purchaser) to forfeit a significant entitlement to liquidated damages for delay. The decision nevertheless appears harsh from the perspective of the shipbuilder given that the risks generally of "compulsory" modifications affecting the vessels' construction were clearly agreed to be borne by the purchaser.

The *Adyard* decision is also significant in confirming in a shipbuilding context the so-called "net basis" of time computation for purposes of determining the builder's

33 *Supra*, at n. 29.

entitlement to an extension of time by reason of the buyer's conduct. In other words, where a builder is already behind schedule in his construction programme and is then further delayed by the buyer's conduct, the builder can seek an extension of time, or avail itself of the prevention principle, only to the extent that such conduct prevents completion by the date on which, in light of his own delays, the builder would otherwise have been able to complete the vessel.[34] In light of the judge's finding that the project was in "irretrievable critical delay" long before any of the buyer's alleged delaying conduct had occurred, the shipbuilder was unable to rely upon the prevention principle

Where no provision for an extension of time by reason of delays caused by the buyer is included in the contract and the works are so delayed, the builder is only required to complete the construction of the vessel within a reasonable time after the contractually agreed delivery date.[35] If he fails to do so, the buyer is entitled to claim damages for breach of such obligation but will be obliged to prove his loss in the normal manner; he will not, however, be limited in such circumstances by the provisions of the liquidated damages clause.[36]

It should be noted in this context that it is not clearly decided in English law whether the "prevention principle" operates only to preclude the buyer from claiming liquidated damages or also affects his right to exercise contractual rights of termination for delay. However, in *Multiplex*,[37] the High Court stated clearly that the effect of an act of prevention is to set time "at large" generally.[38] It would appear inconsistent with this approach, and wrong in principle, that the buyer can be prevented from claiming liquidated damages for delay caused by his acts or omissions, but still entitled in such circumstances to exercise the remedy of termination for delay.

In the majority of shipbuilding projects, the circumstances which customarily entitle the buyer to claim liquidated damages and, ultimately, to rescind the contract are:

(i) delay in delivery;
(ii) insufficiency of speed;
(iii) excessive fuel consumption;
(iv) inadequate deadweight capacity and
(v) other deficiencies.

(i) Delay in delivery

Liquidated damages for delay in delivery of the vessel beyond the agreed date are usually calculated on a *per diem* basis; in common with the liquidated damages payable for other breaches of the contract, these will be paid to the buyer either by way of a reduction of

34 On the issue of the contractual effect of consecutive and concurrent delaying events, see pages 151–154, *infra*.

35 *Thornhill* v. *Neats* (1860) 8 C.B. (N.S.) 562; *Wells* v. *Army and Navy Co-operative Society* (1902) 86 L.T. 764.

36 *E. Turner and Sons Ltd* v. *Mathind Ltd* (1989) 5 Const. L.J. 273. It should be noted that the above principles do not apply to a construction contract in which the buyer's remedy for delay lies only in a claim for unliquidated damages (i.e., there is no liquidated damages clause); see *McAlpine Humberoak Ltd* v. *McDermott International Inc. (No. 1)* (1992) 58 B.L.R. 1, C.A. As previously indicated, this is, however, very rare in a shipbuilding context.

37 *Supra*, at n. 28.

38 Assuming always that the contract does not expressly or impliedly afford the builder the right to extend the contractual delivery date.

the contract price effected through an adjustment of the delivery instalment or, less commonly, in cash upon delivery. In negotiating the terms of their contract, the buyer and the builder will seek to agree both the point at which the buyer's rights to liquidated damages will accrue and the level of the damages to be paid. They will also typically agree upon the period of delay which must elapse before the buyer is entitled to exercise a right to rescind the contract.

(a) The accrual of the buyer's rights

Under Article III.1 of the SAJ Form the parties agree as follows:

(1) the builder impliedly promises to deliver the vessel by the Delivery Date defined in Article VII.1;
(2) the builder is permitted a "grace" period of 30 days beyond the Delivery Date within which he may deliver the vessel without incurring a financial liability to the buyer;
(3) following expiry of the grace period, the builder becomes liable to pay to the buyer liquidated damages for each further day of delay up to a maximum of 180 days, i.e., a total of 210 days calculated from the Delivery Date;
(4) where the delay in delivery of the vessel reaches 180 days calculated from the 31st day after the Delivery Date, the builder's liability to pay further liquidated damages ceases. At this point, however, the buyer becomes entitled to rescind the contract in accordance with Article X and to recover the amount of his advance instalments of the contract price, together with interest at the agreed rate.

Similar provisions apply under the NEWBUILDCON Form where the buyer's entitlement to rescind is expressed to arise after 180 days of unauthorised delay in delivery, and under the CMAC Form.[39]

This structure has a number of important features. First, the point of reference in determining the extent of delay in delivery is always the Delivery Date. Although initially defined as a specific calendar date, the Delivery Date is continually adjusted throughout the life of the contract to reflect the occurrence of permissible delays and, in particular, the impact of the *force majeure* events defined in Article VIII.1.[40]

This arrangement ensures that the builder will not breach the contract if his failure to deliver the vessel by the date originally agreed results from a range of events outside his control. It will be appreciated, however, that such a mechanism also has the effect of allowing the builder a theoretically unlimited period of time within which to perform his contractual obligations; so long as *force majeure* events and other permissible delays extend the Delivery Date, the buyer cannot rescind the contract for delay.

An open-ended commitment of this type is commercially unacceptable to most newbuilding purchasers and their financing banks. The buyer and the builder will therefore typically agree that the buyer should also be entitled to rescind the contract

39 Clauses 13, 28 and 39(a)(iii) of the NEWBUILDCON Form and Articles VI.5, XIV.1, XV.3 and XXVII.3 of the CMAC Form.

40 In addition to Article VIII.1 of the SAJ Form, Articles XI.3 (buyer's default) and XVII.3(d) (delay in delivery of buyer's supplies) provide for automatic extensions of the Delivery Date.

where the permissible delays claimed exceed in aggregate a stipulated figure. Under the SAJ Form, this right of rescission, which is contained in Article VIII.4,[41] accrues where permissible delays exceed 210 days in total.

Alternatively, the contract may legislate for the problem by allowing the buyer the right to rescind for delay on a specific calendar date falling, for example, 270 days after the Delivery Date originally defined in the agreement. The date on which the buyer's right of rescission accrues (which is sometimes colloquially referred to as the "drop dead" date) will not normally be capable of extension for any reasons other than the buyer's own default, to take account of agreed modifications or to accommodate the conduct of arbitration proceedings between the parties.

Secondly, in line with the general principle described above, the parties' agreement upon the remedy of liquidated damages for delay will usually preclude the buyer from pursuing other claims for damages sustained by reason of late delivery.[42] Although the SAJ Form does not expressly so provide, Article III.1 therefore defines the exclusive measure of compensation payable to the buyer for delay in delivery.[43]

Thirdly, the SAJ Form contains no general provision extending the Delivery Date by the period of any delays caused by the buyer—the default provisions of Article XI are limited to failures by the buyer to pay instalments of the contract price or to take delivery of the vessel when duly tendered by the builder.[44] It would therefore seem that the rule in *Holme* v. *Guppy* (1838)[45] will excuse the builder from liability for liquidated damages in circumstances in which, and to the extent that, the delay in completion has been caused by the buyer. It is clear, however, that the rule will not be invoked merely by reason of the buyer's exercise of his right to call for modifications to the specifications because Article V.1 of the SAJ Form specifically permits the builder to require that the Delivery Date be extended in such circumstances.

Fourthly, where the buyer under the SAJ Form elects to rescind for excessive delay,[46] he equally has no right to claim substantial damages for the loss of the contract itself; Article X expressly provides that the builder's obligations in such circumstances shall be "completely discharged" by the repayment of the buyer's advance instalments with interest thereon.[47] If the buyer envisages that rescission of the contract will expose him to an unacceptable significant loss of market opportunity, he must therefore either seek to amend this language or arrange delayed delivery or cancellation insurance to cover the risk.[48]

41 See pages 167–168, *infra*.

42 See, e.g., *Suisse Atlantique* (*ibid.*) where the existence of demurrage provisions in a consecutive voyage charterparty precluded a claim in damages for loss of expected freights consequent upon the charterers' delay in loading and discharging the vessel.

43 The NEWBUILDCON and CMAC Forms equally contain no express limitation on the buyer's rights to claim additional general damages for delay in delivery and deficiencies in performance, although (as indicated) this restriction is not required in English law if liquidated damages clearly apply.

44 See pages 209–210, *infra*.

45 *Supra*, at n. 25.

46 Or for any other cause provided in the contract.

47 Similar exclusionary language is included in the NEWBUILDCON Form at Clauses 37(e) and 39(e) and in the CMAC Form by virtue of Article VI.9; depending upon the precise wording of the contract, it may nevertheless be open to the buyer to claim damages at common law.

48 See pages 199–201, *supra* for discussion of the buyer's right to claim damages for repudiatory breach where this exclusionary language is not included in the contract.

(b) The level of liquidated damages

The level of compensation payable by the builder for delay in delivery will depend very much upon the relative bargaining positions of the parties and the custom and practice of the particular newbuilding market in question. There are two alternative methods by which the level of liquidated damages may be calculated.

First, the parties may agree that the buyer should be paid a daily sum assessed by reference to an assumed market rate of hire for the vessel upon delivery, which may or may not be reduced by the amount of her estimated operating expenses. Thus, in *Clydebank Engineering*[49] it was suggested that an appropriate level of liquidated damages for delay could be established by:

> " . . . finding out what the ordinary use of a vessel of this size, capacity and so forth would be, what would be the hire of such a vessel, and what would therefore be the equivalent in money of not obtaining the use of that vessel according to the agreement during the period which had elapsed between the time of proper delivery and the time at which it was delivered in fact."[50]

This method of calculation is, however, rarely used in modern shipbuilding contracts. Given the difficulties of predicting at the outset of the contract the likely market rate of charter hire for the vessel at the time of delivery, it is now almost invariably agreed that the buyer should be compensated for any delay beyond the Delivery Date by reference to the cost to him of the investment represented by his advance instalments. Where this approach is adopted, liquidated damages are usually agreed at a level reflecting the interest cost to the buyer of funding the instalments of the Contract Price which will be payable by him in the period before delivery and acceptance of the vessel.

(c) The buyer's right to rescind for excessive delay

Under the SAJ Form, where the delay continues for a period of 211 days counted from the Delivery Date, the buyer is entitled to rescind the contract. Subject to the possibility of waiver by words or conduct,[51] this right may normally be exercised by the buyer at any time whilst the delay in delivery continues.

This may represent a serious problem for the builder, who may be very reluctant to expend further time and money on the vessel's construction unless it is clear that the buyer still wishes to take delivery. Most shipbuilding contracts therefore incorporate terms entitling the builder to require the buyer to elect either to exercise his rights of rescission for delay or to waive such rights and maintain the contract on the basis of a revised date for delivery acceptable to both parties.

Under Article III.1 of the SAJ Form, where the buyer's right to rescind has accrued and he has not served a notice of rescission, the builder may require him to elect within 15

49 *Supra*, at n. 5.

50 *Per* the Earl of Halsbury L.C. at page 12.

51 A detailed examination of the circumstances in which a express right to terminate a contract may be waived by action or inaction is beyond the scope of this book; see generally *Chitty on Contracts* (30th edn) paragraph 22-053 and the authorities cited therein. In *Ateni Maritime Corporation* v. *Great Marine Ltd (The "Great Marine") (No. 1)* [1990] 2 Lloyd's Rep. 245, which concerned the sale of a second-hand vessel, the High Court held that "in the context of a profit-earning chattel such as a ship or an aircraft" the seller's failure to exercise a cancellation right within one week of the date of its accrual was "too long" and led to the waiver of such right. It is submitted, however, that this is inappropriately short in relation to a long-term newbuilding project and that the existence of express provisions entitling the builder to require the buyer to elect whether or not to cancel the contract (*infra*) is likely in any event preclude the application of the doctrine of waiver.

days " . . . either to rescind [the] Contract or consent to the acceptance of the Vessel at an agreed future date". The paragraph appears to assume that, if the buyer does not rescind, the parties will be able to agree upon a future date for delivery and makes no direct provision for the possibility that a consensus cannot be reached. Where, however, the parties have not agreed within the 15-day period upon a mutually acceptable date, it is submitted that the buyer must be deemed to have elected to rescind. If this were not so, the buyer could always defeat the objectives of the paragraph by simply refusing to agree to any revision of the date for delivery.[52]

Where the builder is contractually entitled to require the buyer to make an election of the type described above, the buyer cannot circumvent such provisions by communicating an intention not to rescind before his right of rescission arises. In *Harland & Wolff Ltd* v. *Lakeport Navigation Co. Panama S.A.* (1974),[53] the shipbuilding contract stipulated that, where delay in delivery (inclusive of *force majeure* delays) continued for a period of more than 150 days from the "delivery date set forth in this Agreement" (28 February 1973), the buyer was entitled to an option to cancel. The contract further provided at Article 4.(1)(d) that:

"If the Buyer has not served . . . notice [of cancellation] the Builder shall upon the expiration of the afore-mentioned . . . 150 days period of delay demand in writing that the Buyer shall make an election, in which case, the Builder and the Buyer shall negotiate and agree within thirty (30) days . . . either to cancel, or to consent to deliver and accept the vessel at a future date under the conditions mutually agreed by the Buyer and the Builder in the course of negotiation. . . . "

The vessel's completion was seriously delayed but the buyer indicated at all times that he wished to maintain the contract. On 29 July 1973 (i.e., following the expiry of the 150-day period) the builder formally required the buyer to elect whether to cancel or to accept the vessel on terms to be agreed in the course of negotiations; the builder intended in these negotiations to call for an increase in the contract price to reflect losses allegedly incurred in the course of the vessel's construction.

The buyer argued that, on the proper construction of Article 4.(1)(d), renegotiation of the contract terms could only be demanded if he had already exercised his right to cancel. Alternatively, the buyer submitted that there was to be implied into the contract a term that the "conditions mutually agreed" in the course of the renegotiations would be limited to terms in his favour. The buyer pointed out that, if the article were not to be so construed, its practical effect was to allow the builder the opportunity of renegotiating the terms of the contract in circumstances in which substantial delay in delivery had resulted—either wholly or partially—from his own default.

The buyer failed on both counts, Ackner J. ruling that the wording of Article 4.(1)(d) was clear and that the buyer could not circumvent its terms by communicating to the builder his intention not to rescind before such right accrued; there was in any event no scope for the implication of the term suggested by the buyer that the negotiations must result only in terms in the buyer's favour. Unsurprisingly, the judge also held that the words "delivery date set forth in this Agreement" referred to the original delivery date of

52 It is arguable that this construction is unduly favourable to the builder who, by delaying delivery in a rising market and then refusing to agree to a revised delivery date, might in theory be able to force a rescission upon the buyer. By analogy with the principles pertaining to Effective Date clauses (see pages 265–270, *infra*), it seems unlikely, however, that the court would in such circumstances permit the builder to take advantage of his own deliberate breach of contract.

53 [1974] 1 Lloyd's Rep. 301.

28 February 1973, rather than as adjusted to take into account periods of *force majeure* and other permissible delays.

Ackner J.'s construction of the unambiguous (if somewhat unusual) wording of Article 4.(1)(d) was plainly right. In reaching his decision, the judge nevertheless seems to have been unduly influenced by the fact that, if the buyer's interpretation of the Article prevailed, he alone enjoyed the right to initiate contract renegotiations in circumstances in which the cancelling right was triggered by 150 days of *force majeure* delay. In the judge's view this would:

"deprive the builder of a very valuable right to impose cancellation upon the buyer who wishes to continue with the contract but refuses to pay reasonable increases in the price caused by delays due to force majeure."[54]

It should be noted, however, that in modern shipbuilding projects the right to rescind for excessive *force majeure* delay is usually granted only to the buyer[55]; the risk of rescission in such circumstances accordingly represents an exposure which most shipbuilders are accustomed to accept. Furthermore, given that the essence of any *force majeure* provision is the allocation of the risk of loss caused by events beyond either party's control, there was no real justification for presuming that the buyer and the builder had implicitly agreed to share this risk between them.

Assuming that the parties do agree upon a revised date for the delivery of the vessel, a further right of rescission will accrue to the buyer under Article III.1 of the SAJ Form. If the vessel is not delivered by that date the builder is not entitled to any grace period beyond the "agreed future date".

(d) Repudiation of the contract

Where the delay in delivery in excess of the cancelling date is so excessive as to constitute an effective repudiation by the builder of his contractual obligations, the buyer may, upon accepting such breach as terminating the contract, be entitled to claim substantial damages at common law for his loss of bargain.[56] In practice, however, this situation is unlikely to arise given the builder's rights under Article III.1 of the SAJ Form to require the buyer to elect whether or not to rescind. Mere failure by the builder to deliver the vessel on the Delivery Date cannot, under the structure employed in the SAJ Form, normally constitute a repudiatory breach of contract; see *Lindvig* v. *Forth Shipbuilding & Engineering Co. Ltd* (1921).[57]

(e) The builder's bonus

It should be noted that the SAJ Form also incorporates (at Article III(d)) provision for a premium or "bonus" payable to the builder where the vessel is delivered earlier than the Delivery Date.[58] The amount of the bonus will usually mirror the *per diem* amount of liquidated damages payable for delay in delivery.

54 At page 310.
55 See, e.g., Article VIII.4 of the SAJ Form.
56 See pages 199–201, *infra*.
57 (1921) 7 Ll.L.Rep. 253, *per* Roche J. at page 255.
58 See also Article VI.5(5) of the CMAC Form.

The builder's right to demand the bonus only arises, however, where early delivery takes place at the specific request of the buyer. It is accordingly always open to the buyer to circumvent the provisions of the paragraph by undertaking to accept the vessel before the Delivery Date only if the builder will agree to waive or reduce the amount of his bonus.

(ii) Insufficiency of speed

The vessel's ability to reach her promised speed is a factor of crucial importance to her future employment prospects. Many standard charterparty forms contain detailed speed warranties and provisions for the payment of damages and/or a right of cancellation in favour of the charterer if these are not met. Proving her speed is therefore a primary purpose of the vessel's trials, which will almost invariably include one or more speed tests conducted over an agreed distance and under defined sea and weather conditions. If the actual conditions vary from those specified in the contract, the speed achieved in the trials will usually be corrected by reference to the model test results obtained at the design stage of the vessel's construction.

The SAJ Form provides for the payment of liquidated damages to the buyer where the actual speed of the vessel "as determined by the trial run" falls below the guaranteed speed defined in Article I.2. Commencing at 3/10ths of a knot, the builder's liability rises in gradations of 1/10th of a knot until the deficiency exceeds a full knot, at which point the builder's liability is capped. The buyer then has the option of accepting the vessel at this maximum level of liquidated damages or of rejecting her and rescinding the contract.[59]

Given that a large number of factors may affect the vessel's ability to achieve the guaranteed speed, it is important from the builder's perspective to define the precise scope of his warranty.[60]

An example of a shipbuilder's failure to take this precaution is provided by the decision of the Court of Appeal in *Admiralty Commissioners* v. *Cox and King* (1927).[61] Under a wartime contract concluded with the Admiralty, the builders were to construct a fast motor boat and install "450 h.p. Sunbeam engines" supplied by the purchasers.[62] The contract provided that the completed vessel should have a guaranteed speed of 40 knots and permitted the purchasers to cancel if the vessel failed to achieve in trials an average speed of 38 knots. This in fact occurred and the purchasers in due course cancelled the contract. Although the cause of the failure to achieve the guaranteed speed lay in the inability of the engines supplied to generate 450 horsepower when installed on board, the Court of Appeal held that the contract contained no warranty by the purchasers to such effect; the term "450 h.p Sunbeam engines" merely described the type of engines that would be provided.

59 The CMAC Form in addition provides for a premium to be paid to the builder if the trial speed exceeds the contractually guaranteed speed.

60 Note that under the SAJ and CMAC Forms, the buyer is entitled to cancel the contract when the vessel fails by a defined margin to achieve the guaranteed speed, while the NEWBUILDCON Form permits cancellation where the maximum amount of liquidated damages for the deficiency has been reached. This distinction, which applies also to deficiencies in deadweight and engine fuel efficiency, is unlikely to be material in practice.

61 (1927) 27 Ll.L.Rep. 223.

62 These were, in fact, aircraft engines which had been adapted by the Admiralty for marine use.

Recognising the importance of the issue of definition, the NEWBUILDCON Form sets out in admirably detailed format the parameters which must be adopted in proving the vessel's speed. Unless the parties have otherwise agreed in the specification, Clause 2(b)(i) of Section 1 of the Form provides that:

"... The Vessel's average speed on a sea trial undertaken in both directions over a measured distance of one (1) nautical mile, with clean hull, in weather with wind speed and sea state not exceeding Beaufort Wind Force Scale 3 and Douglas Sea State Scale 2 respectively on a draft as stated in [Box 4D(i)] shall be at least the number of knots stated in [Box 4D(ii)]. During such a sea trial the engine's output in kilowatts shall be as stated in Box 4D(iii) corresponding to the percentage of the engine's maximum continuous power output stated in [Box 4D(iv)] at the approximate revolutions per minute stated in [Box 4D(v)]".

Clause 2(b)(i) does not state what is intended by the parties if the vessel's engine output or other parameters (e.g., her draft) differ from those stipulated for the achievement of the guaranteed speed, although it seems unlikely that any variance would in itself generate any claim by the buyer. The language is in other words almost certainly descriptive of the conditions under which the vessel is required to achieve the guaranteed speed, rather than prescriptive—as such, it is submitted that, where the engine output or other parameters to achieve the vessel's measured speed on her sea trials differ from the contractually agreed parameters, the measured speed must be adjusted mathematically for the purposes of comparison with the guaranteed speed,

Where (unusually) the shipbuilding contract does not provide for liquidated damages for a deficiency in the vessel's speed, the buyer's remedies will normally be limited to a claim in unliquidated damages for any proven diminution in her value by reason of the deficiency.[63]

(iii) Excessive fuel consumption

The efficiency of the vessel's main engine is often a factor of at least equal importance to her speed. Under the SAJ Form the builder warrants that, at a given engine rating and power output, using bunkers of an agreed minimum specification and at a defined draft as normally set out in the specifications, the main engine's fuel consumption will not exceed a guaranteed figure. Where the figure is exceeded, the buyer is entitled to liquidated damages assessed by reference to the amount of the excess expressed as a percentage of the guaranteed figure; the builder is, however, allowed a small franchise within which he will not be penalised.

In contrast to the assessment of her speed and deadweight, the fuel consumption of the vessel's main engine will typically be ascertained well prior to the sea trials and delivery and acceptance of the vessel. The required tests will usually be conducted at a testbed facility in the workshops of the engine manufacturer and under conditions carefully detailed in either the contract itself or the specifications. No guarantee is provided by the builder that the engine will necessarily give the same results when installed on board the vessel.

Where the excess consumption of the engine, measured during shop trials, is greater than an agreed percentage of the guaranteed figure, the SAJ Form allows the buyer to

63 For an example of the approach taken by the English courts to such a claim (and an illustration of the difficulties faced by a buyer in proving his loss in this situation) see *Riva Bella S.A.* v. *Tamsen Yachts GmbH* [2011] EWHC 1434 (Comm) at paragraphs 99–106 of Eder J.'s judgment.

reject the vessel and rescind the contract. This can, however, cause considerable hardship to the builder in circumstances in which the engine can be modified or substituted without affecting the date of delivery of the vessel under the contract. The SAJ Form is therefore occasionally amended to provide expressly that the buyer may not rescind in such circumstances in return for which the builder must substitute the deficient engine with one conforming to the requirements of the contract.[64]

(iv) Inadequate deadweight capacity

In addition to warranties relating to the vessel's speed and fuel consumption, most shipbuilding contracts incorporate a specific guarantee as to her deadweight carrying capacity. This is again of vital importance to the buyer, whose ability to operate the vessel profitably is likely to be impaired if the warranty is breached and may possibly be enhanced if the guaranteed figure is exceeded.[65]

The builder's guarantee of the vessel's deadweight will be based on an agreed draught. It is also usual to incorporate within the contract a definition of the term itself,[66] which will often be that employed in SOLAS 1981:

"the difference in tonnes between the displacement of a ship in water of a specific gravity of 1.025 at the load waterline corresponding to the assigned summer freeboard and the lightweight of the ship."[67]

Under the SAJ Form, the buyer and the builder agree that the contract price shall be reduced where the deadweight capacity is less than the guaranteed figure; by the same token, the contract price is increased if the guaranteed figure is exceeded. In either case the figure incorporates a small tolerance within which no adjustment is made to the contract price. The adjustments are again made by reference to the percentage of the guaranteed figure represented by the shortfall (or excess).[68]

(v) Other deficiencies

In relation to certain specialised newbuildings various other deficiencies may also, by express agreement between the buyer and the builder, give rise to a right in the former to claim liquidated damages, and ultimately to rescind the contract, if the required standards are not met.

The most common examples of such further standards are those of noise and vibration, which are usually of substantial importance in the context of cruise vessels and ferries;

64 Under the NEWBUILDCON Form the buyer can reject the engine and either (a) require the builder to replace it with another engine meeting the requirements of the specifications (the time taken by the builder to replace the engine and undertake all relevant re-testing is not treated as Permissible Delay) or (b) terminate the contract; see Clause 9(c)

65 Provided, of course, that there is no adverse effect upon other performance criteria (e.g., speed, maximum draught etc.).

66 Under the NEWBUILDCON Form the deadweight calculation shall include fuel, provisions, stores, freshwater, crew and passengers in addition to spare parts not less than the requirements of the Classification Society.

67 Chapter 2, Part A, Regulation 3.21. Lightweight is defined by Regulation 3.22 as: "the displacement of the ship in tonnes without cargo, fuel, lubricating oil, ballast water, fresh water and feed water in tanks, consumable stores, and passengers and crew and their effects."

68 The NEWBUILDCON Form does not provide for a bonus for excessive deadweight.

shipbuilding contracts for such vessels typically stipulate maximum noise and vibration readings in all, or a defined category of, passenger cabins and public spaces and provide for liquidated damages and rescission rights in favour of the buyer if these standards are not met.[69] Problems associated with excessive noise and vibration are, however, often capable of resolution by adjustments made to the vessel and, from the perspective of the builder, it is clearly important that, in the event of a problem occurring, he should be given a reasonable opportunity to make the necessary changes before his liability to the buyer crystallises.

In addition to noise and vibration, other criteria which are often subject to liquidated damages include hold or cubic capacity,[70] cargo "boil-off" (for LNG tankers), pumping capacity (for oil tankers and floating storage and production vessels) and bollard pull capacity (for tugs and other towing vessels).

SETTLEMENT OF THE BUILDER'S LIABILITY IN LIQUIDATED DAMAGES

Although this is not expressly provided in the SAJ Form, commercial shipbuilding contracts often state that the builder's liability should be settled, either by way of an adjustment of the delivery instalment or in cash, at the time of delivery of the vessel.[71] Thus, for example, Article 15(c) of the NEWBUILDCON Form provides that "Any amounts for liquidated damages . . . shall be calculated and determined before delivery and . . . may be deducted from the Final Instalment".

In *Cenargo*,[72] language requiring that the buyer's liquidated damages should be deducted from the delivery instalment was, however, held to be of limited effect. In circumstances in which the buyer's claim for liquidated damages by reason of alleged deficiencies in the vessels' carrying capacity had not been asserted at the time of delivery, both the High Court and the Court of Appeal somewhat surprisingly held that the buyer could still make a retrospective claim for such damages after delivery. Given that the language of the NEWBUILDCON Form, stating the liquidated damages may be deducted from the delivery instalment, is less prescriptive than that considered in *Cenargo*, it seems unlikely that a buyer would be prevented by the terms of the contract alone from subsequently asserting a claim.[73]

Because the builder will normally have no opportunity after delivery to rectify defects in the vessel which might otherwise give rise to a retrospective liquidated damages claim, the effects of this decision seem somewhat harsh. The case is, however, based on somewhat unusual facts, in that the true cargo carrying capacity of the vessels could not

69 As with other performance criteria, a "franchise" (i.e., a limited range within which liquidated damages will initially not be payable) is, however, normally granted to the builder.

70 See Clause 11 and Article VI.3 of the NEWBUILDCON and CMAC Forms, respectively.

71 Settlement may, however, be delayed where the operational performance of the vessel (e.g., the cargo boil-off characteristics of an LNG carrier) cannot be adequately demonstrated prior to delivery.

72 *Supra*, at n. 15.

73 The decision in *Cenargo* is also important in deciding that, although the contract also contained provisions to the effect that the builder's post-delivery warranty replaced and excluded any other liability "imposed or implied by the law, customary, statutory, admiralty and otherwise", this language did not exclude the builder's express liability for liquidated damages; such liability crystallised upon delivery of the vessel, whether or not the buyer asserted a claim at that time.

realistically have been demonstrated before delivery. Where the buyer seeks after delivery to claim liquidated damages based on facts known to him but not communicated to the builder prior to delivery, there clearly remains a possibility that such claim will be deemed waived or abandoned by reason of his silence.[74]

LIQUIDATED DAMAGES AND RESCISSION

Where the buyer rescinds the contract, the extent of any deficiencies in the vessel obviously ceases to be a matter of interest or concern to him. In common with most shipbuilding contracts, the SAJ Form therefore provides (at Article III.5) that liquidated damages are not payable if the contract is rescinded[75]; this is, of course, consistent with the usual practice that the liquidated damages are paid to the buyer by way of a reduction of the contract price.

The position with regard to liquidated damages for delay in delivery is, however, somewhat different. Whether or not the buyer rescinds, it is arguable that he suffers a loss of use either of the vessel or of the investment represented by his advance instalments in the period between the Delivery Date and the date of his notice of rescission. It is therefore sometimes conceded by the builder that liquidated damages for delay in delivery should be payable in any event.

''CAPS'' ON LIQUIDATED DAMAGES

Although not forming a part of the SAJ, NEWBUILDCON or CMAC Forms, large-scale shipbuilding contracts sometimes contain clauses limiting the aggregate of the builder's liabilities under the various liquidated damages provisions of the contract to a fixed amount, usually calculated as a percentage of the Contract Price. "Capping" provisions of this type are in principle enforceable but, depending upon their true construction, apply only to the extent of limiting the builder's liability for the type of damages to which they relate; if the buyer can establish an additional breach of contract which does not fall within the ambit of any of the liquidated damages provisions thereof, the "cap" will not apply to such extent.[76] Where, for example, the builder's refusal to progress the project constitutes a repudiation by him of the shipbuilding contract which is "accepted" by the buyer, the latter's claim for damages will be determined in accordance with normal contract principles,[77] and this process will not be constrained by any "cap" on liquidated damages contained in the contract.

74 An argument based on waiver was initially asserted but not developed by the builder in *Cenargo* and the matter was therefore decided only on the basis of contractual interpretation.

75 Clauses 37(e) and 39(e) of the NEWBUILDCON Form and Article VI.9 of the CMAC Form are to similar effect.

76 Thus, for example, in *Royal Coast Maritime S.A.* v. *Malta Drydocks Ltd*, *supra*, the repairers' liability for liquidated damages for delay in delivery, calculated in accordance with an agreed daily rate, was "capped" at 7.5% of the Contract Price. This provision was held to be effective in limiting the repairer's liability for damages for delay although inapplicable in relation to the owner's claims for damages at large in consequence of the repairer's unlawful abandonment of the works. See also the unreported decision in *Phillips Petroleum Co. U.K. Ltd* v. *Snamprogetti Ltd & anr* [2001] EWCA Civ 889, C.A.

77 On this subject generally see pages 284–285, *infra*.

Article IV—Approval of plans and drawings and inspection during construction

1. Approval of Plans and Drawings:

(a) The BUILDER shall submit to the BUYER three (3) copies of each of the plans and drawings to be submitted thereto for its approval at its address as set forth in Article XVIII hereof. The BUYER shall, within fourteen (14) days after receipt thereof, return to the BUILDER one (1) copy of such plans and drawings with the BUYER'S approval or comments written thereon, if any. A list of the plans and drawings to be so submitted to the BUYER shall be mutually agreed upon between the parties hereto.

(b) When and if the Representative shall have been sent by the BUYER to the Shipyard in accordance with Paragraph 2 of this Article, the BUILDER may submit the remainder, if any, of the plans and drawings in the agreed list, to the Representative for its approval, unless otherwise agreed upon between the parties hereto. The Representative shall, within seven (7) days after receipt thereof, return to the BUILDER one (1) copy of such plans and drawings with his approval or comments written thereon, if any. Approval by the Representative of the plans and drawings duly submitted to him shall be deemed to be the approval by the BUYER for all purposes of this Contract.

(c) In the event that the BUYER or the Representative shall fail to return the plans and drawings to the BUILDER within the time limit as hereinabove provided, such plans and drawings shall be deemed to have been automatically approved without any comment.

2. Appointment of BUYER's Representative:

The BUYER may send to and maintain at the Shipyard, at the BUYER'S own cost and expense, one representative who shall be duly authorized in writing by the BUYER (herein called the "Representative") to act on behalf of the BUYER in connection with modifications of the Specifications, adjustments of the Contract Price, approval of the plans and drawings, attendance to the tests and inspections relating to the VESSEL, its machinery, equipment and outfitting, and any other matters for which he is specifically authorized by the BUYER.

3. Inspection by Representative:

The necessary inspections of the VESSEL, its machinery, equipment and outfittings shall be carried out by the Classification Society, other regulatory bodies and/or an inspection team of the BUILDER throughout the entire period of construction, in order to ensure that the construction of the VESSEL is duly performed in accordance with this Contract and the Specifications. The Representative shall have, during construction of the VESSEL, the right to attend such tests and inspections of the VESSEL, its machinery and equipment as are mutually agreed between the BUYER and BUILDER. The BUILDER shall give a notice to the Representative reasonably in advance of the date and place of such tests and inspections to be attended by him for his convenience. Failure of the Representative to be present at such tests and inspections after due notice to him as above provided shall be deemed to be a waiver of his right to be present.

In the event that the Representative discovers any construction or material or workmanship which is not deemed to conform to the requirements of this Contract and/or the Specifications, the Representative shall promptly give the BUILDER a notice in writing as to such non-conformity. Upon receipt of such notice from the Representative, the BUILDER shall correct such non-

conformity, if the BUILDER agrees to his view. In all working hours during the construction of the VESSEL until delivery thereof, the Representative shall be given free and ready access to the VESSEL, its engines and accessories, and to any other place where work is being done, or materials are being processed or stored, in connection with the construction of the VESSEL, including the yards, workshops, stores and offices of the BUILDER, and the premises of subcontractors of the BUILDER, who are doing work or storing materials in connection with the VESSEL'S construction.

4. Facilities:

The BUILDER shall furnish the Representative and his assistant(s) with adequate office space, and such other reasonable facilities according to the BUILDER'S practice at, or in the immediate vicinity of, the Shipyard as may be necessary to enable them to effectively carry out their duties.

5. Liability of BUILDER:

The Representative and his assistant(s) shall at all times be deemed to be the employees of the BUYER and not of the BUILDER. The BUILDER shall be under no liability whatsoever to the BUYER, the Representative or his assistant(s) for personal injuries, including death, suffered during the time when he or they are on the VESSEL, or within the premises of either the BUILDER or its subcontractors, or are otherwise engaged in and about the construction of the VESSEL, unless, however, such personal injuries, including death, were caused by a gross negligence (*sic*) of the BUILDER, or of any of its employees or agents or subcontractors. Nor shall the BUILDER be under any liability whatsoever to the BUYER, the Representative or his assistant(s) for damage to, or loss or destruction of property in Japan of the BUYER or of the Representative or his assistant(s) unless such damage, loss or destruction were caused by a gross negligence (*sic*) of the BUILDER, or of any of its employees or agents or subcontractors.

6. Responsibility of BUYER:

The BUYER shall undertake and assure that the Representative shall carry out his duties hereunder in accordance with the normal shipbuilding practice of the BUILDER and in such a way as to avoid any unnecessary increase in building cost, delay in the construction of the VESSEL, and/or any disturbance in the construction schedule of the BUILDER.

The BUILDER has the right to request the BUYER to replace the Representative who is deemed unsuitable and unsatisfactory for the proper progress of the VESSEL'S construction. The BUYER shall investigate the situation by sending its representative(s) to the Shipyard if necessary, and if the BUYER considers that such BUILDER'S request is justified, the BUYER shall effect such replacement as soon as conveniently arrangeable.

While it is the builder's exclusive obligation to construct and complete the vessel in accordance with the contract and the specifications, it is customary in shipbuilding projects for the buyer to be permitted continuously to monitor the progress of the contract works. For this purpose the buyer is usually afforded two distinct contractual privileges:

(a) the right to approve in advance the builder's detailed plans and drawings for the vessel; and
(b) the right to be personally represented at the shipyard by resident supervisors who are contractually entitled to inspect and approve the contract works.

By exercising these rights, the buyer is able to keep a close watch on the course of the vessel's construction and, in particular, to ensure that appropriate quality control standards are met. A balance must be struck, however, between the interests of the buyer in ensuring

compliance with the requirements of the contract and those of the builder in seeking to complete the vessel in accordance with his construction schedule.

APPROVAL OF PLANS AND DRAWINGS

Although the specification will usually incorporate a limited number of plans and drawings by way of initial definition of the project, these will not extend to the detailed "working" drawings, which will normally be prepared by the builder during the course of the construction programme. It is therefore usually agreed that the drawings will be submitted to the buyer for approval and comment as these are produced; a proportion of the drawings will also need to be approved by the classification society and the regulatory authorities.

By permitting the buyer the opportunity to review and approve working drawings in advance of their use at the shipyard, the parties seek to avoid technical errors and thereby to minimise the need for costly alterations to the vessel at a later stage in the construction process. This procedure is not intended, however, to alter the basic division of liabilities under the contract, i.e., where, as is usual, the builder is contractually responsible for the vessel's design, the buyer's approval of plans and drawings will not usually impose upon him financial liability for the builder's additional costs or losses associated with any errors and omissions in the same.

The buyer's approval of plans and drawings may, however, in certain circumstances prevent (or "estop") him from subsequently contending that elements of the vessel's design as developed by such plans and drawings are deficient or non-compliant with specifications. In English law, where parties to a contract "act on an assumed state of facts or law, the assumption being either shared by both or made by one and acquiesced in by the other",[1] either may be prevented from subsequently denying the truth of such assumption where it would be unjust to allow him to do so. A "common assumption" of this type may well occur in a shipbuilding context where a plan or drawing is approved by the buyer as compliant with the Specifications and the builder proceeds with construction of the vessel on the basis of such approval—depending upon the facts, the buyer may in such circumstances be "estopped" from demanding later changes to the vessel on the grounds that the plans or drawings he has previously approved are not in fact compliant.

However, where the contract contains an express term providing that the buyer's approval of plans and drawings shall not affect the parties' contractual obligations, the builder will usually be precluded from asserting a defence of estoppel.

In *Cenargo Ltd* v. *Empresa Nacional Bazan de Construcciones Navales Militares S.A.* (2001)[2] which concerned shipbuilding contracts for the construction of two ro-ro ferries, the purchaser claimed liquidated damages for breach of a contractual warranty regarding the vessels' cargo trailer carrying capacity, which was stated in the contracts to be 146 units of 13 metres each. The contracts further provided that "[t]he . . . approvals and/or inspections [of plans and drawings] do not diminish the Builder's responsibilities for the construction of the Vessel".

1 *Republic of India* v. *India S.S. Co. Ltd (No. 2)* [1998] A.C. 878 at page 913.
2 [2001] All E.R. (D) 223 (Jan.).

The shipbuilder argued that, upon the true construction of the contracts, it was obliged to provide cargo deck space equal to 146 slots of 13 metres each, rather than such space which would (taking into account the internal configuration of the decks) accommodate 146 trailers of 13 metres each. The shipbuilder also contended that, since the vessels had been built in accordance with plans showing the vessels with trailer spaces of 13 metres length which the buyers had approved, the latter were now estopped from asserting that the capacity of the vessels should be calculated otherwise.

The High Court held, however, that the contractual language cited above prevented the operation of an estoppel defence as this would be inconsistent with the parties' expressed intention that approval of the plans would not alter the shipbuilder's responsibility to guarantee the cargo carrying capacity of the vessels. The inclusion in the contract of language of this type is therefore clearly an issue of considerable practical importance from the buyer's perspective.

In most shipbuilding projects, the technical departments of both buyer and builder work closely together and in conjunction with the classification society and the regulatory authorities to ensure that the working drawings are approved in sufficient time to meet the demands of the builder's construction schedule. The practice of allowing the buyer to approve the builder's working plans and drawings nevertheless exposes the latter to serious risks of disruption to his construction schedule; if the buyer is slow in providing approvals, the entire project may be seriously delayed without any fault on the part of the builder. Most shipbuilding contracts accordingly incorporate strict time-limits within which the buyer's rights of approval of drawings and plans must be exercised and often provide that delay resulting from the buyer's failure to respect the same shall constitute Permissible Delay.[3]

Under Article IV.1 of the SAJ Form, the buyer is initially allowed 14 days, counting from the date of receipt, within which to approve or comment upon the builder's plans and drawings. However, from the time of arrival of the buyer's representatives at the shipyard, it is assumed that the review process will be conducted on site and the timescale for approval is reduced to seven days. Where the buyer or his representatives fail to comply with these time limits, the plans or drawings in question are deemed automatically to have been approved.[4]

This does not, however, cover the situation in which the buyer expressly refuses to approve a particular drawing or, alternatively, issues an approval subject to remarks or amendments which are unacceptable to the builder. If the buyer can effectively exercise a right of veto in such circumstances, the builder may be potentially exposed if the buyer wishes for commercial reasons to delay the date of delivery of the vessel.

The SAJ Form makes no attempt to anticipate or provide for this contingency; it seems to be assumed that disputes between the buyer and the builder regarding plans and drawings should (in the last resort) be resolved by arbitration, notwithstanding the significant delays this may entail.[5]

3 See page 166, *infra*.

4 Delay caused by the classification society falls within the definition of *force majeure* in Article VIII.1 of the SAJ Form.

5 The builder may, however, be excused from liability in liquidated damages if he can demonstrate that the vessel has been delayed by the buyer's failure to approve plans and drawings in a timely fashion; see pages 66–68, *supra*.

The parties' rights under the NEWBUILDCON Form are more clearly defined. In particular, the builder is obliged to "commence or continue construction" of the vessel on the basis of the buyer's remarks and amendments to the builder's plans and drawings only where these are not "of a nature or extent that constitutes a modification or change" to the contract. It is further provided that, if the builder considers that any comments, remarks and amendments made by the buyer constitute such a "modification or change", the builder shall give notice to the buyer and, unless the buyer disagrees, the change will be dealt with under the modifications provisions of the contract.[6] However, in the event that the buyer does not agree that the comment gives rise to a modification, this issue is then to be dealt with under the dispute resolution provisions of the contract. Finally, pending the outcome of such a dispute, the NEWBUILDCON Form entitles the buyer to require the builder to proceed in accordance with the corrected drawing or plan on the basis that the consequences of the builder so doing will be determined by the relevant dispute resolution process (and presumably reflected in the granting to the builder of additional time or financial compensation).[7]

Somewhat confusingly, the CMAC Form provides[8] that if the buyer's remarks

"are of a nature or substance constitute (sic) necessary modifications, the BUILDER shall commence or continue construction of the VESSEL in accordance with the modified drawings and technical documents".

It is unclear whether (i) this language is simply wrong (and the draftsman meant to say that the builder is obliged to proceed on the basis of the revised drawings only if the buyer's remarks do *not* constitute a request for a modification) or (ii) the use of the word "necessary" is intended to limit its application to changes which are agreed by the builder as suitable and appropriate in light of errors in the original drawings or other technical documents submitted to the buyer.

BUYER'S REPRESENTATIVES

In addition to approving the builder's plans and drawings the buyer is also entitled to maintain his own supervisory staff at the shipyard throughout the course of the construction programme. There is no obligation upon the buyer to do so in either the SAJ or NEWBUILDCON Forms, but the CMAC Form provides, in prescriptive terms, that the buyer "shall send in good time and maintain" at the builder's shipyard one or more representatives to supervise and inspect the construction of the vessel.[9] It is nevertheless difficult to envisage that the builder would suffer significant loss by reason of any breach by the buyer of such obligation.

The rights and duties of such representatives[10] will vary from project to project, the usual practice being for the buyer to write to the builder before their arrival at the shipyard identifying the individuals in question and detailing the scope of their respective authorities.

6 Clause 20(d).
7 Clause 24(e).
8 See Article VIII.1.
9 Article IX.1.
10 The buyer's representatives are frequently referred to as his "superintendents" or "supervisors".

Generally speaking, however, the representatives' task will be to inspect the contract works as these progress and to attend on the buyer's behalf all tests of the vessel, her machinery and equipment both at the shipyard and at the premises of the builder's subcontractors and suppliers. Under the SAJ Form, it is envisaged that the buyer's representatives[11] will also be authorised on the buyer's behalf to agree to modifications to the specification and (as we have seen) to approve all working drawings and plans.

In order to permit the buyer's representatives to carry out their duties effectively, the contract will usually provide that they should be entitled to free access to the shipyard and the work premises of the builder and his subcontractors during working hours and reasonable prior notice in writing of the time and date of all tests and inspection of the vessel, her machinery and equipment. The contract will often further stipulate that, where due notice has been given, failure on the part of the buyer's representatives to attend a test or inspection shall be regarded as a formal waiver of the buyer's right to be present.

An issue will often arise in this context concerning the extent to which the buyer's representatives are entitled during the course of the construction process to conduct or demand their own tests of the vessel or parts thereof. Assume, for example, that the buyer's representatives suspect that the welding between certain plates is defective but the builder refuses their requests to conduct ultrasonic testing; are the buyer's representatives entitled in such circumstances to conduct their own tests?

This is a difficult question which will turn largely upon the precise terms of the contract in question, including the specifications. However, under the SAJ Form, the rights of the buyer's representatives are expressed to extend only to attendance at tests and inspections undertaken by "the Classification Society, other regulatory bodies and/or an inspection team of the BUILDER", implying that the representatives have no independent right to undertake tests, even of a non-destructive type.

The NEWBUILDCON Form is considerably more favourable to the buyer, providing that:

"The Buyer's Representative and/or assistants shall have the right to attend all tests trials and inspections, including those supervised by the Classification Society and Regulatory Authorities, on any parts of the Vessel whether or not installed."[12]

The buyer's representatives are further entitled under the NEWBUILDCON Form to carry out their own inspections of the vessel[13] and are permitted to communicate directly with the classification society, provided that such communication does not unreasonably interfere with the builder's own communications.[14]

In order to conduct their activities, the buyer's representatives will usually require office space at the shipyard and facilities, including e-mail links and internet access, to permit them both to communicate with the buyer and to maintain detailed records of the vessel's construction. It is customary for such accommodation and facilities to be provided to them by the builder, who will incorporate the costs of the same within the contract price. The buyer will, however, usually bear all international telephone, internet service and other communication charges incurred by his representatives whilst at the shipyard.

11 Under the SAJ Form the buyer is permitted only one representative at the shipyard, although the latter may employ an apparently unlimited number of "assistants".

12 Clause 23(b).

13 Clause 23(a). Under Article IX-2 of the CMAC Form, inspections are carried out by the buyer's representatives working alongside those of the Classification Society.

14 Clause 22(d).

The buyer is, of course, also responsible for the salaries and other costs of employing his representatives at the shipyard. It will nevertheless sometimes be agreed that the builder will finance all or part of these costs by incorporating a "buyer's allowance" for the same within the contract price.[15]

THE OBLIGATION TO NOTIFY DEFECTS

The privileges and assistance thus afforded to the buyer's representatives usually carry with them certain responsibilities to the builder. In particular, the contract will almost certainly require the buyer to notify the builder as soon as his representatives become aware of a defect in the workmanship or materials employed in the vessel's construction.

Article IV.3 of the SAJ Form[16] provides that, where such a notice has been given, "the BUILDER shall correct such non-conformity, if the BUILDER agrees to his [i.e., the Representative's] view". Nothing is said, however, as to the position where the builder disagrees with the views of the buyer's representative, and it would seem that the form again envisages that the dispute thereby arising should be resolved by arbitration. Article XIII.1 provides in this respect a mechanism by which the parties may agree to refer to the decision of the classification society:

" . . . any dispute or difference of opinion arising in regard to the construction of the VESSEL, her machinery or equipment, or concerning the quality of materials or workmanship thereof or thereon. . . . "

It should be noted, however, that the application of this mechanism is not mandatory upon the parties; if either the buyer or the builder disagrees to its use, the "compulsory" procedure under Article XIII.1 for arbitration before a panel of arbitrators must be invoked.[17]

The SAJ Form incorporates no specific sanction for breach by the buyer of the obligation that his representatives should notify defects to the builder. If, however, a defect is discovered and a notice is not issued, the buyer may be held liable for the builder's additional costs of remedying the same. In *A/B Gotaverken* v. *Westminster Corporation of Monrovia* (1971),[18] a ship repair dispute, the contract provided that "claims on account of asserted defects or deficiencies of material or workmanship shall always be given immediately after such defects or deficiencies have been discovered". According to the High Court (Donaldson J.) this placed upon the owners:

"an obligation . . . breach of which sounds in damages . . . but does not bar a claim [under the guarantee provisions of the contract]. If, for example, the owners know that the engine bed-plates are defective but allow the engines to be installed before saying anything, they may be liable in respect of the additional cost of remedial work".[19]

15 See pages 53–56, *supra*.

16 Article IX-2 of the CMAC Form incorporates almost identical language.

17 Under Article I.3 of the SAJ Form, disputes specifically relating to the vessel's compliance with class rules are to be resolved by the classification society itself, whose decision is final and binding.

18 [1971] 2 Lloyd's Rep. 505.

19 At page 513.

A more radical approach was, however, suggested in *Nelson* v. *William Chalmers & Co. Ltd* (1913),[20] a Scottish decision, in which it was alleged that the purchaser's representative had failed to advise the shipbuilder that his method of preparing steel plates for a yacht was unacceptable. Although rejecting this allegation on the facts, Lord Kinnear held that the wording of the contract, which required that all works were to be to the purchaser's satisfaction, imposed a duty upon him to report defects in the vessel to the shipbuilder. According to his Lordship:

" . . . if [the purchaser] had neglected his duty or if, on inspection, he was satisfied or had concealed his dissatisfaction so as to allow the contractors to go on with the work on the understanding that so far as already seen it was sufficient, he would in my opinion have lost his right to object to the vessel on the grounds of disconformity to contract".[21]

The obligation to construct the vessel in accordance with the requirements of the contract nevertheless remains exclusively upon the builder; it is accordingly submitted that very clear evidence of both the buyer's knowledge of a defect and his concealment of such knowledge would be needed to transfer responsibility for the same to him.[22] The SAJ Form certainly imposes no liability upon the buyer for simple negligence on the part of his representatives in failing to detect defective workmanship or materials.

No such issues arise under the NEWBUILDCON Form, which clearly negates the possibility of any waiver by, or liability upon, the buyer by reason of any failure to notify the Builder of non-conformities. Clause 23(d) of the form provides in this regard that:

"Neither the Buyer's Representative and/or assistants' inspection and/or attendance at any inspection, test or trial, nor the Buyer's Representative's and/or assistants' failure to notify the Builder of any non-conformity shall relieve the Builder from its obligations under the Contract or be deemed to be or construed as a waiver of any objection to, or any acceptance of, faulty design, construction, material and/or workmanship, or any admission that any materials or workmanship are of the standard required for the due performance of this Contract."

The buyer is more exposed, and the builder better protected, under the CMAC Form, which includes an express undertaking by the buyer that its supervisor shall act in a way to "minimize any increase in building costs and delays in the construction of the VESSEL"[23]; such obligation can, at least in principle, generate a claim in damages by the builder to the buyer to the extent of any loss caused by reason of failure by the supervisor to promote these objectives. It is, however, likely to be difficult in practice to draw line between the legitimate interests of the buyer and his supervisor in ensuring that the vessel is properly constructed and the apparently unqualified obligation upon them to minimise increased costs and delays.

LIABILITY FOR THE BUYER'S REPRESENTATIVES

In common with the builder's own workforce, the buyer's representatives will be exposed to the risk of personal injury or death resulting from industrial accidents at the shipyard

20 1913 S.C. 441.

21 At page 451. This may, however, be no more than a specific application of the general doctrine of contractual waiver.

22 Where the builder deliberately conceals a defect, this may affect the scope of his warranty obligations; see page 184, *infra*.

23 Article IX-2.

and elsewhere. The builder will normally seek to exclude any responsibility to the buyer in respect of these risks. Where, however, the contract is governed by English law and the Unfair Contract Terms Act 1977 applies, any such purported exclusion of liability for death or personal injury will normally be ineffective.[24]

Under Article IV.5 of the SAJ Form, the builder accepts a legal liability for death, personal injury or damage to the property of the buyer's representatives only in the event of his "gross negligence" or that of his workforce or subcontractors. The distinction between "gross" and "simple" negligence is, however, one that the English courts have traditionally been very reluctant to make; in *Pentecost* v. *London District Auditor* (1951),[25] for example, Lord Goddard C.J. expressed the view that:

" . . . the words 'gross negligence' should never be used in connection with any matter to which the common law relates, and for this reason: negligence is a breach of duty. If there is a duty and there has been a breach of it which causes loss, it matters not whether it is a venial breach or a serious one."

However, in *Red Sea Tankers Ltd and Others* v. *Papachristidis and Others* (1997)[26] the Commercial Court reviewed the concept of "gross negligence" in the context of management agreements relating to a fund for the acquisition and operation of oil tankers. The agreements provided that the defendants would be exempt from liability towards the claimants except for damages resulting from acts or omissions which constituted gross negligence or wilful misconduct, fraud or bad faith.

Although the agreements were subject to New York law, Mance J. considered at length the definition of "gross negligence" in English law. In his view,[27] as a matter of simple grammatical meaning, this meant "serious negligence amounting to reckless disregard, without any necessary implication of consciousness of the high degree of risk or the likely consequences of the conduct on the part of the person acting or omitting to act . . . 'Gross' negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. . . . "

Mance J. did not discuss the *Pentecost* decision in his judgment but his definition of "gross negligence", given in relation to a standard exclusion clause in a commercial contract, appears more relevant to the interpretation of Article IV.5 of the SAJ Form than the earlier judgment.

Although this is not a feature of the SAJ Form, the NEWBUILDCON Form[28] extends the concept of mutual exclusions of liability to provide for a positive "knock-for-knock" indemnity scheme as between the buyer and the builder in relation to their respective employees, subcontractor and suppliers and/or their respective personal property.

Under these arrangements, which are also a common feature of construction contracts for offshore oil and gas units, the buyer agrees, in consideration of a reciprocal promise from the builder, to indemnify the builder against claims for death, personal injury and loss or damage to property made by or through the buyer's employees, suppliers and subcontractors.

Except in respect of death, personal injury and loss or damage to property inflicted with intent to cause the same "or recklessly and with knowledge" that the "same would

24 See pages 188–191, *infra*.
25 [1951] 2 K.B. 759.
26 [1997] 2 Lloyd's Rep. 547.
27 At page 586.
28 At Clauses 37(f) and (g).

probably result", each party to a NEWBUILDCON Form contract agrees to "accept responsibility and liability" for its own personnel,[29] and (it would appear[30]) undertakes to indemnify the other party with respect thereto.

Provided that neither party is a consumer, reciprocal indemnity arrangements of this type are fully enforceable in English law and unaffected by the Unfair Contract Terms Act 1977.[31]

UNSUITABILITY OF THE BUYER'S REPRESENTATIVES

In view of the potential for loss to the builder if the buyer's inspection privileges are abused, the contract will typically contain provisions permitting the builder to request the replacement of any representative who is believed to be unfairly hindering the contract works. The buyer is normally under no absolute obligation to remove the representative in question, although he will usually assume a responsibility to investigate the builder's complaints and to effect a replacement if he considers these to be justified.

Wording to this effect is incorporated in Article IV.6 of the SAJ Form and Article IX-6 of the CMAC Form. Under the NEWBUILDCON Form the builder is entitled to require the buyer to replace any supervisor only where the builder can demonstrate that the supervisor is carrying out his duties "in an unreasonable manner detrimental to the proper progress of the Vessel".[32]

29 *Ibid*.

30 The language of the clause is not entirely clear.

31 *Thompson* v. *T. Lohan (Plant Hire) Ltd* [1987] 1 W.L.R. 649; *Hancock Shipping Co. Ltd* v. *Deacon & Trysail (Private) Ltd and Another* [1991] 2 Lloyd's Rep. 550. In *E.E. Caledonia Ltd* v. *Orbit Valve Co. Europe* [1993] 2 Lloyd's Rep. 418, [1994] 1 W.L.R. 221, Hobhouse J. expressed the view (at pages 423–424) that "the English courts should show no reluctance to give full effect to such a provision".

32 Clause 22(c).

Article V—Modifications

1. Modifications of Specifications:

The Specifications may be modified and/or changed by written agreement of the parties hereto, provided that such modifications and/or changes or an accumulation thereof will not, in the BUILDER'S judgment, adversely affect the BUILDER'S planning or program in relation to the BUILDER'S other commitments, and provided, further, that the BUYER shall first agree, before such modifications and/or changes are carried out, to alterations in the Contract Price, the Delivery Date and other terms and conditions of this Contract and Specifications occasioned by or resulting from such modifications and/or changes.

Such agreement may be effected by exchange of letters signed by the authorised representatives of the parties hereto or by cables confirmed by such letters manifesting agreements of the parties hereto which shall constitute amendments to this Contract and/or the Specifications.

The BUILDER may make minor changes to the Specifications, if found necessary for introduction of improved production methods or otherwise, provided that the BUILDER shall first obtain the BUYER'S approval which shall not be unreasonably withheld.

2. Change in Class, etc:

In the event that, after the date of this Contract, any requirements as to class, or as to rules and regulations to which the construction of the VESSEL is required to conform are altered or changed by the Classification Society or the other regulatory bodies authorised to make such alterations or changes, the following provisions shall apply:

(a) If such alterations or changes are compulsory for the VESSEL, either of the parties hereto, upon receipt of such information from the Classification Society or such other regulatory bodies, shall promptly transmit the same to the other in writing, and the BUILDER shall thereupon incorporate such alterations or changes into the construction of the VESSEL, provided that the BUYER shall first agree to adjustments required by the BUILDER in the Contract Price, the Delivery Date and other terms and conditions of this Contract and the Specifications occasioned by or resulting from such alterations or changes.

(b) If such alterations or changes are not compulsory for the VESSEL, but the BUYER desires to incorporate such alterations or changes into the construction of the VESSEL, then the BUYER shall notify the BUILDER of such intention. The BUILDER may accept such alterations or changes, provided that such alterations or changes will not, in the judgment of the BUILDER, adversely affect the BUILDER'S planning or program in relation to the BUILDER'S other commitments, and provided, further, that the BUYER shall first agree to adjustments required by the BUILDER in the Contract Price, the Delivery Date and other terms and conditions of this Contract and the Specifications occasioned by or resulting from such alterations or changes.

Agreements as to such alterations or changes under this Paragraph shall be made in the same manner as provided in Paragraph 1 of this Article for modifications or changes to the Specifications.

3. Substitution of Materials:

In the event that any of the materials required by the Specifications or otherwise under this Contract for the construction of the VESSEL cannot be procured in time or are in short supply to maintain the Delivery Date of the VESSEL, the BUILDER may, provided that the BUYER shall so agree in writing, supply other materials capable of meeting the requirements of the Classification Society and of the rules, regulations and requirements with which the construction of the VESSEL must comply. Any agreement as to such substitution of materials shall be effected in the manner provided in Paragraph 1 of this Article, and shall, likewise, include alterations in the Contract Price and other terms and conditions of this Contract occasioned by or resulting from such substitution.

The specifications, although usually intended to represent a comprehensive definition of both the vessel and the method of her construction, will almost invariably be amended on numerous occasions during the life of the contract. The majority of such amendments will be sought by the buyer in light of changes in his requirements for the vessel. The need to effect modifications to the specifications may, however, also result from amendments to the rules of the classification society and/or the regulatory authorities.[1] Finally, the builder himself may wish to alter the specifications to reflect changes either in his own working methods or in the availability of particular items of equipment and materials.

The pre-contract negotiations concerning this issue will almost certainly bring sharply into focus the conflicting interests of the buyer and the builder. While the buyer will wish to reserve the right to require that modifications be made to the specifications at any stage until delivery, the builder will be concerned to ensure that his construction programme will not be unduly disrupted by substantial or last minute changes. Where he is able and willing to undertake additional works at the buyer's request, the builder will also wish to ensure in advance that he is to be properly compensated for the same.

In most shipbuilding contracts this conflict of interests is largely resolved in favour of the builder. Although the buyer will be entitled at any stage to request modifications to the specifications, the builder's obligation to implement specific proposals will usually be conditional rather than absolute. In particular, the builder will not be obliged to accept changes to the specifications unless he is satisfied that there will be no adverse effect upon his performance of the contract or of the other contractual commitments he has assumed and the buyer agrees to vary those terms of the contract whose performance will be affected by the proposed changes. Such terms will typically relate to the price of the vessel and the Delivery Date; the builder may nevertheless also require that the vessel's speed, deadweight or fuel consumption warranties are amended or that he is partially released from his post-delivery guarantee obligations.

In practice, however, the builder will usually make substantial efforts to accommodate the buyer's requests for modifications, particularly where these are initially generated by the vessel's classification society or by the regulatory authorities. It is rare, therefore, that the parties are totally unable to agree terms for the implementation of specific modifications.

BUYER'S MODIFICATIONS

The SAJ Form adopts the approach described above, stating at Article V.1 that the vessel's specifications may be modified at any time by the buyer provided that, either individually

1 See pages 27–33, *supra*.

or when aggregated with earlier modifications, these will not in the builder's judgement "adversely affect" his "planning or programme in relation to . . . other commitments" and that the parties have reached prior agreement on adjustments to the contract terms " . . . occasioned by or resulting from such modifications and/or changes". Curiously, the SAJ Form does not permit the builder to take into account the effect of the proposed modifications upon his "planning or programme" for the vessel itself.

The practical effect of adopting this structure is to allow the builder alone to determine whether or not specific modifications should be adopted, although in so doing he is obliged, in accordance with general principles of English contract law, not to exercise such discretion unfairly.[2] In practice, except where the buyer's proposals are relatively limited in extent or actually reduce the scope of the contract works, it is likely to be open to any builder with a substantial order book to object to particular modifications on the grounds that these will adversely affect his construction programme at the shipyard. Perhaps reflecting the interests of its predominantly shipowner membership, BIMCO's NEWBUILDCON Form has taken a more robust approach to this issue, incorporating a mechanism under which the builder's refusal to undertake a requested modification can be challenged. Under this form, where the buyer seeks a modification which "in the Builder's reasonable judgement" will adversely affect his other commitments, the builder may serve a notice upon the buyer declining to undertake such modification. In such circumstances, if the buyer does not accept the builder's decision, he may override this by ordering that the work should be undertaken in any event, but on the basis that the "consequences" (which must be taken to mean the contractual consequences) of the same should be decided in accordance with the dispute resolution provisions of the contract.[3]

Although provisions of this type are regularly seen in an offshore construction context,[4] it is difficult to believe that this language will find ready acceptance in conventional shipbuilding projects. Given the "production line" approach to shipbuilding adopted by the majority of the successful north Asian shipyards, their ability to refuse buyers' modifications which will materially impact upon the performance of other projects is likely to remain a crucial protection and a significant potential obstacle to the acceptance of the unamended NEWBUILDCON language.

Somewhat archaically, Article V.1 of the SAJ Form provides that the parties may reach agreement by an exchange of letters or by cable messages confirmed subsequently by an exchange in writing; the paragraph appears nevertheless to be permissive only and the parties are not bound to agree only in writing.[5] Where, however, the parties have not reduced their agreement to paper, it may be difficult for the builder thereafter to prove the terms on which the additional works were undertaken. In particular, although it may be possible to imply a term that the buyer should pay a reasonable price for any additional

2 In *Socimer International Bank Ltd* v. *Standard Bank London Ltd* [2008] 1 Lloyd's Rep. 558, C.A., Rix L.J. held (at pages 575–577) that "a decision-maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality".

3 Clause 24(e).

4 Such contracts are typically more favourable to the oil company "employer" than conventional shipbuilding contracts are to the shipowner.

5 In contrast, the CMAC Form provides (at Article XII) that any modification "shall be effective by exchanges of . . . documents" evidencing the agreed amendments, while the NEWBUILDCON Form similarly envisages (at Clause 24) that the process will primarily be conducted in writing.

works,[6] it may be very difficult to infer from the buyer's silence his agreement to extend any indulgence in relation to other terms of the contract.[7] This may be of particular importance in relation to the time of payment for modifications, which the SAJ Form indicates[8] should be made upon the delivery and acceptance of the vessel. Such an arrangement may, however, impose significant financing burdens upon the builder where the modifications are substantial; it is therefore plainly important from his perspective that any agreement to undertake such additional works should be conditional upon amendment of the payment schedule or reimbursement of the builder's financial "carrying costs" for the same period until delivery of the vessel. It is in practice often agreed that a proportion, perhaps as much as 50%, of the agreed price of modifications should be payable to the builder "up front", with the balance payable upon the delivery.

''CLASS'' MODIFICATIONS

While it is the builder's contractual obligation to ensure that the vessel complies in full with the requirements of the classification society and the relevant regulatory authorities, this task may be immeasurably complicated if such requirements are altered during the course of construction; particularly where such alterations affect parts of the vessel which have already been completed, the costs of compliance with the revised standards may be substantial. Furthermore, the extent of the risks involved cannot easily be evaluated by either the builder or the buyer at the planning stages of the project.

Given these circumstances, it is unusual for the builder to warrant at the outset that the vessel will comply at the time of delivery with the rules then in force of the classification society and the regulatory authorities. The usual practice is rather to cast this particular risk upon the buyer by providing that any changes in the relevant class or other regulatory rules implemented after the date of signature of the contract shall be treated in the same manner as buyer's modifications, i.e., undertaken at the buyer's cost on the basis of agreed alterations to the contract terms. A more elaborate, and perhaps more modern, approach to the allocation of this construction risk is adopted in the NEWBUILDCON Form, which provides that the vessel must comply not only with applicable laws, rules, regulations and requirements in force as of the date of the contract, but also those which "if not in force

6 Section 8(2) of the 1979 Act and s. 15(1) of the Supply of Goods and Services Act 1982; what is "reasonable" is in each case a question of fact rather than law. It may in the alternative be open to the builder to assert under restitutionary principles a *quantum meruit* claim (i.e., for the value of work done) if the additional works are undertaken without a specific agreement as to price: see *Alexander Thorn* v. *The Mayor and Commonalty of London* (1876) 1 App. Cas. 120 and *Hescorp Italia SpA* v. *Morrison Construction Ltd* (2001) 75 Con. L.R. 51. In such a case, the remuneration awarded should be calculated at a fair commercial rate bearing in mind all the relevant circumstances; see *Greenmast Shipping Co. S.A.* v. *Jean Lion & Cie S.A.* [1986] 2 Lloyd's Rep. 277, which may well include an assessment of the market value of the benefit received, *Benedetti* v. *Sawiris* [2010] EWCA Civ 1427. The amount awarded will usually be the actual cost plus an uplift for overheads and profit calculated as a lump sum or as a percentage of the contract price: see *Sanjay Lachhani* v. *Destination Canada (UK) Ltd* (1996) 13 Const. L.J. 279 and *ERDC Group Ltd* v. *Brunel University* [2006] EWHC 687 (TCC).

7 See *Hull Central Dry Dock & Engineering Works Ltd* v. *Ohlson Steamship* (1924) 19 Ll.L.Rep. 54.

8 See Article II.3(d). A similar approach is taken in the NEWBUILDCON Form (see Clause 15(b)(i)) and in the CMAC Form (see Article V3(5)).

as of the date of this contract . . . are ratified and promulgated on or before the date of this contract and which will be compulsory for the Vessel on or before delivery".[9]

Under the SAJ Form, as in many shipbuilding contracts, a formal distinction is drawn between changes in class and other regulatory rules which are compulsory for the vessel and those which are merely recommended by the classification society or other relevant authority.

The practical difference between the two types of alteration is nevertheless limited. Each party to the SAJ Form is under a contractual duty promptly to pass on to the other any information it receives relating to compulsory variations, whereas this obligation does not arise where the alteration is non-compulsory in nature.[10] In relation to both types of change, the builder's position is, however, again carefully protected in that his obligation to revise the specifications is subject to the same conditions as apply to buyer's modifications under Article V.1.

In practice, it will be very rare for the builder not to agree that the specifications should be amended to comply with the revised requirements of the classification society and the regulatory authorities. If such an amendment is not made and the buyer subsequently defaults,[11] the vessel's resale value at public or private auction is likely to be substantially affected by her non-compliance with class and other regulatory requirements.

For this reason shipbuilding contracts occasionally provide that the builder shall be permitted unilaterally to make changes to the specifications in order to ensure compliance with revised class and other rules. Where this is agreed, the builder will normally be entitled to an increase in the contract price of the vessel to reflect the costs of compliance. Under the NEWBUILDCON Form, the builder is required to incorporate within the vessel any compulsory changes unless the buyer obtains a waiver from the classification society or regulatory authority imposing the same; this obligation applies even if the parties cannot agree to any required adjustments to the contract terms, although in such case the extent of the contractual adjustments is required to be assessed by an expert or a tribunal.[12] The CMAC Form is in this respect less clear, providing that compulsory changes must be accepted by the builder even if there is no agreement between the parties; in such circumstances the builder is entitled to reserve its right as to any adjustment of the contract price and the delivery date, although the form provides no guidance as to how such right may in practice be exercised.[13]

BUILDER'S MODIFICATIONS

Under the SAJ Form, the builder himself is entitled to propose modifications to the specifications in two distinct situations. As with buyer's modifications, however, the builder must in each case seek the buyer's prior consent.

9 See Clause 3(a); it is reasonable to suppose that the reference to "delivery" in this provision is intended to mean that the builder should comply with rules and regulations which are scheduled to become effective on or before the Contractual Delivery Date, this being the expected date of delivery when the contract is signed.

10 In addition, the builder's acceptance of "compulsory alterations" is unqualified, i.e., it is not subject to the requirement that the alterations in question should not adversely affect his other commitments, which is the case in relation to "non-compulsory" class or other regulatory changes.

11 See pages 209–210, *infra*.

12 See Clause 26(b).

13 See Article XII.2(3).

The first of these situations is defined in Article V.1, which permits the builder to make "minor changes to the specifications, if found necessary for the introduction of improved production methods or otherwise". The meaning of the words "or otherwise" is obscure but the sub-paragraph will often be invoked where technical errors or shortcomings have been identified in the plans and drawings forming part of the specifications which need to be amended before the contract works can proceed. In such cases, the buyer's prior approval must be obtained, although he may not unreasonably withhold the same.[14] The second situation in which the builder is contractually entitled to call for modifications arises under Article V.3 where materials required for the construction of the vessel "cannot be procured in time or are in short supply to maintain the delivery date". In such circumstances, the builder may supply substitute materials provided these are acceptable to the buyer, the classification society and the regulatory authorities.

This provision typically applies where specific items of subcontracted machinery and equipment cannot be supplied in time by a manufacturer who has been specifically identified in the specifications. The sub-paragraph is nevertheless also relevant where the items in question are "in short supply"; given, however, that the builder's rights are triggered only where the delivery date of the vessel would otherwise be affected, the wording does not entitle him to substitute a particular subcontractor or supplier merely on the grounds of cost or administrative convenience.

In contrast to the position under Article V.1, the buyer is in this situation free of any express obligation not to withhold his consent unreasonably.[15] If, however, he acts unreasonably, it is submitted that the builder may be entitled to invoke the *force majeure* exception of "shortage of materials or equipment" in Article VIII.1 of the SAJ Form as soon as the resulting delays begin to affect his performance of the contract.

The NEWBUILDCON Form allows the builder to make minor modifications and substitute materials provided that they do not affect the other terms of the contract and are approved by the classification society and regulatory authorities as well as by the buyer[16]; any savings made as a result of the modification or substitution must be credited to the buyer. Under the CMAC Form, the builder may substitute materials provided that they comply with regulations and are approved by the buyer, but he does not have the express right to make minor modifications.

DISPUTES

Difficult legal issues arise where the builder refuses to undertake modifications to the specifications because the parties have failed to reach agreement on alterations to the contract price, delivery date or other significant terms of the contract. In particular, can the buyer require the builder to submit to arbitration to establish objectively reasonable terms for the implementation of a particular modification?

14 For discussion of the meaning and extent of the obligation "not to unreasonably withhold consent", see pages 249–250, *infra*.

15 Although he must still act with "honesty, good faith, and genuineness": see n. 2, *supra*.

16 The reasons for which minor modifications may be justified are set out in more detail in the NEWBUILDCON Form, being "by virtue of changes to the builder's local conditions or facilities, the availability of materials and equipment, the introduction of improved methods or any other reason of a similar nature" (Clause 25).

As a matter of general principle, English law will not enforce either contracts to negotiate or agreements to agree.[17] If, therefore, the parties are unable to agree the basis upon which the work should be either increased or reduced, an English court or arbitration tribunal will not usually be prepared to dictate terms to them.

Much will depend, however, upon the precise terms of the contract itself. Where this imposes upon the builder an obligation to accept and implement any modifications demanded by the buyer, a failure by the builder to comply will obviously constitute a breach of contract. The existence of a contractual right in the buyer unilaterally to make modifications is not usual in a conventional shipbuilding context but is a common feature of contracts for the construction of vessels and structures for the "offshore", i.e., oil and gas industries, where the same are usually known as Variations.[18]

Where the contract does not itself stipulate "unit rates" for labour and materials for modifications and the parties cannot agree upon an appropriate adjustment to the contract price to reflect the cost of the same, English law will be quick to imply a term that the court or arbitration tribunal should determine the dispute arising between them.

Thus, in *Vosper Thornycroft Ltd* v. *Ministry of Defence* (1976)[19] the shipbuilding contract provided that, "in the event of exceptional dislocation and delay . . . due to modifications . . . or any other cause beyond the contractor's control", the effect of the same should be assessed by mutual agreement, failing which the Ministry might pay for the vessel on an "actual cost" basis plus a fair and reasonable sum for the shipbuilder's profit. The parties having failed to agree upon the extent of the dislocation and delay costs, the Ministry contended that nothing was due from them. They further argued that there was no dispute between the parties which could form the basis of arbitration proceedings.

The Court nevertheless held that, in order to render the contract workable, it was necessary to imply a term that the difference that had arisen between the parties should be determined by arbitration; in reaching this decision, Ackner J. was plainly influenced by the fact that the contract provided that the shipbuilder should undertake any works "of whatsoever nature or extent" which might from time to time be ordered by the Ministry of Defence in addition to, or in substitution for, the specifications. Unless a term could be implied that the shipbuilder could call for arbitration where agreement on the cost of modifications could not be reached, it was in the judge's words, " . . . difficult to imagine a situation in which a commercial enterprise could have given greater hostages to fortune".[20]

Where, however, the contract imposes no obligation upon the builder to accept the buyer's request for modifications, the justification for the implied term disappears. In such circumstances, it is submitted that the general rule that an "agreement to agree" is unenforceable continues to apply. There can accordingly be no right in the buyer to invoke

17 See pages 11–12, *supra*.

18 See, e.g., the "*Norsk Fabrikasjonskontrakt*" (Norwegian Fabrication Contract) 2007 (http://www.norskindustri.no/getfile.php/Dokumenter/PDF/NF_07_NorskFabrikasjonskontrakt.pdf), which provides (at Article 12.1) that: "Company has the right to order such Variations to the Work as in Company's opinion are desirable. Variations to the Work may include an increase or decrease in the quantity, or a change in character, quality, kind or execution of the Work or any part thereof, as well as changes to [the Contract Schedule]. Nevertheless, Company has no right to order Variations to the Work which cumulatively exceeds that which the parties could reasonably have expected when the Contract was entered into."

19 [1976] 1 Lloyd's Rep. 58.

20 At page 61.

the remedy of arbitration should the builder refuse to implement particular modifications following the parties' failure to agree upon mutually acceptable changes to the contract.

It is for this reason often specifically agreed that the cost and time impact of modifications sought by the buyer should, in the event of a dispute with the builder, be determined by an independent expert, whose decision on the matter will be final and binding, or by the relevant arbitration tribunal.[21] The NEWBUILDCON Form expressly provides, for example, that in the event that the buyer does not accept the builder's proposed amendments to the contract terms to address the consequences of a requested modification, the buyer may within seven days of receipt of notice of such amendments, require the builder to proceed with the modification on the basis that the amendments will be determined under the dispute resolution mechanism of the contract by an expert or, in default of an agreement thereon, by an arbitration tribunal.[22]

Finally, it should be noted that, where the buyer is entitled unilaterally to demand variations to the contract, the exercise of such right may prejudice his entitlement to claim liquidated damages for delay in completion and to cancel the contract if the builder is not permitted a reasonable extension of time for the performance of the works.[23]

21 See pages 236–237, *infra*.
22 Clause 24(3).
23 *Dodd* v. *Churton* [1897] 1 Q.B. 562, see pages 66–68, *supra*.

Article VI—Trials

1. Notice:

The BUYER shall receive from the BUILDER at least fourteen (14) days prior notice in writing or by cable confirmed in writing of the time and place of the trial run of the VESSEL, and the BUYER shall promptly acknowledge receipt of such notice. The BUYER shall have its representative on board the VESSEL to witness such trial run. Failure in attendance of the representative of the BUYER at the trial run of the VESSEL for any reason whatsoever after due notice to the BUYER as above provided shall be deemed to be a waiver by the BUYER of its right to have its representative on board the VESSEL at the trial run, and the BUILDER may conduct the trial run without the representative of the BUYER being present, and in such case the BUYER shall be obligated to accept the VESSEL on the basis of a certificate of the BUILDER that the VESSEL, upon trial run, is found to conform to this Contract and the Specifications.

2. Weather Condition:

The trial run shall be carried out under the weather condition which is deemed favourable enough by the judgment of the BUILDER. In the event of unfavourable weather on the date specified for the trial run, the same shall take place on the first available day thereafter that the weather condition permits. It is agreed that, if during the trial run of the VESSEL, the weather should suddenly become so unfavourable that orderly conduct of the trial run can no longer be continued, the trial run shall be discontinued and postponed until the first favourable day next following, unless the BUYER shall assent in writing to acceptance of the VESSEL on the basis of the trial run already made before such discontinuance has occurred.

Any delay of trial run caused by such unfavourable weather condition shall operate to postpone the Delivery Date by the period of delay involved and such delivery shall be deemed as a permissible delay in the delivery of the VESSEL.

3. How Conducted:

(a) All expenses in connection with the trial run are to be for the account of the BUILDER and the BUILDER shall provide at its own expense the necessary crew to comply with conditions of safe navigation. The trial run shall be conducted in the manner prescribed in the Specifications, and shall prove fulfilment of the performance requirements for the trial run as set forth in the Specifications. The course of trial run shall be determined by the BUILDER.

(b) Notwithstanding the foregoing, fuel oil, lubricating oils and greases necessary for the trial run of the VESSEL shall be supplied by the BUYER at the Shipyard prior to the time of the trial run, and the BUILDER shall pay the BUYER upon delivery of the VESSEL the cost of the quantities of fuel oil, lubricating oils and greases consumed during the trial run at the original purchase price. In measuring the consumed quantity, lubricating oils and greases remaining in the main engine, other machinery and their pipes, stern tube and the like, shall be excluded. The quantity of fuel oil, lubricating oils and greases supplied by the BUYER shall be in accordance with the instruction of the BUILDER.

4. Method of Acceptance or Rejection:

(a) Upon completion of the trial run, the BUILDER shall give the BUYER a notice by cable confirmed in writing of completion of the trial run, as and if the BUILDER considers that the results of the trial run indicate conformity of the VESSEL to this Contract and the Specifications. The BUYER shall, within three (3) days after receipt of such notice from the BUILDER, notify the BUILDER by cable confirmed in writing of its acceptance or rejection of the VESSEL.

(b) However, should the results of the trial run indicate that the VESSEL, or any part or equipment thereof, does not conform to the requirements of this Contract and/or the Specifications, or if the BUILDER is in agreement to non-conformity as specified in the BUYER'S notice of rejection, then, the BUILDER shall take necessary steps to correct such non-conformity (*sic*). Upon completion of correction of such non-conformity (*sic*), the BUILDER shall give the BUYER a notice thereof by cable confirmed in writing. The BUYER shall, within two (2) days after receipt of such notice from the BUILDER, notify the BUILDER of its acceptance or rejection of the VESSEL.

(c) In any event that the BUYER rejects the VESSEL, the BUYER shall indicate in its notice of rejection in what respect the VESSEL, or any part of equipment thereof does not conform to this Contract and/or the Specifications.

(d) In any event that the BUYER fails to notify the BUILDER by cable confirmed in writing of the acceptance of or the rejection together with the reason therefor of the VESSEL within the period as provided in the above sub-paragraph (a) or (b), the BUYER shall be deemed to have accepted the VESSEL.

(e) The BUILDER may dispute the rejection of the VESSEL by the BUYER under this Paragraph, in which case the matter shall be submitted for final decision by arbitration in accordance with Article XIII hereof.

5. Effect of Acceptance:

Acceptance of the VESSEL as above provided shall be final and binding so far as conformity of the VESSEL to this Contract and the Specifications is concerned and shall preclude the BUYER from refusing formal delivery of the VESSEL as hereinafter provided, if the BUILDER complies with all other procedural requirements for delivery as provided in Article VII hereof.

6. Disposition of Surplus Consumable Stores:

Should any fresh water or other consumable stores furnished by the BUILDER for the trial run remain on board the VESSEL at the time of acceptance thereof by the BUYER, the BUYER agrees to buy the same from the BUILDER at the original purchase price thereof, and payment by the BUYER shall be effected upon delivery of the VESSEL.

Although the buyer will have approved the vessel's plans and drawings and inspected her throughout the construction period, it is, of course, her condition and performance when completed (together with her adherence to the rules of the classification society and the relevant regulatory authorities) which will determine whether she complies with the standards set by the contract. It is accordingly an invariable requirement of shipbuilding projects large or small that the builder should demonstrate to the buyer that the vessel meets these standards before she is tendered for delivery.[1] Where, as is usual, the vessel is to be classed and certificated, the classification society and the regulatory authorities

1 Section 35(2)(a) of the 1979 Act, as amended by s. 2(1) of the 1994 Act, provides in any event that a purchaser of goods should have "a reasonable opportunity of examining them for the purpose . . . of ascertaining whether they are in conformity with the contract".

will also require that she should be fully and satisfactorily tested in their presence before class and statutory certificates are issued.[2]

For these purposes it is normally agreed that trials of the vessel should be conducted by the builder following completion of the construction and outfitting works; these are usually scheduled to take place one or two weeks before the anticipated date of delivery of the vessel. In the case of technically complex newbuildings, the formal trials will often be preceded by so-called "builder's trials" which, although attended by the buyer's representatives, usually have no contractual significance. Their purpose is to allow the builder to anticipate and remedy defects in the vessel before she is presented to the buyer, the classification society and the relevant regulatory authorities as being ready in all respects for their inspection and approval.

Although often referred to generically as "sea trials", these normally comprise two distinct elements, dockside tests and inspections of the vessel, which will usually include an inclining experiment to establish her lightweight and deadweight, and a period at sea during which the builder will be required to prove the vessel's speed, endurance, manoeuvrability and general sea-keeping characteristics.[3] Although the buyer, the classification society and the regulatory authorities will each be entitled and expected to attend, the vessel will remain throughout her trials at the builder's risk and under his exclusive control.

The nature and extent of the tests to be conducted by the builder will frequently be agreed by the parties at the outset of the project and defined in the contract or specifications.[4] Unfortunately, it seems to be equally common for this issue to be addressed in outline only during the negotiations for the contract on the understanding that the parties will finalise the details at a later stage, close to the vessel's expected date of delivery. This often results in serious last minute differences between the parties as to the tests and inspections which must be undertaken to prove her compliance with the contract.

During the course of the trials the builder will seek to demonstrate that the vessel performs in accordance with the requirements of the contract and specifications and, in particular, that no liquidated damages are due for deficiencies in speed, deadweight or other agreed performance requirements.[5]

Article VI.3(a) of the SAJ Form requires the builder to "prove fulfilment of the performance requirements for the trial run as set forth in the Specifications".[6] The term "performance" is not defined, although this is likely to be construed expansively so as to include the vessel's condition. In *McDougall* v. *Aeromarine of Emsworth Ltd* (1958),[7] a

2 Most shipping registers will, however, normally authorise the vessel's classification society to act on their behalf in issuing the required statutory certificates.

3 The SAJ Form refers only to a "trial run" and make no express provision for dockside tests and inspections; this is also the position under the NEWBUILDCON and CMAC Forms (although these refer to "sea trials", rather than a trial run). Any required dockside tests and inspections will, however, usually be detailed in the specifications.

4 Article I.2 of the SAJ Form provides that "the definitions and method of measurement and calculations [of the Vessel's principal characteristics] are as indicated in the Specifications".

5 The trials will not seek to prove the fuel consumption of the vessel's main and auxiliary engines, which will already have been demonstrated on a testbed; see page 75, *supra*.

6 In similar terms, the NEWBUILDCON Form provides (at Article 27(c)(i)) that the sea trials shall be: "of sufficient scope and duration to enable the parties to verify and establish that the vessel conforms in all respects with the performance requirements."

7 [1958] 2 Lloyd's Rep. 345.

contractual term that a racing yacht newbuilding would be deemed completed "provided that the performance of the craft during [her] trial run is to the reasonable satisfaction of the purchasers" was held to refer to both her condition and her performance. Giving judgment, Diplock J. expressed the view that he should:

" . . . construe the expression [i.e., 'performance of the craft'] widely and as including the standard of workmanship and materials and the compliance of the craft with the specification. To read the words . . . in a narrower sense would result in the seller being deemed to have fulfilled his contract even if the interior fittings were incomplete so long as the vessel sailed well."[8]

NOTICE OF THE TRIALS

Most shipbuilding contracts provide that the buyer should be entitled to attend every part of the vessel's trials. Although his representatives at the shipyard will normally be well aware of the proposed timetable of the trials, the contract will accordingly incorporate provisions entitling him to advance notice in writing of the same.[9]

Where, notwithstanding that the contractual period of notice has been given, the buyer's representatives fail to attend the trials, the buyer will be taken to have waived his right of attendance. In such circumstances, the contract will usually provide that, upon completion of her trials, the vessel will be deemed conclusively to comply with the requirements of the contract and specifications where the builder issues and furnishes to the buyer a certificate to such effect. In order to protect the buyer, the contract may require that such certificate of compliance be countersigned by the classification society; the extent to which the latter will be able or willing to confirm the vessel's condition and performance will, however, vary from society to society and may in practice be very limited.

Under the SAJ Form there is no requirement that the builder's certificate of compliance should be verified or countersigned by the classification society or other third party. Even if he disputes that the trials are being validly conducted,[10] it is therefore advisable for the buyer to attend the same under protest. Where he simply ignores the trials, he obviously runs the risk that he may be obliged to accept the vessel on the basis of the builder's certification of her compliance with the contract.[11]

By analogy with the position of the purchaser's surveyor *in Frederick Leyland & Co. Ltd (J. Russell & Co.)* v. *Compania Panamena Europea Navegacion Ltda* (1943),[12] it nevertheless seems clear that the builder owes a duty to act fairly in such circumstances and that the buyer may challenge the validity of a certificate issued by the builder where the vessel plainly does not comply with the standards of the contract.

8 At page 357.

9 See Article VI(1) of the SAJ Form, Clause 27(a) of the NEWBUILDCON Form and Article XIII(1) of the CMAC Form.

10 Because, e.g., he considers that the vessel is insufficiently completed to allow the trials properly to be conducted.

11 In contrast, the NEWBUILDCON Form allows the builder to proceed with sea trials in the absence of the buyer's representative, but only if a representative of the classification society and the regulatory authorities is present. Under the CMAC Form, the builder may conduct the sea trials without a representative of the buyer, the classification society or the regulatory authorities being present; his certificate confirming compliance of the vessel with the contract must nevertheless be confirmed by both the classification society and the regulatory authorities.

12 (1943) 76 Ll.L.Rep. 113, see pages 48–49, *supra*.

THE CONDUCT OF THE TRIALS

(i) Location

The trials will usually be conducted in a sea area selected by the builder in or off the territorial waters of the country in which the shipyard is located. For the purposes of determining the vessel's speed, the parties will often agree upon a distance over which the speed trial should be run (frequently a nautical mile measured by radar techniques), the minimum water depth at such location and the number of runs which are to be conducted.

(ii) Weather conditions

The contract will normally also define the weather conditions under which the trials should be conducted. Thus, for example, it may be provided that these are to take place in "good weather and smooth seas".

Under the SAJ Form, it is for the builder to determine whether the weather conditions are sufficiently favourable for the trials, which, given that he remains in legal and factual possession of the vessel until delivery, is understandable. Such approach is, however, not followed in the NEWBUILDCON Form which provides in purely objective terms that the "sea trials shall be conducted in weather conditions as described in this Contract and/or Specification".[13]

The contract will also incorporate provisions dealing with sudden changes in the weather during the course of the trials. Where the builder decides that all or any part of the trials should be postponed on account of weather conditions, the contract will usually permit him to take this step without the risk of incurring a financial penalty for delay.[14] Any time lost by reason of such decision will usually be treated as Permissible Delay.

Even if these do not prevent the trials from taking place, adverse weather conditions may nevertheless significantly affect the results obtained. This is particularly important in the context of the speed trials, as the vessel's guaranteed speed will frequently be referenced in the contract to specific wind and sea conditions simulated during model testing at the design stage of the project; it is also likely that the trials will be conducted at a ballast draught, while the guaranteed speed will usually be expressed in terms of a design loaded draught.

In such cases, the parties will usually agree that, where the weather and/or the vessel's draught during trials vary from the contract conditions, the results obtained will be adjusted to produce a true figure based upon such conditions. The adjustment will be made by reference to the model test data, the parties often agreeing that the research institute at which the model testing for the project was originally undertaken should make the necessary calculations. It is the vessel's speed, adjusted to reflect the contract conditions, which will then be used to determine whether the builder is liable in liquidated damages for any shortfall below the guaranteed speed.[15]

13 Clause 27(b).

14 Surprisingly, however, under the CMAC Form, the buyer and the builder must agree to discontinue the trials (see Article XIII.1).

15 See the High Court decision in *Cenargo Ltd* v. *Empresa Nacional Bazan de Construcciones Navales Militares S.A.* [2002] EWCA Civ 524 for an example of the complexities involved in determining a vessel's adjusted trial speed.

(iii) Crewing and navigation

Whether or not title to the vessel passes prior to that time, she will almost certainly remain at the builder's risk of loss or damage until her delivery to, and acceptance by, the buyer.[16] It is logical therefore that the builder should provide his own crew for the trials and should assume responsibility for all expenses and liabilities associated with their operation of the vessel on his behalf.[17] The terms of the builder's construction insurances will, however, usually protect him against most of the risks of loss arising in the course of the trials.[18]

The buyer's representatives will normally travel with the vessel during the course of her sea trials. In addition, the buyer may also be permitted to embark certain of his own officers and crew for purposes of familiarising themselves with her operation. The role of all such invitees will nevertheless be limited to that of observer and they will normally be permitted to play no part in the vessel's navigation. Furthermore, the fact that the builder has allowed the buyer's representatives or crew on board the vessel during the trials will not in the normal course expose the builder to liability for third party loss or damage directly caused by their negligence.

In *Hobson* v. *Bartram & Sons Ltd* (1950),[19] the plaintiff, who was employed by a sub-contractor of the shipbuilders, was seriously injured when he fell through an unprotected tweendeck hatch during the vessel's trials. The evidence indicated that the hatch had been battened down by the shipbuilders but that the battens had been removed by members of the purchasers' crew who had been allowed on board as observers and were conducting an unauthorised inspection of the vessel's holds. The plaintiff contended that the purchasers' crew were the agents of the shipbuilders during their period on board the vessel and that the shipbuilders were as such vicariously liable for their negligence.

At first instance it was held that, because (i) the shipbuilders and the purchasers "were equally interested in the success of the trials", (ii) the purchasers' crew were subject to the overall direction of the shipbuilders and (iii) their inspection of the holds was "an integral part" of the trials, the shipbuilders were liable to the plaintiff for their negligence. This decision was, however, reversed on appeal, Tucker L.J. holding that the crew were "in exactly the same position as the agents of any purchaser who goes to inspect goods before the purchase is completed". That the parties had a "common interest" in the success of the trials was wholly insufficient to render the shipbuilders liable for the negligence of the purchasers' crew.

(iv) Provisioning

It is customary in substantial shipbuilding projects for the builder to pay all the costs of provisioning the vessel during her trials. The principal expense involved is the cost of bunkers, lubricating oils and stores consumed while at sea. In the case of an LNG carrier, steps will normally need to be taken to supply a sufficient quantity of liquid "heel" in order to allow the builder to undertake before delivery the required gas handling trials and to demonstrate the "boil-off" characteristics of the vessel's cargo tanks.

16 See pages 143–144, *infra*.
17 The vessel will normally sail unregistered during her trials.
18 See pages 222–232, *infra*.
19 (1950) 83 Ll.L.Rep. 313.

Practice varies, however, as to which party is to be responsible for actually supplying such items. Under certain standard shipbuilding contracts, including the SAJ Form, it is the obligation of the buyer to purchase and provide the bunkers, lubricating oils and greases which the builder indicates are needed to undertake the trials[20] and that of the builder to supply the necessary consumable stores, including fresh water for the crew and for ballasting. Upon delivery of the vessel, the builder will give credit to the buyer, at the latter's cost price or the prevailing market rate, for the quantities of bunkers etc. consumed during the trials and the buyer will pay the builder for the unused stores remaining on board. Under the SAJ Form, the builder is not obliged to pay for the cost of lube oils and greases estimated upon delivery to remain in "the main engine, other machinery and their pipes, stern tube and the like".

This arrangement is nevertheless complicated and often administratively inconvenient for the buyer. It may also lead to minor disputes at the time of delivery, for example as to the quantities of lubes retained within the vessel's machinery, as well as the parties' obligations with regard to broached but only partly-used stores and lubes in drums.

To avoid these problems, it is accordingly sometimes agreed that the builder will provision the vessel with such bunkers, lubes and stores as he needs to undertake the trials. In such event, the contract will impose upon the buyer an obligation to purchase from the builder the quantities of these items remaining on board at the time of delivery and acceptance; the parties will usually agree that lubes and stores should be paid for only if unbroached. This is precisely the effect of Clause 27(c)(iii) of the NEWBUILDCON Form.

COMPLETION OF THE TRIALS: THE MEANING OF ''ACCEPTANCE''

Given the enormous complexity of most large-scale shipbuilding projects, it is almost inevitable that the trials will reveal the existence of deficiencies in parts of the vessel's hull, machinery and equipment. The completion of the trials accordingly marks the commencement of a vitally important stage of the project, namely the rectification of defects and shortcomings in the vessel in order to render her deliverable, i.e., in such a condition that the buyer is contractually obliged to accept her.

The interests of the buyer and the builder are likely at this point be at their most divergent. The builder, who will have expended substantial sums in completing the vessel, will be pressing the buyer to take delivery of the vessel, to pay the instalment of the contract price due at that time and, if a builder's credit has been provided, to furnish the agreed securities for the post-delivery portion of the contract price. The buyer will, in contrast, wish to ensure before accepting the vessel that she is fully completed and equipped, that all known defects have been remedied and that the certificates and documentation required for her operation have each been issued.

In considering in detail the process by which these differing interests are reconciled, it is important to appreciate that many shipbuilding contracts, including the SAJ, NEWBUILDCON and CMAC Forms, ascribe two entirely distinct meanings to the term

20 This has the advantage from the buyer's perspective of ensuring that the bunkers supplied meet his own quality and cost requirements.

"acceptance of the vessel". In its first sense, it means simply the buyer's confirmation, issued following the completion of her trials, that he approves the vessel as complying with the technical standards of the contract. Confusingly, however, the term is often also employed to denote the buyer's assumption of physical possession and control of the vessel following a formal tender of delivery by the builder.

Throughout the remainder of this chapter, "acceptance" is used in the first of these two senses, i.e., the buyer's confirmation to the builder of his approval of the vessel. The processes of acceptance and handover are nevertheless linked because the effect of an unconditional acceptance will normally be to oblige the buyer to pay the delivery instalment and take over the vessel as soon as she is tendered by the builder in accordance with the procedural requirements of the contract.[21] If, therefore, the buyer considers that the completed vessel does not meet the standards of the contract such that he is not prepared to take delivery, it is upon conclusion of her trials, rather than when she is tendered for delivery, that his objections must be voiced and any resulting dispute resolved by negotiation or arbitration.

METHOD OF ACCEPTANCE OR REJECTION

Most shipbuilding contracts incorporate detailed provisions setting out an agreed procedure by which the vessel is to be finalised by the builder and accepted by the buyer. The process will also be influenced by the general principles of English law relating to the delivery and acceptance of goods under contracts of sale.

Presentation of the trial results

Following completion of the trials, the builder will usually be required to submit the results obtained to the buyer and the classification society. Although their precise form and substance will depend upon the type of newbuilding in question, the results will typically incorporate details both of her static characteristics (e.g., lightweight and deadweight) and of her performance at sea. Data will also be provided by the builder concerning the operation under trial conditions of major items of the vessel's machinery and equipment.

The buyer's election

Following receipt of the trial results, the buyer is permitted a limited period of time (normally in the order of two to six days[22]) in which to evaluate the information provided to him and to consult with the classification society, the regulatory authorities and his representatives at the shipyard. Within such timeframe he must, however, normally elect

21 That is, together with the required certificates and other delivery documentation. The buyer is, of course, only obliged to take over the vessel if she remains at the time of delivery in the same condition as when accepted by him following completion of the trials. If, for example, the vessel has in the interim sustained damage, it is for the builder to repair her before she is tendered for delivery.

22 The CMAC Form provides for six days.

either to accept the vessel as complying with the standards of the contract or to reject her for want of such compliance.[23] If the buyer makes no election at all within the time allowed, he will usually be deemed to have accepted the vessel. This outcome is expressly provided for in Article XIII(4)(c) of the CMAC Form.

Acceptance of the vessel

If the buyer accepts the vessel following submission to him of the trial results, this step is normally irrevocable. The construction process is thereby brought to an end and the buyer becomes obliged to take delivery of the vessel as soon as she is formally tendered to him by the builder. This will usually involve a short delay as the delivery documentation is prepared and agreed in a draft form with the buyer and, where appropriate, his bank. A formal "closing" (i.e., a meeting, usually held at the shipyard, at which the delivery documentation will be executed and delivered against payment of the delivery instalment) will then be scheduled at the earliest opportunity.

It should be noted in this context that Article VI.5 of the SAJ Form provides that the buyer's express or deemed acceptance of the vessel "shall be final and binding so far as conformity of the VESSEL to this contract and the specifications is concerned". The purpose of such provision is plainly to seek to limit the buyer's rights following delivery to those arising under the builder's post-delivery warranty of workmanship and materials.

However, in *China Shipbuilding Corporation* v. *Nippon Yusen Kabukishi Kaisha and another* (2000),[24] the High Court held that the effect of this wording is limited and that the buyer's acceptance of the vessel following her sea trials operates merely to prevent him from refusing delivery of the vessel when she is tendered thereafter; it does not preclude him from asserting after delivery the existence of specific defects whether previously notified to the builder or latent at the time of delivery.[25] According to Thomas J, " . . . the purpose of the provision [is] to deal with non-rejection and the buyers' rights [are] otherwise not affected by it . . . ".[26] It is equally clear from the Court of Appeal decision in *Cenargo Ltd* v. *Empresa Nacional Bazan de Construcciones Navales Militares S.A.* (2001)[27] that acceptance of the vessel does not preclude the buyer from asserting, either upon or following delivery, a claim for liquidated damages for breach of the principal performance warranties given by the builder in respect of the vessel.[28]

It should be noted in this context that some contract forms adopt a different and more balanced approach to the effect of the buyer's acceptance of the vessel by providing that the builder's post-delivery warranty also applies to defects notified to him by the buyer at

23 The NEWBUILDCON Form also provides (at Article 27(d)(2)) that, in addition to the ground of non-conformity with the contract, the buyer may also reject the vessel following the sea trials "for other reasons which the Builder accepts as valid". However, it is entirely unclear which "other" reasons might be accepted by the builder as justifying rejection of a vessel conforming with the contract requirements and this provision seems in practice unlikely to be used.

24 [2000] 1 Lloyd's Rep. 367.

25 See pages 174–175, *infra*.

26 At page 375.

27 [2002] EWCA Civ 524.

28 See generally pages 77–78, *supra*.

the time of delivery[29]; it is submitted, however, that even where such a remedy is available, its existence does not affect the buyer's general rights in damages, whether liquidated or unliquidated, for defects existing on delivery.[30]

Rejection of the vessel

As stated above, it is highly exceptional in large scale shipbuilding projects for the vessel to comply precisely with the contract and the specifications at the time of her initial presentation to the buyer. Usually, the buyer will take the view that elements of the vessel's construction, outfitting or performance fail to comply in full with the contract and will, pending their remedy or completion, either refuse to accept, or reject, her by notice in writing to the builder. Where, however, the buyer's representatives and the builder's yard managers have co-operated closely during the vessel's construction, a middle course may sometimes be followed under which the defects will be informally discussed and a remedial programme undertaken before the results of the sea trials are formally presented to the buyer; in such cases, the formal acceptance procedures laid down in the contract will effectively be disregarded.

If the buyer refuses to accept or rejects the vessel, he is normally obliged to serve a notice, known either as a "defects list" or a "punch list", specifying in detail the respects in which she fails to meet the requirements of the contract and specifications.[31] The list will typically comprise both defective and incomplete items of work, incorporating not only deficiencies revealed by the trials but also those identified during the construction process which in the buyer's view have not been properly rectified.[32] This must, however, be prepared on the basis of objective criteria, i.e., the buyer is not entitled to reject the vessel merely because he honestly believes that she is defective if in fact she meets the standards of the contract.

In *Docker* v. *Hyams* (1969),[33] a case involving the sale of a secondhand yacht, the contract provided that:

"After the completion of . . . survey, if any material defect or defects in the yacht or her machinery shall have been found, the Purchaser may give notice to the Vendor . . . of his rejection of the yacht by indicating the nature of the defect or defects . . . the Vendor shall forthwith either indicate his willingness to make good such defect or defects without delay or make a mutually agreed cash allowance in lieu. . . . "

Following inspection, the purchaser rejected the yacht and a dispute arose as to whether, on its true construction, the contract entitled him to do so regardless of the materiality of the defects upon which he purported to rely. The Court of Appeal held that it did not,

29 Article 12(a) of the now rarely used Association of West European Shipyards (AWES) standard form contract provides, for example, that the Builder's guarantee extends to: " . . . any defects notified in writing by the PURCHASER on the VESSEL'S delivery due to bad workmanship and/or use of defective materials or defects not discoverable on delivery which become apparent during the period of . . . days from the date of delivery . . . "

30 The position is obviously otherwise where the contract expressly provides that the buyer's rights upon acceptance of the vessel shall be limited to those arising pursuant to the builder's guarantee,

31 See Article VI.4(a) and (c) of the SAJ Form, Article 27(d)(iii) NEWBUILDCON Form and Article XIII(4) of the CMAC Form.

32 Most shipbuilding contracts impose an obligation upon the buyer's representatives immediately to notify the builder of defects identified by them during the construction period see pages 85–86, *supra*. The builder is not, however, normally obliged to effect remedial works if he disagrees with the buyer's views.

33 [1969] 1 Lloyd's Rep. 487.

Edmund Davies L.J. stating that he could not accept the view that "provided he is honest, the purchaser is free to point to anything and call it a material defect even though it in fact is not."[34]

Upon receipt of the defects list, the builder must decide whether to remedy the matters raised by the buyer or to challenge his rejection of the vessel as unjustified. Where he adopts the latter course, the dispute arising between the parties will normally be resolved by arbitration.[35] To the extent, however, that the builder accepts that the buyer has identified actual defects or shortcomings in the vessel, he is normally required to remedy the same at his cost and to bear the consequences of any delay in delivery thereby caused. Following completion of the remedial works, the buyer is then obliged to re-inspect the vessel and elect once more whether to accept or to reject her. He will, however, normally be expected to limit his re-examination to the items set out in his original defects list and not permitted to raise new defects in parts of the vessel he has previously approved.

By such process of elimination, the deficiencies initially identified in the vessel are gradually reduced to the point at which she becomes legally deliverable and must therefore be accepted by the buyer[36]; depending upon the vessel's state of completion and performance during trials, this may involve the builder in making several presentations of the vessel to the buyer. It should be emphasised, however, that in the overwhelming majority of shipbuilding projects, this is a wholly constructive and co-operative process in which both parties' representatives work together to ensure the completion and delivery of the vessel at the earliest opportunity.

WHEN IS THE VESSEL DELIVERABLE?

When, therefore, is the vessel to be regarded as deliverable, i.e. sufficiently conforming to the requirements of the contract that the buyer is legally obliged to accept her? This is for a number of reasons one of the most complex issues in shipbuilding contract law.

The difficulties arise primarily out of a need to balance the interests of the buyer in ensuring that the vessel complies with the contract with those of the builder in effecting her delivery without unreasonable delay and cost. Given that the builder's post-delivery obligations are usually limited to remedying defective workmanship and materials discovered during the warranty period, the buyer's unwillingness to accept the vessel if she is incomplete or partly defective is obviously understandable; however, if absolute and unwavering compliance with the contract and specifications is required as a condition of delivery, the extent of the builder's potential exposure is enormous.[37] Where, for example, the purchaser of a cruise newbuilding costing US$250 million refuses to accept her and

34 At page 493. The position may, however, be different where (unusually) the contract states that delivery of the vessel shall be subject to the buyer's "approval" or "satisfaction"; in such cases, "then [the buyer] is the judge and as long as he is honest he need not be reasonable", *per* Harman L.J. at page 491. See also *Cammell Laird & Co. Ltd* v. *Manganese Bronze & Brass Co. Ltd* (1933) 45 Ll.L.Rep. 89, C.A., *per* Greer L.J., whose dissenting judgment was upheld on this point by the House of Lords. Note, however, that the contract, which was for the sub-supply of a propeller, provided that the propeller should be to the "entire satisfaction" both of the shipbuilder and of the vessel's purchaser.

35 See pages 233–238, *infra*.

36 This process is similar to the "snagging" procedures employed in non-marine construction projects.

37 This will normally comprise the costs of financing the unpaid balance of the contract price and safeguarding and insuring the vessel pending her eventual delivery.

to pay the delivery instalment because of a variety of minor defects costing US$25,000 to remedy, the cost to the builder if he is legally required to complete the remedial works before tendering the vessel for delivery is likely to be wholly disproportionate to the benefit such works will confer upon the buyer.[38] This is particularly so where (as is usually the case) the builder is willing to undertake the works as soon as practically possible after delivery and acceptance have taken place.

The matter is further complicated by the fact that the buyer's conduct may not always be exclusively motivated by legitimate concerns as to the vessel's condition. Disputes as to the deliverability of a newbuilding are notoriously prone to occur in a poor freight market, when the buyer wishes to delay delivery or even to avoid taking delivery altogether. If he can successfully contend that he is not obliged to accept her until all outstanding work items of any nature whatsoever have been completed, this may cause the vessel's delivery to be sufficiently postponed that the buyer can exercise a right to rescind the contract for delay.

The third source of difficulty in this context has been the failure of English law to develop detailed rules to define the quality standards which must be met in order to render manufactured goods legally deliverable. Much of the nineteenth century case law forming the foundation of the Sale of Goods Act 1893 (on which the 1979 and 1994 Acts are modelled) related to contracts for the sale of commodities, rather than manufactured items;[39] until recently, however, there has been relatively little consideration given by judges and parliamentary draftsmen to the circumstances in which complex manufactured goods demonstrate substantial, but not total, compliance with the terms of a detailed technical specification forming part of a contract of sale. As a consequence, the English courts have usually resorted to applying generalised concepts of the standards of the "reasonable purchaser" to determine the circumstances in which such goods are legally deliverable, which approach was given statutory endorsement in the 1994 Act.

A. General principles

Conditions, "innominate" terms and warranties

Before considering the specific issue of the buyer's right to reject the vessel on quality grounds,[40] it is necessary to examine briefly the distinction which exists generally in English law between three principal types of contractual term, *viz.* conditions, "innominate" terms and warranties. This was succinctly expressed by Lord Scarman in *Bunge Corporation* v. *Tradax Export S.A.* (1981)[41] in the following terms:

"A condition is a term the failure to perform which entitles the other party to treat the contract as at an end. A warranty is a term breach of which sounds in damages but does not terminate, or entitle the other party to terminate, the contract. An innominate or intermediate term is one the effect of

38 Much will obviously depend, however, on the nature and quality of the defects in question. A minor problem in her navigational system costing only a nominal sum to remedy may, for example, prevent the vessel from operating altogether.

39 See, e.g., the comment of Farwell L.J. in *Bristol Tramways & Carriage Co. Ltd* v. *Fiat Motors Ltd* [1910] 2 K.B. 831, that the term "merchantable quality", as used in the 1893 Act, was "more . . . appropriate to natural products such as grain, wool or flour, than to a complicated machine".

40 That is, on grounds that the vessel does not meet the express or implied standards of the contract.

41 [1981] 2 Lloyd's Rep. 1, H.L.

non-performance of which the parties expressly or (as is more usual) impliedly agree will depend on the nature and consequences of the breach."[42]

Although the 1893 and 1979 Acts refer only to "conditions" and "warranties", it is clear from the decision of the Court of Appeal in *Cehave M.V.* v. *Bremer Handelsgesellschaft mbH (The "Hansa Nord")* (1975)[43] that the tripartite division of contractual terms referred to above applies equally to contracts of sale as to other commercial agreements governed by English law.

Principles of construction

In order to determine whether a contractual provision is a condition, an innominate term or a warranty, this must in each case be construed against the background of the contract as a whole and the factual matrix of which it forms a part.[44] There are, however, two guiding principles which are of particular importance in this context. First, English courts and arbitration tribunals will, where possible, seek to avoid construing terms in contracts of sale as conditions if to do so would allow the purchaser of goods unreasonably to reject them. This presumption is a specific application in the context of the sale of goods of a general rule laid down by the House of Lords in *Schuler (L) A.G.* v. *Wickman Machine Tool Sales Ltd* (1973)[45] that a contractual term will not, in the absence of clear wording, be interpreted as a "condition" if this would produce a wholly unreasonable result. In the words of Roskill L.J. in *The "Hansa Nord"* (1975)[46]:

" . . . a Court should not be over ready, unless required by statute or authority so to do, to construe a term in a contract as a 'condition' any breach of which gives rise to a right to reject. . . . In principle contracts are made to be performed and not to be avoided according to the whims of market fluctuation and where there is a free choice between two possible constructions, I think the Court should tend to prefer that construction which will ensure performance and not encourage avoidance of contractual obligations."[47]

In *B.S. & N. Ltd (BVI)* v. *Micado Shipping Ltd (Malta) (The "Sea Flower")* (2001)[48] Waller L.J., citing a passage from Chitty on Contracts,[49] held that a contractual term would be categorised as a condition where:

" . . . the nature of the contract of the subject-matter or the circumstances of the case lead to the conclusion that the parties must, by necessary implication, have intended that the innocent party would be discharged from further performance of his obligations in the event that the term was not fully and precisely complied with . . . "

and that unless otherwise so categorised by statute, judicial decision or the agreement itself, all other contractual terms should be treated as innominate in nature.

Secondly, if the term in question is one which can be breached in a number of different ways, each of which will have distinct financial consequences for the innocent party, it is

42 At page 7.
43 [1975] 2 Lloyd's Rep. 445, C.A.
44 *Per* Lord Wilberforce in *The "Diana Prosperity"*, *infra*, as approved by Lord Scarman in *Bunge* v. *Tradax* at page 7.
45 [1973] 2 Lloyd's Rep. 53, cf. *Charter Reinsurance Co. Ltd* v. *Fagan* [1997] A.C. 313 at 388.
46 *Supra* at n. 43.
47 At page 457.
48 [2001] 1 Lloyd's Rep. 341, C.A.
49 28th edn, paragraph 12–040.

likely to be categorised as an innominate term. According to Lord Scarman in *Bunge* v. *Tradax*:

"If the stipulation is one which on the true construction of the contract the parties have not made a condition, and breach of which may be attended by trivial, minor or very grave consequences, it is innominate and the court (or an arbitrator) will, in the event of dispute, have the task of deciding whether the breach that has arisen is such as the parties would have said, had they been asked at the time they made their contract, 'It goes without saying that, if that happens, the contract is at an end'."[50]

In *Bunge* v. *Tradax*, his Lordship, referring to the seminal decision of the Court of Appeal in *Hongkong Fir Shipping Co. Ltd* v. *Kawasaki Kisen Kaisha* (1961),[51] cited the example of the shipowner's implied obligation under a time charterparty to deliver a seaworthy vessel. This was plainly innominate in nature because its breach "may be trivial (e.g., one defective rivet) or very serious (e.g. a hole in the bottom of the ship)".[52]

In *Aktion Maritime Corporation of Liberia* v. *S. Kasmas & Brothers Ltd (The "Aktion")* (1987)[53] which involved the sale of a secondhand vessel, the Commercial Court (Hirst J.), relying heavily upon *The "Hansa Nord"*, held that a contractual term which provided (*inter alia*) that the vessel should be delivered with "Class fully maintained", all certificates "clean valid and unextended for a minimum of six months after delivery" and her machinery in "normal working condition" was innominate in nature rather than a condition. Hirst J. reached his decision on the basis that, given the "very widely variable gravity of potential breaches" to which the clause could give rise, it was "more reasonable" to interpret it as an innominate term than as a condition. In the context of a deliverability dispute relating to various items of allegedly defective equipment (in particular faulty air-conditioning and cathodic protection systems), the court held, in effect, that minor problems which could easily be rectified should not give rise to an absolute right of rejection.[54]

The right to reject goods on quality grounds

Against this background, the general rules of English law determining the rights of a purchaser to reject goods on quality grounds are as follows:

(a) goods tendered under a contract of sale are in a deliverable state where the purchaser "would under the contract be bound to take delivery of them"[55];
(b) the purchaser is not bound to accept delivery of goods tendered to him if their deficiencies or shortcomings are such as to constitute either breach of a condition[56] or breach of an innominate term which "goes to the root of the contract"[57] or "deprives him of substantially the whole benefit which it was the

50 *Supra*, at page 543 of the judgment.
51 [1961] 2 Lloyd's Rep. 478.
52 *Supra*, at page 543 of the judgment.
53 [1987] 1 Lloyd's Rep. 283.
54 See also the *Attica Sea Carriers Corporation* v. *Ferrostaal Poseidon Bulk Reederei GmbH (The "Puerto Buitrago")* [1976] 1 Lloyd's Rep. 250, where a time-charterer's obligation to redeliver the vessel in "the same good order and condition as on delivery" was held not to be a contractual condition.
55 Section 61(5) of the 1979 Act.
56 See *Arcos Ltd* v. *E. A. Ronaasen & Son* [1933] A.C. 470.
57 See *The "Hansa Nord"*, *supra,* at n. 43.

intention of the parties that he should obtain from the contract".[58] Where, however, the defect represents either a lesser breach of an innominate term or a breach of warranty, there is no right of rejection and the purchaser is limited to an action in damages;

(c) unless otherwise excluded, there are to be implied into any contract of sale governed by the 1979 Act[59] under which the seller sells "in the course of a business" three specific conditions (hereafter the "statutory implied terms") relating to quality[60]:
   (i) that, in sales of goods by description (which encompass agreements to sell future goods to be manufactured by the vendor), the goods will correspond with their contractual description (s. 13);
   (ii) that the goods will be of "satisfactory" quality (s. 14(2))[61];
   (iii) that, where the purchaser has made known to the vendor that the goods are being purchased for a particular purpose, they will be "reasonably fit" for that purpose (s. 14(3));

   Unless this is "so slight" that it would be unreasonable for the buyer to do so, a breach by the seller of any of these implied conditions entitles the buyer to reject the goods.[62]

(d) subject to the Unfair Contract Terms Act 1977,[63] the implication of any of the above terms may, however, be "negatived or varied" by express agreement, a course of dealing between the parties or a usage (i.e. a custom of the trade) which binds both of the parties.[64]

B. The application of the general principles

In considering the effect of these rules in a shipbuilding context, it is important to appreciate that in most newbuilding contracts the parties expressly agree to exclude the statutory implied terms.

This reflects the customary practice by which the builder, although undertaking to deliver a newbuilding meeting the requirements of the contract and to rectify all defects discovered during the warranty period resulting from faulty workmanship or materials,[65] provides no general guarantee of quality and accepts no financial liability for the buyer's losses caused by deficiencies or shortcomings in the vessel. While the builder agrees to bear the cost of work and materials to repair defective items falling within the terms of his

58 *Per* Lord Diplock in *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] 1 Lloyd's Rep. 545 at page 553.

59 That is, any sale of (or agreement to sell) goods for a "money consideration"; s. 2(1) of the 1979 Act.

60 Section 12(1) of the 1979 Act also implies a condition that the vendor is entitled to sell the goods, or will be so entitled at the moment in time at which title is to pass to the purchaser; this is not usually a contentious issue in a shipbuilding context.

61 As amended by s. 1(1) of the 1994 Act.

62 Note, in this context, the observation of Ormrod L.J. in *The "Hansa Nord"*, *supra*, that ". . . in all those sections of the Sale of Goods Act which create implied conditions, the word 'condition' is by definition a code word for 'breach of this term will entitle the buyer to reject the goods' . . ." (at page 467 of the report). The contract nevertheless remains in force and the seller is usually entitled to re-tender conforming goods to the buyer; see *infra* at pages 122–123.

63 See pages 188–191, *infra*.

64 Section 55(1) of the 1979 Act.

65 See pages 170–188, *infra*.

warranty, all other expenses and losses resulting from defects discovered after delivery almost invariably fall to the buyer's account.

Under the SAJ Form, this is achieved by the provisions of Article IX.4(c) which state that the builder's post-delivery warranty:

"... replaces and excludes any other liability, guarantee, warranty and/or condition imposed or implied by the law, customary, statutory or otherwise, by reason of the construction and sale of the VESSEL by the BUILDER for and to the BUYER."

Subject to the application of the Unfair Contract Terms Act 1977, there is little doubt that provisions of this type are fully enforceable in English law[66] and achieve their intended objective of excluding the statutory implied terms.[67] Furthermore, as will be seen,[68] the 1977 Act has only limited application in the context of shipbuilding projects.

In considering questions of the deliverability of the vessel, it will therefore usually be the express terms of the contract, rather than the provisions of ss. 13 and 14 of the 1979 Act, which are of relevance. The situation in which the buyer and the builder have contracted without excluding the statutory implied terms nevertheless often occurs and is therefore also considered below (see section B.(ii)).

(i) Where the statutory implied terms are excluded by the terms of the contract

If (as under the SAJ, NEWBUILDCON and CMAC Forms) the statutory implied terms have been excluded, what are the builder's obligations with regard to the quality of the vessel?

This will obviously depend entirely upon the precise terms of the contract. Under the SAJ Form, for example, the builder's obligations as to quality, which are primarily contained in Article I, require him to construct, equip and complete the vessel in accordance with the contract and the specifications (Article I.1), with certain agreed dimensions and characteristics (Article I.2) and with the requirements of the classification society and the regulatory authorities (Article I.3). The builder also gives certain undertakings as to the vessel's speed, deadweight and other performance criteria, although the remedy for breach of these terms is limited to a right to claim liquidated damages and/or rescind the contract (Article III). It is further agreed that neither the construction of the vessel nor her sale will involve a breach of patent or other intellectual property rights vesting in third parties (Article XVI).

Although this will again depend on all the circumstances of the particular case, it is submitted that, with the exception of the requirement that the vessel should be in Class (as to which see below), these terms are innominate in nature rather than contractual conditions. Whether or not the buyer is entitled to reject the vessel for non-compliance

66 *Per* Lord Diplock in *Ashington Piggeries Ltd* v. *Christopher Hill Ltd* [1972] A.C. 441 at page 501: "... subject to any limitations imposed by statute or by common law rules of public policy, parties to contracts have freedom of choice not only as to what will each mutually promise to do but also as to what each is willing to accept as the consequences of the performance or non-performance of those promises". The agreement must not, however, be so emasculated by exclusion clauses as to lose "the legal characteristics of a contract"; *Photo Productions Ltd* v. *Securicor Transport Ltd*, *supra*, again *per* Lord Diplock at page 553.

67 See, e.g., *McDougall* v. *Aeromarine of Emsworth Ltd.*, *supra*.

68 See pages 188–191, *infra*.

accordingly depends upon whether the breach in question deprives him of "substantially the whole benefit" of the contract.[69]

The requirement that the vessel should be fully in Class is, however, of a different order of importance. The confirmation of the classification society, evidenced by the granting of the required notation, that the vessel has been constructed to an internationally recognised standard is not only a vital assurance of quality to the buyer but also a virtually indispensable prerequisite to his ability to insure and trade her in a commercially efficient manner.

It therefore seems probable that an English court or arbitration tribunal would be prepared to hold that the vessel's inability to obtain the agreed notation constitutes a breach of condition automatically entitling the buyer to reject her.[70] In *Cosmos Bulk Transport Inc.* v. *China National Foreign Transportation Corporation (The "Apollonius")* (1978)[71] Mocatta J. held that a term as to the vessel's class was "clearly" a condition of her delivery under a time charterparty.

The buyer's rights of rejection under the NEWBUILDCON Form are more specifically addressed. In common with the SAJ Form, where the buyer rejects the vessel, he is obliged to advise the builder of the defects (defined in the NEWBUILDCON Form as "Delivery Defects") on which he relies as evidencing non-compliance with the contract.[72] Clause 27(d)(iv) then provides that:

"If the Delivery Defects are of minor importance and do not affect Class or the operation of the Vessel in its intended trade but the Builder is unable to rectify the matter within a reasonable time and in any event before the accrual of the Buyer's right to terminate in accordance with Clause 39 (Suspension and Termination), the Builder may nevertheless require the Buyer to take delivery of the Vessel, on condition that the Builder first:

(1) undertakes to remedy the Delivery Defects for its own cost and expense as soon as possible; and
(2) agrees in writing to indemnify the Buyer for any loss incurred as a consequence thereof, including loss of time; and
(3) provides the Buyer with a guarantee issued by the party named in Box 32 (or if Box 32 is not filled in, a bank guarantee from a first class bank) substantially in the form and substance set out in Annex A(iv) for a sum which the Buyer reasonably requests to cover (1) and (2) above, failing agreement such sums to be resolved in accordance with Clause 42 (Dispute Resolution);

whereupon the Buyer shall accept delivery of the Vessel."

A number of practical issues nevertheless arise in relation to this wording.

69 The principle is analogous to that applying to non-marine construction contracts for the provision of work and materials at a lump sum price. Where the value of the incomplete or defective work is limited, the contractor is not prevented from claiming the contract price, although a deduction may be made for the unfinished or unsatisfactory elements thereof (see *H. Dakin & Co. Ltd* v. *Lee* [1916] 1 K.B. 566; *Hoenig* v. *Isaacs* [1952] 2 All E.R. 176 and *Young T/A Allcounties Tarmacadam* v. *Thames Properties*, C.A., 21 October 1999). The principle cannot, however, apply where (as sometimes occurs) the contract provides that the builder's right to deliver the vessel is subject to fulfilment of all of his prior obligations; the effect of such a provision is (probably) to render the contract "entire" in nature and, subject to the "*de minimis*" principle (*infra*, at n. 81), to require very precise compliance with the contractual specification as a condition of delivery by the builder.

70 *Cf. The "Aktion"*, *supra* at n. 53, in which a delivery clause incorporating a "Class fully maintained" provision was held to be innominate. The vessel was, however, a five-year-old vessel sold on quite different terms from those of a typical newbuilding; furthermore, the defects in question do not appear to have affected her classification status.

71 [1978] 1 Lloyd's Rep. 53 at page 61.

72 Clause 27(d)(iii).

First, it should be noted that, in order for a defect to attract the operation of the subclause, it must both (i) be "of minor importance" and (ii) not affect "Class or the operation of the vessel in its intended trade"; furthermore the builder must be unable to rectify the defect within a "reasonable time", and in any event before the buyer would be entitled to terminate the contract for delay in delivery.[73] Although the language used is imprecise,[74] the combination of these various criteria is likely to mean in practice that only the most basic and limited defects in the vessel will attract the operation of the subclause—all other defects will, *ex hypothesi*, entitle the buyer to refuse to accept delivery of the vessel even where their practical impact upon the revenue-generating capability of the vessel is limited.

Secondly, and perhaps more importantly, for the builder to be entitled to compel delivery of the vessel notwithstanding the existence of a Delivery Defect, he is obliged both to undertake to rectify the same "as soon as possible" and to indemnify the buyer "for any loss incurred as a consequence thereof, including loss of time". The builder's indemnity is unlimited in amount and not subject to any requirement that the buyer's losses recoverable thereunder should have been the reasonably foreseeable consequence of the repairs to the Delivery Defect in question.

Thirdly, the builder is obliged to provide to the buyer a third-party guarantee by way of security for his repair and indemnity obligations, the guarantee being "for a sum which the Buyer reasonably requests" or, in the absence of agreement, as determined under the dispute resolution provisions of Clause 42 of the form. Although, unlike the builder's own indemnity, the pro forma guarantee appended to the NEWBUILDCON Form is subject to a financial limit, defined as the "Maximum Liability", the guarantee is open-ended in terms of its period of validity and unlikely as such to be acceptable to a range of financial institutions from whom the builder might wish to obtain it.[75]

Unless the contract provides for an unusually high level of liquidated damages for delay in delivery, or the buyer might otherwise be entitled to terminate for delay, the risks to which the builder is exposed by implementing the Clause 27(d)(iv) procedure therefore seem very substantial in comparison with the alternative of simply rectifying the "minor" defect itself. As such, it seems unlikely that the procedure provided by Clause 27(d)(iv) will in practice be widely embraced by the shipbuilding community.

The equivalent CMAC Form provisions,[76] which state simply that:

"The BUYER shall not reject to take delivery of the VESSEL due to remarks made after the sea trials and/or further sea trials. While the BUILDER shall remove the remarks (if such remarks are acceptable to the BUILDER) before effecting delivery of the VESSEL to the BUYER under the contract"

are ungrammatical and difficult to understand. It seems unlikely that any export buyer would in practice be prepared to agree that his "remarks" regarding the vessel's condition

73 This is obviously problematic in that the Clause requires an assessment of the likely date on which the buyer's termination rights will accrue, which may in turn depend upon a number of matters, including future Permissible Delays, which cannot be prospectively assessed. It is submitted that the clause is workable only (if at all) on the basis that the potential impact of all such potential delaying events is left out of the "equation".

74 The sub-clause in particular provides no assistance as to the categorisation of defects into those of "major" and "minor" importance, nor as to the timescale within which repairs ought reasonably to be completed.

75 See Clause 4 of the *pro forma* guarantee.

76 Article XIII.4(e).

can effectively be disregarded by the builder on the basis that these are not "acceptable" and that delivery can accordingly be effected without the builder addressing the same.

(ii) Where the statutory implied terms are not excluded by the terms of the contract

As previously indicated, the terms as to quality implied by the 1979 Act are compliance with description, satisfactory quality and reasonable fitness for purpose.[77]

General principles

The duties imposed upon the builder by the statutory implied terms are strict in nature and the buyer's rights to reject the goods tendered and/or to claim damages for breach are not therefore dependent upon demonstrating that this has resulted from the builder's negligence in the performance of the contract works. Nor is the builder excused if the defect giving rise to the breach results from a quality failure attributable to a subcontractor, even if that subcontractor represents the only source of supply of the item in question.[78] Furthermore, the fact that the builder provides a post-delivery warranty of the vessel and her equipment does not in itself prevent the implication of the statutory terms[79]; as previously discussed, however, the warranty clause will normally also incorporate an express exclusion of any and all implied terms as to quality, whether statutory or otherwise.

(a) Compliance with description

In the context of all contracts for the sale of goods by description, s. 13 of the 1979 Act implies a condition that the goods tendered will "correspond with the description". Historically, the English courts have taken the view that this provision is to be strictly applied, so that any deviation whatsoever from the contractual description entitles the purchaser to reject the goods tendered to him, whether or not the non-conformity would have caused him loss had he accepted them.[80]

This can, however, cause obvious hardship to a seller who has complied substantially with the requirements of his contract, particularly if the goods in question are complex in nature and the defects constituting the element of non-compliance are of no real importance to the purchaser.[81] In recent times judicial moves have accordingly been made

77 There is also implied as a matter of common law a condition that the vessel will be seaworthy; see *J. Samuel White & Co. Ltd* v. *Coombes, Marshall & Co. Ltd* (1922) 13 Ll.L.Rep. 122, *McDougall* v. *Aeromarine of Emsworth*, *supra*, and *Dixon Kerly Ltd* v. *Robinson* [1965] 2 Lloyd's Rep. 404 (where the existence of the condition was assumed, although a breach was not proven). It is, however, very unlikely, if the vessel is in fact unseaworthy, that she will comply with any of the statutory implied terms as to quality.

78 *Young & Marten Ltd* v. *McManus Childs Ltd* [1969] 1 A.C. 454; see also *Independent Broadcasting Authority* v. *EMI Construction Ltd and BICC Construction Ltd* (1978) 11 B.L.R. 29.

79 *Cammell Laird & Co. Ltd* v. *Manganese Bronze & Brass Co. Ltd*, *supra*, *per* Greer L.J. at page 115; *Rogers* v. *Parish (Scarborough) Ltd* [1987] 2 W.L.R. 353, C.A.

80 See, e.g., *Arcos Ltd* v. *Ronaasen (E.A.) & Son* [1933] A.C. 470; *Re Moore & Co. Ltd and Landauer & Co.* [1921] 2 K.B. 519. Note, however, that these authorities were said by Lord Wilberforce in *The "Diana Prosperity"*, *infra*, to be "excessively technical and due for a fresh examination" (at page 626). In light of similar criticisms by Lord Simon of Glaisdale and Lord Kilbrandon, they are probably no longer good law.

81 It is open to English courts and arbitration tribunals to apply the principle "*de minimis non curat lex*" (the law does not concern itself with trifles) to preclude reliance by the purchaser upon very minor breaches of contract. The scope of the doctrine is, however, very limited indeed.

to restrict the ambit of s. 13 in quality disputes by holding that, for this purpose, the contractual description of goods only encompasses terms which, viewed objectively, are of commercial significance to the purchaser.[82] This more pragmatic approach was clearly sanctioned by the House of Lords in a charterparty case of some significance, *Reardon Smith Line Ltd* v. *Yngvar Hansen Tangen (The "Diana Prosperity")* (1976),[83] which was argued and decided[84] on the assumption that the relevant principles were the same as those applying to contracts of sale.

In *The "Diana Prosperity"* a long-term charterparty had been concluded on a "Shelltime 3" form in respect of a vessel under construction described as "Japanese flag . . . Newbuilding motor tank vessel called Yard No. 354 at Osaka Zosen [Shipyard]". The vessel which was in due course tendered to the charterers had, however, been constructed at the Oshima shipyard, where she was known as hull 004, under sub-contracting arrangements concluded between Oshima and Osaka. Against the background of a falling freight market, the charterers rejected the vessel on the grounds that she did not comply with her contractual description.

The House of Lords ruled that they were not entitled to do so. Delivering the principal judgment, Lord Wilberforce (with whom Lord Simon of Glaisdale and Lord Kilbrandon expressly agreed) held that:

"Even if a strict and technical view must be taken as regards the description of unascertained future goods (e.g., commodities) as to which each detail of the description must be assumed to be vital, it may be, and in my opinion is, right to treat other contracts of sale of goods in a similar manner to other contracts generally so as to ask whether a particular item in a description constitutes a substantial ingredient of the 'identity' of the thing sold, and only if it does to treat it as a condition."[85]

In expressing this view, his Lordship expressly accepted the correctness of both the approach taken by the Court of Appeal in *The "Hansa Nord"*[86] in "attending to the nature and gravity of a breach . . . rather than in accepting rigid categories which do or do not give a right to rescind . . . " and the views expressed by Mocatta J. and Lord Denning M.R. in the lower courts in *The "Diana Prosperity"* that absolute compliance with the terms of the contractual description was not a condition of the charterers' obligation to accept the vessel.[87]

Even if this view were wrong, however, Lord Wilberforce held that the charterers had still failed to establish a right to reject the vessel. Assuming "the strictest rules as to 'description'" applied, it was in his view necessary to draw a distinction in such cases between terms whose object was to state or identify an essential part of the description of the goods and terms intended to identify the goods in the sense of "pointing out where

82 There is some authority for the proposition that s. 13(1) has no application at all to quality disputes; see *Manchester Liners* v. *Rea* [1922] 2 A.C. 74, *per* Lord Dunedin at page 80 and *Ashington Piggeries Ltd* v. *Christopher Hill Ltd*, *supra*.

83 [1976] 2 Lloyd's Rep. 621.

84 At least in the House of Lords.

85 At page 626.

86 *Supra* at n. 43.

87 See *per* Mocatta J. at page 67 ("Rescission would only be justified if the misdescription is sufficient to make a fundamental difference to that which the party has contracted to take") and *per* Lord Denning M.R. at page 72 ("It is sufficient that the vessel to be delivered will be in substance the vessel described in the charterparty"). A similar test was applied in the context of misdescription of a time-chartered vessel in *Cargo Ships "El-Yam" Ltd* v. *Invoer-En Transport Onderneming "Invotra" N.V.* [1958] 1 Lloyd's Rep. 39, *per* Diplock J. at page 52.

they may be found"; only those falling within the former category constituted part of the contractual description of the goods for the purposes of s. 13. Employing this test, Lord Wilberforce held that the vessel's hull number was merely a label, or "substitute for a name", used to identify the vessel to be tendered under the charterparty, which accordingly fell within the latter category.[88]

Although Lord Wilberforce also referred to the specifications attached to the charterparty as "by way of warranted description with which of course the vessel must strictly comply",[89] it is clear from his judgment as a whole that he intended that a commonsense approach should be taken to the exercise by a purchaser of rights to reject goods for non-compliance with their contractual description.[90] This echoes an earlier House of Lords' judgment, that of Lord Diplock in *Ashington Piggeries Ltd* v. *Christopher Hill Ltd* (1972)[91] in which, anticipating the views expressed by Mocatta J. and Lord Denning M.R. in *The "Diana Prosperity"*, his Lordship held that:

"The 'description' by which unascertained goods are sold is . . . confined to those words in the contract which were intended by the parties to identify the kind of goods which were to be supplied. It is open to the parties to use a description as broad or narrow as they choose. But ultimately the test is whether the buyer could fairly and reasonably refuse to accept the physical goods proffered to him on the ground that their failure to correspond with that part of what was said about them in the contract makes them different goods from those he had agreed to buy."[92]

In the light of these authorities, it seems that, where the buyer seeks to rely upon s. 13 as a basis for rejecting the vessel, he may do so only where the deficiencies and shortcomings relied upon constitute "a substantial ingredient" of her description such that a reasonable purchaser would regard her as wholly distinct from the ship he had contracted to purchase.

Section 15A of the 1979 Act[93] provides in this regard for a further limitation upon the buyer's rights of rejection.

Subject to any contrary intention of the parties,[94] s. 15A(1) of the 1979 Act provides that, where the buyer would otherwise have been entitled to reject goods by reason of a breach by the seller of any of the statutory implied terms of compliance with description, "satisfactory quality"[95] or "reasonable fitness for purpose"[96] but:

" . . . the breach is so slight that it would be unreasonable for him to reject them, then, if the buyer does not deal as a consumer, the breach is not to be treated as a condition but may be treated as a breach of warranty."

88 The same view of the status of the vessel's hull number was taken by the Court of Appeal in *Sanko S.S. Co. Ltd* v. *Kano Trading Ltd* [1978] 1 Lloyd's Rep. 156, in which *The "Diana Prosperity"* was followed and applied.

89 *Supra*, at page 626; if these followed the usual format of Appendix B to the "Shelltime 3" form, the specifications were, however, significantly less detailed than those attached to most shipbuilding contracts.

90 Note that Lord Wilberforce had previously expressed the view in *Ashington Piggeries*, *infra* (at page 489) that s. 13 was not designed: "to provoke metaphysical discussions as to the nature of what is delivered, in comparison with what is sold. The test of description, at least where commodities are concerned, is intended to be a broader, more commonsense, test of a mercantile character. The question whether that is what the buyer bargained for has to be answered according to such tests as men in the market would apply."

91 [1972] A.C. 441.

92 At pages 503–504.

93 As inserted by s. 4 of the 1994 Act.

94 Section 15A(2).

95 *Infra*, pages 118–120.

96 *Infra*, pages 120–121.

As such, it is clear that the applicable test in rejection disputes under sales contracts which are subject to the statutory implied terms is whether, in light of the condition in which the goods were tendered for delivery by the seller, a "reasonable purchaser" would have accepted or rejected them. The burden of proof of unreasonable conduct rests upon the seller.[97] This issue will depend in each case upon expert evidence as to market practice in the industry in question and, in relation to complex goods such as newbuildings, it is obviously impossible to elucidate any universal principle which will determine what would and would not be regarded as acceptable by a reasonable shipowner.[98]

By way of example, however, it is thought that a shipowner would normally be justified in rejecting a "geared" bulk carrier if she is tendered for delivery with cranes which manifestly fail to meet the standards of the specifications, thereby preventing her from operating safely and efficiently as a self-unloading vessel. Where, in contrast, she suffers from defects or shortcomings in minor items of machinery and equipment (for example, the air-conditioning system for the bridge and accommodation areas), which faults would obviously neither affect her class status nor impede her commercial operations, it is very unlikely to be "reasonable" for the buyer to reject her.[99]

Particularly if he has reserved his right to require that these defects be rectified after delivery, it also seems improbable that the buyer's acceptance of the vessel in such circumstances would be regarded by an English court or arbitration tribunal as excusing performance of the builder's basic obligation to complete her in accordance with the contract and the specifications[100]; a failure by the builder to meet this obligation would sound in damages.

(b) "Satisfactory quality"

Prior to 1995, contracts for the sale of goods were, unless the parties had agreed otherwise, subject to a statutory implied condition that the goods should be of "merchantable quality". In *The "Hansa Nord"* (1975)[101] the Court of Appeal held that this condition was broken only if the defect was so serious that a "commercial man" would have thought that the purchaser should be entitled to reject the goods. In making this assessment, there were in the Court's view a variety of factors to be taken into account, namely the purpose for which the goods had been purchased, their description, the price and the existence of any express or implied terms of the contract allowing the purchaser an abatement of the price to reflect the extent of the defects in question.

However, since 1995 this test of "merchantable quality" has been replaced with a new implied standard of "satisfactory quality". Unless the parties have excluded its application by agreement, this standard, together with the requirements of "compliance with

97 Section 15A(3) of the 1979 Act (as amended).

98 The three reported decisions on the scope of s 15(A)(1) since the 1994 Act entered into effect, *Truk (UK) Ltd* v. *Tokmakidis GmbH and others* [2000] 2 All E.R. (Comm) 594; *Hi-Flyers Ltd* v. *Linde Gas Ltd* [2004] All E.R. (D) 321 and *Filobake Ltd* v. *Rondo Ltd* [2004] All E.R. (D) 177, each turned on their particular facts and are of no assistance in a shipbuilding context.

99 The position may, however, be very different if the vessel in question is a passenger cruise vessel intended to operate in tropical climates and the air-conditioning fault affects her passenger cabins or public rooms.

100 See in this regard *China Shipbuilding Corporation* v. *Nippon Yusen Kabukishi Kaisha and another* [2000] 1 Lloyd's Rep 367, *infra* at pages 174–175.

101 *Supra*, at n. 43.

contractual description" and "reasonable fitness for purpose", applies to all English law contracts for the sale of goods supplied in the course of a business.[102]

The 1994 Act implemented the recommendations of the English and Scottish Law Commissions[103] which considered that, to the extent that it retained any coherent meaning at all, "merchantable quality" had become synonymous only with "fitness for purpose" and that other elements of the concept of "quality", particularly those of importance to individual consumers, were no longer relevant. Accordingly, under the 1994 Act, goods are to be regarded as of "satisfactory quality" if they meet the standard that a "reasonable person" would regard as satisfactory taking account of any description of the goods, the price (if relevant) and "all other relevant circumstances", including:

(a) their fitness for all of the purposes for which goods of the kind in question are commonly supplied;
(b) their appearance and finish;
(c) their freedom from minor defects;
(d) their safety; and
(e) their durability.[104]

While it is clearly appropriate that consumer goods should be capable of rejection for failure to comply with these principles, it was also recognised by the Law Commissions that it might cause considerable hardship to a seller under a commercial contract if the goods were to be capable of rejection for quite insignificant or purely "cosmetic" defects. As previously indicated, the Act therefore also provides by way of counterbalance that, in the context of a commercial sale, rejection of goods for non-compliance with the elements of the new standard should no longer be permitted where the "breach is so slight that it would be unreasonable to allow [the purchaser] to do so".[105]

Although it is clear that the introduction of the new standard has altered the emphasis in quality disputes from that of "fitness for purpose" to the requirements of the reasonable purchaser, there is very little judicial authority as to the scope of the standard in the context of a complex machine such as a ship. It is nevertheless submitted that in the sphere of shipbuilding the key constituent of the statutory definition of "satisfactory quality" will that of "fitness for purpose". Applying the standards of the "reasonable purchaser", defects which do not affect either the safe operation of the newbuilding or her ability to compete effectively within the market for which she was built will not normally render her "unsatisfactory" in quality terms; even more rarely will they permit a purchaser of a newbuilding to reject her outright following completion of her construction.

Finally, it should be noted that, as in relation to the previous standard of "merchantable quality", the requirement of "satisfactory quality" is not limited in English law to the physical characteristics of the goods in question. Goods may, for example, be of

102 Section 14(2) of the 1979 Act as amended by s. 1(1) of the 1994 Act. Although described merely as a "term", the requirement that the goods should be of "satisfactory quality" is, in common with the further implied terms requiring compliance with description and "reasonable fitness for purpose", a condition of the contract; see Schedule 2, s. 7(5) of the 1994 Act.

103 "Report on the Sale and Supply of Goods" (Cm. 137 May 1987).

104 Reasonable durability was already an element of the definition of "merchantable quality", *Lambert* v. *Lewis* [1982] A.C. 225, but see *Crowther* v. *Shannon Motors Co.* [1975] 1 All E.R. 139.

105 Section 15(A)(1) of the 1979 Act (as amended), *supra*; the fact that the purchaser is not entitled in such circumstances to reject the goods will not, of course, prevent him from claiming against the seller for his losses flowing from breach of the implied term.

"unsatisfactory quality" within the meaning of the 1979 and 1994 Acts where they are sold with inadequate or misleading instructions[106] or in breach of patent, copyright or trademark rights belonging to third parties which are capable of enforcement against the purchaser.[107] In a shipbuilding context, the builder may in such latter circumstances breach not only the provisions of s. 14(2) but also attract a liability under the express indemnity he will customarily provide to the buyer in respect of possible infringement of such rights.

(c) Reasonable fitness for purpose

Section 14(3) of the 1979 Act provides that:

"Where the seller sells goods in the course of a business and the buyer, expressly or by implication, makes known . . . any particular purpose for which the goods are being bought, there is an implied condition that the goods supplied . . . are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied, except where the circumstances show that the buyer does not rely, or that it is unreasonable for him to rely, on the skill or judgment of the seller. . . . "

Section 14(3) will not, however, normally assist the purchaser of a newbuilding in a quality dispute. The subsection is designed to cover the situation in which the goods are required for a specific purpose made known to the seller before the contract is signed; it is as such likely to be inapplicable in the overwhelming majority of shipbuilding projects, in which the vessel is built for use in standardised trades which are well known to, and understood by, both the buyer and the builder.

That s. 14(3) will not normally apply to a quality dispute over a vessel of standard specification is well illustrated by the Scottish case of *Britain Steamship Co. Ltd* v. *Lithgows Ltd* (1975),[108] in which a newbuilding contract for a bulk carrier incorporated main engine specifications which included a reference to "Power:—continuous service output—16,800 bhp . . . rpm: continuous service output—110"; the contract did not exclude the statutory implied terms. The engine failed repeatedly after delivery, whereupon the purchasers sued the shipbuilders alleging (*inter alia*) breach of the forerunner of s. 14(3).[109] It was alleged that the purpose for which the vessel was required was to deliver on a continuous basis the stipulated engine output.

As might have been anticipated, the purchasers' claim failed, Lord Maxwell holding that:

"Commercial men do not buy ships for the 'purpose' of getting a machine which will produce a particular power or speed of operation. They may require that their ship's engine shall have particular power or speed of operation because that is what they believe is required in order that the ship may fulfil its purpose, but the horse-power and speed of operation are themselves matters of quality, not 'purpose'."[110]

The court also rejected a further argument that the vessel was, by reason of her engine failures, not reasonably fit for the wider purpose of operating as "a bulk carrier".

106 See n. 112, *infra*.
107 *Niblett* v. *Confectioners' Materials Co. Ltd* [1921] 3 K.B. 387.
108 1975 S.L.T. 20.
109 The case was decided under the 1893 Act.
110 At page 22.

The implied term will nevertheless still be of relevance in the relation to highly specialised newbuildings or where (to the knowledge of the builder) a standard vessel is to be used by the buyer in extreme conditions, e.g., ice or constant bad weather. In *Bristol Tramways & Carriage Co. Ltd* v. *Fiat Motors Ltd* (1910)[111] the sellers of a number of motor buses were held liable for breach of the implied condition in circumstances in which the vehicles supplied, although suitable for normal use, were to their knowledge intended by the purchasers to be used in Bristol, a city with a large number of steep hills, for which they were unsuitable.

It should also be noted that, in assessing fitness for purpose, it may be appropriate to consider any instructions given by the manufacturer for the use of the goods in question[112]; the builder may therefore be liable to the buyer for breach of s. 14(3) if the operating manuals he provides for the vessel or her equipment prove to be materially misleading or inadequate.

In order to invoke s. 14(3), the buyer must, however, be able to demonstrate that he reasonably relied upon the builder's skill and judgement. If, for example, the vessel is to be built to an experimental design of which neither party have any prior experience, it may well be right to infer that the buyer either has not relied upon the builder's skill and judgement or, that if he has so relied, it was unreasonable of him to do so.[113]

Where the buyer's reliance upon the builder is reasonably founded, the latter may nevertheless be liable for breach of the implied condition even if the buyer has provided plans and drawings for the vessel's construction. In *Cammell Laird & Co. Ltd* v. *Manganese Bronze & Brass Co. Ltd* (1934),[114] the defendants agreed to cast two propellers for ships to be constructed by the plaintiff shipbuilders. The latter provided certain specifications for the propellers but left a number of technical matters, in particular the thickness of the blades, to the defendants. One of the propellers proved defective for reasons that did not relate to the specifications furnished by the plaintiffs, who sued for breach of the implied condition of reasonable fitness for purpose. The plaintiffs succeeded on the grounds that "there was a substantial area outside the specification which was not covered by [the plaintiffs'] directions and was therefore necessarily left to the skill and judgment of the [defendants]."[115]

Finally in this context, it should again be pointed out that the buyer is not permitted to reject the vessel for non-compliance with the implied condition of reasonable fitness for purpose where the breach of the standard relied upon is "so slight" that it would be unreasonable for him to do so.[116]

THE EFFECT OF REJECTION

The following paragraphs consider the consequences of the buyer's rejection of the vessel on the assumptions that the same is (a) lawful and (b) unlawful.

111 [1910] 2 K.B. 831.
112 See *Wormell* v. *RHM Agriculture (East) Ltd* [1987] 1 W.L.R. 1091.
113 As in *Dixon Kerly Ltd* v. *Robinson*; see pages 20–21, *supra*.
114 (1934) 48 Ll.L.Rep. 211.
115 *Per* Lord Warrington at page 219.
116 See pages 117–118, *supra*.

(a) Lawful rejection

Assuming that the buyer is entitled to reject the vessel, how far does this affect the parties' obligations under the contract? In particular, is he also permitted as a matter of English law to treat the builder's presentation of a non-conforming vessel as a repudiatory breach of the latter's obligations? This issue is plainly of vital importance because the existence of such a right in the buyer would, if exercised, leave the builder with no opportunity whatever to rectify the defects or shortcomings in question.

English law is unfortunately not entirely clear on this issue. The wording of the 1979 Act[117] suggests, although only obliquely, that, by delivering "non-conforming goods", the vendor indeed commits a repudiatory breach of contract, which, if accepted by the purchaser, brings to an end both parties' primary obligations thereunder. This proposition has, however, been strongly criticised[118] and its strict application to the sale of a complex good such as a newbuilding is plainly unworkable. Its correctness in a shipbuilding context was furthermore specifically doubted by Diplock J. in the leading case of *McDougall* v. *Aeromarine of Emsworth Ltd* (1958).[119]

The contract in *McDougall* provided that the vessel, a racing yacht, should be deemed completed where her performance during trials was to the "reasonable satisfaction" of the purchaser. Having held that the purchaser was entitled to refuse delivery where he was not so satisfied, Diplock J. stated that:

" . . . it does not follow that because . . . the buyer is reasonably dissatisfied with her, he is entitled to treat the defects then existing as a breach of condition, so as to enable him to treat the contract as repudiated. . . . The buyer is entitled to refuse to accept delivery of the vessel in its existing state, but, if the defect is one that can be remedied, and remedied within a time which will still permit the seller to deliver within the period of delivery permitted by the contract, the buyer is not . . . entitled to treat the contract as repudiated by the seller. . . . "[120]

It seems therefore that, where the builder presents for acceptance a non-conforming vessel, this will not normally constitute in itself a repudiatory breach of the contract.[121] Depending upon all the circumstances, a repudiatory breach entitling the buyer to terminate the contract may, however, occur:

(a) where the builder's conduct at the time of presentation indicates that he considers the vessel to comply with the requirements of the contract and that he cannot or will not make any further changes to her, i.e. that the buyer "must take it or leave it"[122]; or

117 See, in particular, s. 11(3) and (4) as well as the definition of "warranty" in s. 61(1).

118 See Goode, *Commercial Law* (2nd edn.), Chapter 10, citing *The "Kanchenjunga"* [1990] 1 Lloyd's Rep. 391, H.L., and *Borrowman Phillips & Co.* v. *Free & Hollis* (1878) 4 Q.B.D. 500; on this subject generally, see also Apps, "The Right to Cure Defective Performance"[1994] L.M.C.L.Q. 525.

119 [1958] 2 Lloyd's Rep. 345.

120 At page 357.

121 See Goode, *op. cit.* Writing in 1966, one of the leading English judges in the post-war period, Lord Devlin, expressed the view that: "A tender of a ship . . . in a condition that does not comply with the terms of the contract is not a breach of contract. What creates the breach in such a case is the failure to tender within the contract time a ship in a condition which does comply with the contract." ("The Treatment of Breach of Contract" [1966] C.L.J. 192 at page 208).

122 The builder in such circumstances almost certainly "evinces an intention no longer to be bound" by the contract (*per* Lord Wright in *Heyman* v. *Darwins Ltd* [1942] 1 All E.R. 337 at page 350) and will commit a repudiatory breach if the vessel is not in fact deliverable at that time; see *Ashmore & Son* v. *S. C. Cox* [1899] 1 Q.B. 436.

(b) where the defect in the vessel which gave rise to the right of rejection is irremediable, either within the agreed delivery period[123] or at all.

It follows that the builder is in the normal course entitled within the agreed delivery period to make an unlimited number of presentations of the vessel to the buyer, who must on each occasion consider whether she meets the requirements of the contract to an extent compelling him to accept delivery.[124] Furthermore, in the majority of shipbuilding contracts, the period of time allowed to the builder for such purpose will not be limited by reference to the delivery date but will continue to run until the buyer lawfully rescinds the contract as a consequence of excessive delay.[125]

This principle is clearly in line with the approach expressly adopted in the SAJ Form. Although Article VI.4 permits the buyer to reject the vessel on the grounds of non-conformity with the contract and specifications, it makes no provision for him to rescind the contract in such circumstances. This should be contrasted with the terms of Article III, under which the buyer is specifically entitled "to reject the VESSEL and rescind this Contract" where she fails to meet the minimum stipulated requirements for speed, fuel consumption or deadweight.

(b) Unlawful rejection

The converse situation to that considered above arises where the buyer rejects the vessel notwithstanding that he is legally obliged to accept her. In such circumstances does the buyer himself commit a repudiatory breach, entitling the builder to an option to accept the same and thereby to bring the contract to an end (subject only to the builder's right to claim damages)?

This is a complex question of English law which, in a broader commercial context, has been the subject of extensive judicial and academic debate. According to the Court of Appeal in *Eminence Property Developments Ltd* v. *Heaney* (2010),[126] this is a question which turns in each case upon the facts of the matter, although the general test is whether:

" . . . looking at all the circumstances objectively, that is from the perspective of a reasonable person in the position of the innocent party, the contract breaker has clearly shown an intention to abandon and altogether refuse to perform the contract . . . "

This yardstick, which is similar to the generally accepted test for repudiatory breach, i.e., that the contract breaker should "evince an intention no longer to be bound" by the contract,[127] is subject to certain further principles discernible from the relevant authorities.

First, it is clearly established that, *prima facie*, conduct by a contracting party, X, which constitutes a repudiatory breach will permit termination by the other party, Y, even if X

123 As in *McDougall* v. *Emsworth*, *supra*, *per* Diplock J. at page 359.

124 It is arguable, however, that where the builder persists in tendering the vessel in circumstances in which she is plainly not deliverable his conduct will eventually constitute a repudiatory breach.

125 See pages 71–73, *supra*.

126 [2010] EWCA Civ 1168.

127 *Per* Lord Wright in *Heyman* v. *Darwins Ltd*, *supra* at n. 122.

was acting *bona fide*, i.e., honestly believing that his conduct was contractually justified.[128] It is irrelevant in this context that X's belief was based upon erroneous legal advice regarding his rights and obligations.[129]

Secondly, however, acceptance of a repudiatory breach will not be permissible where it is obvious to Y (i) that X has made a transparent mistake,[130] which has led him to commit the breach, and (ii) that X will resume performance of his obligations if his mistake is pointed out to him.[131] This is, however, unlikely to occur in practice in the context of a newbuilding rejection dispute—having taken a considered decision to refuse delivery of the vessel, it will be rare for the buyer to resile from this position simply because the builder asserts that his stance is legally unjustified.[132]

Thirdly, there exists a category of cases in which the innocent victim of a repudiatory breach may be prevented from accepting this as terminating the contract even if there has been no obvious mistake on the part of the contract breaker. This category, which is derived from the controversial House of Lords decision in *Woodar Investment Development Ltd* v. *Wimpey Construction (U.K.) Ltd* (1980),[133] as subsequently interpreted,[134] nevertheless appears to be limited to situations in which the parties are agreed that the dispute between them should be resolved by an independent agency (e.g., a court or arbitration tribunal) and the parties are clearly willing to abide by the same.

In *Woodar* the defendants, Wimpey, purported to exercise a contractual right of rescission which they did not as a matter of law enjoy. The plaintiffs treated their conduct as a repudiatory breach of the contract and, accepting the same, sued for substantial damages.

The House of Lords[135] held, however, that Wimpey's conduct was not repudiatory. According to Lord Wilberforce:

" . . . in considering whether there has been a repudiation by one party, it is necessary to look at his conduct as a whole. Does this indicate an intention to abandon or to refuse performance of the contract? . . . so far from repudiating the contract Wimpey were relying on it in invoking one of its provisions, to which both parties had given their consent and, unless the invocation of that provision

128 *Federal Commerce & Navigation Co.* v. *Molena Alpha Inc. ("The Nanfri")* [1979] A.C. 757, H.L.

129 See *per* Lord Denning M.R. in *The Nanfri* [1978] Q.B. 927, C.A. (at page 979) that: "I have yet to learn that a party who breaks a contract can excuse himself by saying that he did it on the advice of his lawyers; or that he was under an honest misapprehension. Nor can he excuse himself on those grounds from the consequences of a repudiation."

130 The mistake in *Eminence Property* permitting the application of this principle was described in the first instance judgment as "screamingly obvious".

131 See *Eminence Property, per* Etherton L.J. at paragraph 65(4) of his judgment. Note also *Vaswani* v. *Italian Motors (Sales and Services) Ltd* [1996] 1 W.L.R. 270 where the seller of a car had erroneously calculated the price payable under the contract, which calculation the buyer did not query but immediately treated as a repudiatory breach. The Privy Council held in effect that the buyer should have invited the seller to indicate whether his presentation of the incorrect calculation constituted a "take it or leave it" ultimatum.

132 The principle has more relevance to a purported rescission by the buyer for delay in delivery where the buyer's notice, founded upon a mistake on his part, is obviously premature.

133 [1980] 1 W.L.R. 277.

134 Principally in *Eminence Property* but see also *Dalkia Utilities Services plc* v. *Celtech International Ltd* [2006] EWHC 63 (Comm) where Christopher Clarke J., seeking to reconcile *Woodar* with the earlier House of Lords decision in *The Nanfri*, emphasised (at paragraph 149 of his judgment) that, notwithstanding the unqualified nature of Wimpey's notice of rescission, the parties had agreed not to treat this as "a hostile act", were content to resolve the dispute between them through court proceedings and prepared to be bound by the outcome.

135 Lord Salmon and Lord Russell dissenting.

was totally abusive or lacking in good faith (neither of which is contended for), the fact that it has proved to be wrong in law cannot turn it into a repudiation."[136]

It should be emphasised in this context that the finding that Wimpey's conduct, viewed objectively, did not indicate an intention to abandon the contract was crucial to a number of their Lordships' judgments; in highlighting this aspect of the matter, their Lordships relied heavily upon the Court of Appeal decision in the curious case of *Spettabile Consorzio Veneziano di Armamento e Navigazione* v. *Northumberland Shipbuilding Co.* (1919).[137]

In *Spettabile* the Italian purchasers of four vessels wrote to the shipbuilders claiming that the contracts they had signed were, for reasons they declined to specify, no longer binding. They thereafter issued a writ seeking a declaration to such effect. Subsequently, however, the purchasers discontinued these proceedings and, effecting an extraordinary *volte-face*, commenced a second action for a declaration that the contracts were still in force. A somewhat bewildered trial judge (Bailhache J.) and thereafter the Court of Appeal held that the purchasers' conduct in contending that the contracts had been rescinded and commencing the first set of proceedings did not amount to a repudiatory breach on their part. In the view of Atkin L.J.:

"the Plaintiffs in the [first] action are asking the court to declare whether they are any longer bound by the contracts. It appears to me that that is an entirely different state of facts altogether from an intimation by the plaintiffs, apart from the courts of law, that they in any event are not going to perform the contracts. It is something quite different from a repudiation. So far from expressing the intention of the parties not to perform the contract, it appears to me to leave it to the court to say whether or not the contract is to be performed, and if the court says it is, then it impliedly states that it will be performed. I think, therefore, there was no repudiation of the contract."[138]

Given the purchasers' somewhat erratic behaviour, it is questionable whether Atkin L.J. was right to infer that they would indeed have performed their contract if they had maintained the first action and lost. It nevertheless seems, on the basis of *Spettabile, Woodar* and *Eminence Property*, that where the buyer wrongfully rejects the vessel but (i) the parties are willing to resolve the dispute between them by litigation, arbitration or expert determination, and (ii) the buyer's conduct, viewed objectively, indicates a willingness to reverse his decision if the determination should result in a finding that the vessel was indeed deliverable, his conduct will not necessarily be judged as repudiatory even if it was unjustified.

Where, conversely, either of the above elements is not present, the buyer's position will be far more precarious, i.e., the risk of committing a repudiatory breach by rejecting the vessel will be much greater. Although there is no specific authority for this proposition, it is submitted that the risk is further enhanced in circumstances in which it is impossible in practice to achieve an early third-party determination of the vessel's deliverability, e.g., where there is a significant factual dispute between the parties regarding her condition.

Furthermore, where the buyer's words or conduct, viewed objectively, demonstrate that his rejection of the vessel is final, i.e., that he will not in any event accept her, this is almost certain to constitute a repudiatory breach if she is in fact in a deliverable condition at that time.

136 See also *Hanect Chandru Vaswani* v. *Italian Motors (Sales & Services) Ltd* [1996] 1 W.L.R. 270, P.C., again *per* Lord Wilberforce: "Repudiation is a drastic conclusion which should only be held to arise in clear cases of a refusal, in a matter going to the root of the contract, to perform contractual obligations".

137 (1919) 121 L.T. 628.

138 At page 635.

Article VII—Delivery

1. Time and Place:

The VESSEL shall be delivered by the BUILDER to the BUYER at the Shipyard on or before ....., 19 (*sic*) ....., except that, in the event of delays in the construction of the VESSEL or any performance required under this Contract due to causes which under the terms of this Contract permit postponement of the date for delivery, the aforementioned date for delivery of the VESSEL shall be postponed accordingly. The aforementioned date, or such later date to which the requirement of delivery is postponed pursuant to such terms, is herein called the "Delivery Date".

2. When and How Effected:

Provided that the BUYER shall have fulfilled all of its obligations stipulated under this Contract, delivery of the VESSEL shall be effected forthwith by the concurrent delivery by each of the parties hereto to the other of the PROTOCOL OF DELIVERY AND ACCEPTANCE, acknowledging delivery of the VESSEL by the BUILDER and acceptance thereof by the BUYER.

3. Documents to be Delivered to BUYER:

Upon delivery and acceptance of the VESSEL, the BUILDER shall deliver to the BUYER the following documents, which shall accompany the PROTOCOL OF DELIVERY AND ACCEPTANCE:

(a) PROTOCOL OF TRIALS of the VESSEL made pursuant to the Specifications.
(b) PROTOCOL OF INVENTORY of the equipment of the VESSEL, including spare parts and the like, all as specified in the Specifications.
(c) PROTOCOL OF STORES OF CONSUMABLE NATURE referred to under Paragraph 3(b) of Article VI hereof, including the original purchase price thereof.
(d) ALL CERTIFICATES including the BUILDER'S CERTIFICATE required to be furnished upon delivery of the VESSEL pursuant to this Contract and the Specifications. It is agreed that if, through no fault on the part of the BUILDER, the classification certificate and/or other certificates are not available at the time of delivery of the VESSEL, provisional certificates shall be accepted by the BUYER, provided that the BUILDER shall furnish the BUYER with the formal certificates as promptly as possible after such formal certificates have been issued.
(e) DECLARATION OF WARRANTY of the BUILDER that the VESSEL is delivered to the BUYER free and clear of any liens, charges, claims, mortgages, or other encumbrances upon the BUYER'S title thereto, and in particular, that the VESSEL is absolutely free of all burdens in the nature of imposts, taxes or charges imposed by the Japanese governmental authorities, as well as of all liabilities of the BUILDER to its subcontractors, employees and crew, and of all liabilities arising from the operation of the VESSEL in trial runs, or otherwise, prior to delivery.
(f) DRAWINGS AND PLANS pertaining to the VESSEL as stipulated in the Specifications.
(g) COMMERCIAL INVOICE.

4. Tender of VESSEL:

If the BUYER fails to take delivery of the VESSEL after completion thereof according to this Contract and the Specifications without any justifiable reason, the BUILDER shall have the right to tender delivery of the VESSEL after compliance with all procedural requirements as above provided.

5. Title and Risk:

Title to and risk of loss of the VESSEL shall pass to the BUYER only upon delivery and acceptance thereof having been completed as stated above it being expressly understood that, until such delivery is effected, title to and risk of loss of the VESSEL and her equipment shall be in the BUILDER, excepting risks of war, earthquakes and tidal waves.

6. Removal of VESSEL:

The BUYER shall take possession of the VESSEL immediately upon delivery and acceptance thereof and shall remove the VESSEL from the premises of the Shipyard within three (3) days after delivery and acceptance thereof is effected. If the BUYER shall not remove the VESSEL from the premises of the Shipyard within the aforesaid three (3) days, then, in such event the BUYER shall pay to the BUILDER the reasonable mooring charges of the VESSEL.

In most shipbuilding projects delivery and acceptance of the completed vessel represents the true point of sale, i.e. the moment in time when title and risk pass from the builder to the buyer. The buyer is at this stage obliged to settle the outstanding balance of the contract price or, if credit terms have been extended by the builder, to pay the delivery instalment and to furnish the agreed securities in respect of payment of the post-delivery portion of the contract price.

DELIVERY OF THE VESSEL

Although most shipbuilding contracts stipulate the place and timescale in which delivery is to take place, the process itself is not usually defined. Under the 1979 Act, "delivery" means "the voluntary transfer of possession".[1]

In the case of a newbuilding, this is usually effected by a two-stage process comprising first the formal "tender", or presentation, of the vessel to the buyer and secondly his acceptance thereof, evidenced by execution of Protocol of Delivery and Acceptance and the assumption of physical possession and control over the vessel by his master and crew.

The place of delivery

In normal circumstances the contract will stipulate that delivery of the vessel should take place at a safe berth or anchorage at or near the shipyard. Where no express or implied provision is made in the contract, s. 29(2) of the 1979 Act provides simply that delivery should take place at "the seller's place of business".

The time of delivery

Most shipbuilding contracts define the timescale for completion of the vessel by reference to an agreed Delivery Date.[2] This is a specific calendar date[3] on which the builder undertakes to deliver the vessel. The date is, however, capable of adjustment during the

1 Section 61(1).
2 Alternatively, the "Contractual Delivery Date".
3 Or a date "falling X months from the Effective Date".

life of the project to reflect periods of *force majeure* and other Permissible Delays properly claimable by the builder.

It is vital in this context to distinguish clearly between the Delivery Date and the date of actual delivery of the vessel. The former is the date on which the builder promises the buyer that the vessel will be ready; the latter is the date[4] on which, having been completed in accordance with the contract and specifications, the vessel is physically delivered to, and accepted by, the buyer. Owing to their size and complexity, relatively few substantial shipbuilding projects are completed precisely to schedule; even if force majeure delays and other postponements are taken into account, most newbuildings are therefore not delivered upon the Delivery Date itself.

As such, the Delivery Date serves merely to define the project at the outset and to provide a yardstick by which the builder's performance can be measured. If the builder delivers the vessel later than the agreed date,[5] he will commit a breach of the contract and (subject to any grace period he may be allowed) will expose himself to a liability to pay liquidated damages by way of a reduction of the price. Where the delay is significant, the buyer may also be entitled to terminate the contract and to recover the instalments of the price he has previously paid.[6]

Where, unusually, the contract does not provide for a Delivery Date, English law will generally imply an obligation to complete the vessel within a reasonable time-frame.[7] Similarly, where the builder undertakes to use best endeavours to deliver by a specified date, he must achieve this within a reasonable time thereafter, failing which he may commit a repudiatory breach of the contract.[8]

The SAJ Form follows the standard formula described above, providing in Article VII.1 for a defined Delivery Date adjustable by reference to *force majeure* periods and other specifically defined Permissible Delays.[9] In line with the *force majeure* provisions of Article VIII.1, the Delivery Date is expressed to be capable of extension by reason of delays either in "construction of the VESSEL" or in "any performance required under this Contract". The builder is thus entitled to an extension even if the delaying event occurs before the vessel's keel has been laid.

Finally in this context, it should be noted that, under both the SAJ and CMAC Forms, there is no defined time scale for delivery of the vessel to take place after completion of her sea trials—this is left to be determined by the builder. However, under Article 27(d)(i) of the NEWBUILDCON Form, the builder, if satisfied with the results of the sea trials, must give a notice of readiness to the buyer for delivery on a date which not earlier than 15 "running"[calendar] days thereafter. In order to avoid a potential breach of contract,

4 Sometimes defined as the "Actual Delivery Date".

5 As adjusted in accordance with the terms of the contract.

6 See pages 71–73, *supra*.

7 Section 29(3) of the 1979 Act.

8 *McDougall* v. *Aeromarine of Emsworth Ltd* [1958] 2 Lloyd's Rep. 345.

9 Similar provisions are contained in Article XIV of the CMAC Form. However, the NEWBUILDCON Form employs separate definitions of "Contractual Date of Delivery" being the date for delivery initially agreed by the parties and "Delivery Date", which is such date adjusted in accordance with the terms of the Contract. It should also be noted that the NEWBUILDCON Form provides for the vessel to be delivered "on *or after* the Delivery Date" (emphasis added); while the use of this language may have been intended to acknowledge the fact that newbuildings are often delivered "late", it is logically inconsistent for the form to provide for the payment of liquidated damages in circumstances in which there would appear to be no breach by the builder by reason of late delivery.

the builder must therefore under this form ensure that he is able to complete the vessel's sea trials at least 15 days prior to the Delivery Date.

Early delivery

Under the SAJ Form delivery is permitted "on or before" the Delivery Date and the buyer may thus be obliged to accept the vessel whenever she is validly tendered to him by the builder.[10] Furthermore, where the delivery of the vessel takes place pursuant to a written request by the buyer more than 30 days prior to the Delivery Date, the builder will be entitled to an agreed bonus under Article III.1(d).[11]

Where early delivery is likely to cause difficulties for the buyer in arranging finance or securing employment for the vessel, the SAJ Form will normally be varied by agreement between the parties. In such circumstances the builder's entitlement to give early delivery of the vessel will often be made conditional upon the buyer's consent and/or the builder furnishing substantial prior notice to the buyer.

It should finally be noted that delivery under the SAJ Form is expressed to be conditional upon the buyer having "fulfilled all of its obligations stipulated under this Contract". This is probably intended to refer to fulfilment of the buyer's payment obligations prior to and at the time of delivery,[12] but the wording is in any event often amended to make delivery subject to the performance of the obligations of both parties to the contract, or even to the builder alone.

The vessel's condition on delivery

Under most shipbuilding contracts, the readiness of the vessel for delivery will have been assessed upon completion of her sea trials and no further physical inspection or evaluation is undertaken at the time of delivery and acceptance, which is essentially a documentary process. Article VII.1 of the SAJ Form makes no reference at all to the condition of the vessel on delivery.

However, the NEWBUILDCON Form, recognising that the vessel's sea trials may have taken place at a time when she was not fully completed and/or otherwise in a condition permitting delivery, requires (at Article 28), that the vessel should be delivered "in a clean and orderly condition, ready for service". While the requirement that the vessel should be "clean and orderly" is readily understandable, the extent of the builder's obligation to render the vessel "ready for service" is undefined and potentially problematic. Clearly, this cannot be read as encompassing those elements of the vessel's operation which are obviously to be undertaken by the buyer (e.g., the provision of a crew), but difficult questions may arise regarding deliverability of the vessel where, for example, the commissioning of equipment or minor construction work is still outstanding; however, it is submitted that these issues are primarily intended to be dealt with under Article 26(d)

10 See in similar vein, Article VI(5)(5) of the CMAC Form. There is no entitlement under the NEWBUILDCON Form for the builder to give early delivery of the vessel.

11 See pages 73–74, *supra*.

12 Including the obligation to deposit the delivery instalment with the builder's bank in advance of the date of delivery; see Article II.4(d).

of the NEWBUILDCON Form[13] and that it will in practice be rare for the vessel to be deliverable under the provisions of that Article but not under Article 28.

Perhaps unexpectedly, the CMAC Form seeks to tilt this balance of interests in favour of the builder, although it does so in a vague and unhelpful manner. Article XI(4) of the Form provides that, in the event that there exist at the time of delivery a "few outstanding items which do not affect the safety and navigation" of the vessel, the parties will list these and the builder will undertake to complete them within four days from delivery. It is entirely unclear what is meant by a "few" items, and the Article makes no reference to the possibility of delivery defects significantly affecting the trading capabilities, as opposed to the safety and navigation, of the vessel; this language is as such unlikely to be widely accepted in its unamended form in an export newbuilding context.

Delivery documentation

(a) The Protocol of Delivery and Acceptance (the "Protocol")

As evidence of the delivery of the vessel by the builder and her acceptance by the buyer, it is customary for the parties to execute a joint written confirmation, or Protocol, which will be dated and timed by the parties' representatives as at the moment of handover of the vessel to the buyer's master and crew.

The Protocol will normally recite that the vessel has been delivered by the builder in compliance with the requirements of the contract and accepted by the buyer on such basis. Where the contract works have not been finalised prior to delivery and acceptance but the parties have agreed that delivery should nevertheless take place, the items still outstanding will normally be detailed in the Protocol, which may also set out the agreed basis upon which the same are to be completed.

The principal purpose of execution of the Protocol is to evidence the moment in time at which risk and (usually) title to the vessel will pass to the buyer.[14] Depending upon the terms of the contract, the Protocol may, however, also be required to permit the builder to obtain payment of the instalment of the contract price due upon delivery. Under the SAJ Form, for example, presentation of a signed copy of the Protocol, executed by both the buyer and the builder, is a condition of release to the latter of the delivery instalment deposited with his bank.[15] By the same token, an executed Protocol may be needed to allow the builder to make demand under a standby letter of credit or other guarantee of the buyer's contractual obligations.

Assuming that the vessel has been duly tendered to the buyer, the contract will normally provide—either expressly or impliedly—that the buyer must immediately execute the Protocol and take over the vessel. Article VII.2 of the SAJ Form stipulates that the delivery of the vessel shall be effected by an exchange of Protocols "forthwith" upon the fulfilment of the buyer's obligations under the contract. These obligations are not defined, although they plainly encompass the duty to deposit the delivery instalment with the builder's bank in accordance with Article II.4(d). They do not, however, extend to the

13 Which, subject to the provision of an indemnity by the builder, renders the vessel "deliverable" notwithstanding the existence of Delivery Defects "of minor importance [which] do not affect Class or the operation of the Vessel in its intended trade"; see pages 113–114, *supra*.

14 A Protocol is required by certain national ship registries, e.g., that of Norway, as a condition of registration of a newbuilding vessel.

15 Article II.4(d).

obligation to make payment of the instalment itself, which is only due against presentation of the Protocol.

In *Riva Bella S.A.* v. *Tamsen Yachts GmbH* [2011],[16] the High Court was asked, in the context of an agreement for the sale of a newly built, but incomplete, "super yacht", whether the signature by the parties of a "clean" Protocol precluded the buyer from asserting claims in damages relating to her condition. Eder J. held that it did not, expressing the view that:

" . . . in certain circumstances, the acceptance of any ship when tendered for delivery by a seller and the signing of a [Protocol of Delivery and Acceptance] may have the effect to preclude a buyer from rejecting the ship (at least with regard to patent defects) and even to preclude a buyer from claiming damages against the seller. However, in the ordinary course, acceptance will not prevent a claim for damages . . . "

The Judge conceded that the legal position might be different:

" . . . where there is not simply an acceptance of delivery by the buyer or signing of a [protocol] by the parties but an actual agreement by the parties operating in effect as a contractual variation whereby the buyer agrees, for example, to modify the terms of the contract or to give up any claim for damages".

but rightly considered that this would rarely occur in practice.[17]

Where the buyer wrongfully refuses to execute the Protocol, it seems that the English courts have power to order specific performance of his obligations.[18] Furthermore, where an order of this type requiring the execution of a document is disobeyed, the High Court has jurisdiction under s. 39 of the Senior Courts Act, 1981 to order that the document be executed by a third party nominated by the court for such purpose.[19]

In *Astro Exito Navegacion S.A.* v. *Southland Enterprise Co. Ltd (The "Messiniaki Tolmi")* (1983),[20] a case involving the sale of a vessel for scrap, the House of Lords held that there are no limits on the purposes for which a document executed in this manner can be used. Where a documentary letter of credit called for the sellers to present a notice of readiness countersigned by the buyers, this requirement was accordingly satisfied by the presentation of a notice executed by an officer of the court in pursuance of a s. 39 order.

(b) Other documentation

In addition to the vessel itself, the builder will usually be obliged by the terms of the contract to deliver to the buyer certain defined documentation needed for her registration and future operation. Although the buyer's requirements will obviously vary depending

16 [2011] EWHC 1434 (Comm).

17 See also, in a different but similar commercial context, *ACG Acquisition* v. *Olympic Airways* [2012] EWHC 1070 (Comm), where the High Court held that execution of a certificate of acceptance under an aircraft lease had the effect of preventing the lessee from refusing delivery, but not from claiming damages for the aircraft's non-compliance with the lease specification. The court emphasised that very clear words would have been required to achieve the latter objective.

18 The power to grant in interlocutory proceedings an order equivalent to specific performance in favour of a seller of goods, rather than the purchaser, derives not from the 1979 Act but from s. 37(1) of the Senior Courts Act 1981 (replacing s. 45(1) of the Supreme Court of Judicature (Consolidation) Act 1925), *per* Ackner L.J. in *The "Messiniaki Tolmi"* [1982] 2 Q.B. 1248 at page 1269, C.A.

19 The court will usually nominate a Queen's Bench Master, i.e., a junior judge, for this purpose.

20 [1983] 2 A.C. 787, H.L.

upon the type of newbuilding involved and her intended registry, the following categories of document are usually specified.

Protocol of Trials

This sets out the formal results of the vessel's trials, details of which will have been provided to the buyer prior to his decision to accept her.[21]

Protocol of Inventory of Equipment

This details the machinery and equipment (including spare parts) installed on board the vessel as stipulated by the specifications.

Protocol of Fuel Oils, Lube Oils and Consumable Stores on board

The buyer will usually have agreed to pay the builder for bunkers, lubes and consumable stores at either the latter's cost price or the market price prevailing at the date of delivery. This Protocol, which will usually be signed by both parties' representatives following a final inspection of the vessel and the sounding of her tanks, records the quantities of these items on board at the moment of handover for the purposes of calculating the payment to be made.

In *The "D'Vora"* (1952),[22] Wilmer L.J. expressed the view that "consumable stores" comprised fuel oil, coal, boiler water and food. These he distinguished from "ship's equipment", which in his view connoted items of a permanent nature, "such as anchors, cables, hawsers, sails, ropes . . . ", notwithstanding that the latter might require renewal from time to time.

Classification and trading certificates

These will comprise certificates issued by the classification society for its own account, evidencing that the vessel has achieved the class status stipulated in the contract, and those issued by the regulatory authorities, often acting through the classification society, demonstrating compliance with the safety and other standards to which the vessel is also to be built.[23] Although the SAJ Form makes no provision to this effect, it will sometimes be expressly agreed that the vessel's class certificates should be "free of recommendations, restrictions or qualifications"; the builder will, however, usually seek to ensure that the buyer's right to reject the vessel for non-compliance with this requirement should only accrue if the recommendation, restriction or qualification affects her operational capabilities.

Under each of the SAJ, NEWBUILDCON and CMAC Form it is also agreed that, if permanent class and trading certificates are not available at the time of delivery, the builder may furnish provisional certificates. In such circumstances the builder undertakes to provide permanent certificates to the buyer as soon as these have been issued.

21 See page 104, *supra*.

22 [1952] 2 Lloyd's Rep. 404.

23 The statutory certificates to be issued by the flag or other regulatory authorities will include those relating to her load line, tonnage, safety construction; see pages 31–33, *supra*.

The NEWBUILCON Form further provides[24] that such interim certificates are accepted on terms that the permanent certificates are obtained "as promptly as possible" and at the buyer's cost and expense. The builder also warrants that the interim certificates will enable the vessel to be registered, trade and operate without restriction pending issuance of permanent documentation and the form goes on to provide that, in the event of any breach of such warranty, the builder shall be liable to compensate the buyer for its losses, "including loss of time". This represents one of only two circumstances[25] where either party under the NEWBUILDCON Form is exposed to a contractual liability for loss of time, and it is questionable whether shipbuilders will be prepared as a matter of principle to accept such an exposure, particularly given that the liability is "uncapped" and may be triggered by circumstances (such as the imposition of a subsequent restriction by the classification society) which are effectively beyond the builder's control.

Declaration of warranty of freedom from encumbrances

It is plainly of critical importance to the buyer that he should enjoy quiet possession of the vessel, free from any claims of the builder's creditors. Although it would be perfectly feasible to incorporate a promise to this effect within the framework of the contract itself, the usual practice is for the builder to issue at the time of delivery a written confirmation, or declaration, of the vessel's freedom from all charges and encumbrances.

Unless specifically excluded by agreement, such an assurance will in any event be implied into the contract by s. 12(2) of the 1979 Act. This provides that, in relation to all contracts of sale to which the Act relates,[26] there is an implied warranty that the goods are:

"... free, and will remain free until the time when property is to pass, from any charge or encumbrance not disclosed or made known to the buyer before the contract is made."

In *Athens Cape Naviera S.A.* v. *Dampfschiffahrtsgesellschaft "Hansa" Aktiengesellschaft and Another (The "Barenbels")* (1985),[27] which involved the second-hand sale of a ship, the similar expression "encumbrances and maritime liens" was held to extend only to proprietary or, possibly, possessory claims capable of assertion against the ship itself and not to third party claims *in personam* against the vendor.

It is clear therefore that the builder gives no warranty regarding claims against him personally, even if these threaten his ability to meet his post-delivery guarantee obligations. Furthermore, the warranty otherwise implied by the 1979 Act is arguably excluded by an express term in the contract that the builder's twelve month guarantee of materials and workmanship replaces "any other warranty, express or implied, whether statutory or otherwise".[28] Such an exclusion will be ineffective where the Unfair Contract Terms Act 1977 applies,[29] although this is unusual in the context of international shipbuilding contracts.[30]

24 At Article 29(e).
25 The other being Article 27(d)(iv), relating to sea trials, see pages 113–114, *supra*.
26 Essentially sales for a monetary consideration; s. 2(1).
27 [1985] 1 Lloyd's Rep. 528.
28 See pages 188–191, *infra*.
29 Section 6 of the Act.
30 See generally page 188, *infra*.

Under the SAJ Form, the scope of the builder's warranty of freedom from encumbrances is very broad indeed, encompassing "liens, charges, claims, mortgages, or other encumbrances upon the BUYER'S title" as well as liabilities both to the builder's "subcontractors, employees and crew" and otherwise arising out of the operation of the vessel in the period prior to delivery (e.g., during her sea trials).[31] The builder's liability for "claims" will, by analogy with the position in respect of second-hand vessel sales under the Norwegian Saleform, almost certainly extend to *all* claims against the newbuilding arising out of pre-delivery events, whether or not such events have genuinely caused the builder to incur a liability to the third party claimant.[32] There is, furthermore, no reason (it is submitted) to limit the wording of the SAJ Form to third-party claims and, by warranting generally that the vessel is free from claims, the builder probably precludes himself arresting the vessel after delivery to secure his own pre-delivery claims; such claims nevertheless remain enforceable against the buyer *in personam*.

Finally, however, it should be noted that, while the builder will be liable in damages for any reasonably foreseeable losses arising from breach of the warranty, he is under no obligation to furnish security to release the vessel if she is arrested in respect of liabilities incurred prior to delivery.

Drawings and plans

The contract will usually provide that the builder shall provide to the buyer upon delivery one or more complete sets of the working drawings and plans of the vessel as approved by the buyer, the classification society and (where appropriate) the regulatory authorities.[33]

Commercial invoice

This may be required by the buyer by way of formal record of the contract price he has paid for the vessel. It may also be needed by him to effect "draw down" of the delivery instalment under the terms of the financing he has arranged for the vessel's purchase.

Bill of sale/builder's certificate

In order to register the vessel upon delivery, the buyer will need to present to the relevant flag authorities formal evidence of the transfer to him of title to the vessel. The documentation required will vary depending upon the registry involved, but the buyer will typically need either a bill of sale executed by the builder in his favour or a builder's certificate, identifying the vessel by reference to her hull number and principal characteristics, and confirming that she has been constructed for the account of the buyer. Whichever document is to be provided, this will normally need to be notarially attested and legalised to permit the vessel's registration upon delivery.

31 Similar wording is contained in the CMAC Form.

32 See *Rank Enterprises* v. *Gerard* [1999] 2 Lloyd's Rep. 666.

33 The NEWBUILDCON Form requires that the builder's drawings and plans should be supplemented by all necessary instruction manuals for supplied equipment; see Article 29(d).

Further documents

The contract may also provide for additional documentation to be provided by the builder to the buyer at the time of delivery. Thus, the NEWBUILDCON Form requires that the builder should furnish to the buyer a "Certificate of Non-Registration", i.e., a certificate that the vessel has not been registered elsewhere, including as a newbuilding under construction, and an IMO Hazardous Material Inventory Statement of Compliance.[34] Furthermore, and somewhat exceptionally in light of usual shipbuilding practice, the builder can also be required under Article 29 of the NEWBUILDCON Form to provide "any other documents reasonably required by the Buyer", the assumption of which obligation represents a potentially significant exposure for the builder.[35]

TITLE TO THE VESSEL

The time at which title to the vessel passes to the buyer is for two reasons an issue of central importance to the entire shipbuilding project. First, whoever owns the vessel during her construction period enjoys a measure of security against the risk of the other party's financial default; in such event, his rights of ownership should (at least in theory) prevail against the other's creditors and permit him to sell the vessel in order to recoup his investment. Secondly, depending upon local law and practice, ownership of the vessel may afford to the builder the right to mortgage or charge her for the purpose of securing the finance needed for her construction.[36]

The overwhelming majority of international shipbuilding contracts confer title to the vessel upon the builder throughout the construction period on the basis that the buyer's pre-delivery credit risk will be secured by a refund guarantee; this will typically be provided to the buyer as a condition of payment of the first instalment of the contract price. Title to the vessel will be transferred to the buyer concurrently with execution of the Protocol of Delivery and Acceptance, whether or not the balance of the contract price is payable in full at that time.

If, however, the builder is not in a position to provide a satisfactory refund guarantee, it may be agreed that the vessel itself should stand as security for the buyer's pre-delivery instalments. In such circumstances the contract will provide that title to the vessel, together with all equipment and materials intended for her, should pass to the buyer during the course of her construction. The title vested in the buyer will, however, usually be conditional, rather than absolute, in nature and will in particular not preclude him from exercising rights to reject the vessel and rescind the contract.[37] In such circumstances title will normally revert to the builder following the buyer's notice of termination and upon the builder's refundment to him of the pre-delivery instalments of the contract price paid at that time, together with interest thereon.

34 See pages 282–283, *infra*.

35 It should also be noted that pursuant to Article 29, the buyer may, upon giving reasonable notice to the builder prior to delivery, require the latter to notarise and legalise any of the required delivery documents at the buyer's expense. This may be administratively complex to achieve in practice.

36 Because of the builder's lien for the price, it is unusual (but not unknown) for the buyer to obtain pre-delivery financing secured on the vessel.

37 *Per* Diplock J. in *McDougall* v. *Aeromarine of Emsworth Ltd*, *supra*; *Nelson* v. *William Chalmers & Co. Ltd*, 1913 S.C. 441.

The legal and practical difficulties involved in using the vessel as security for the repayment of the buyer's pre-delivery instalments are discussed further below.

(a) The effect of the lex situs

In considering questions of the transfer of title to a newbuilding, it should be appreciated that these are not exclusively determined by the governing law of the shipbuilding contract. Although the contract, construed in accordance with its proper law, will decide the point in time at which the parties intend that title to the vessel should pass, it is, as a matter of English law, for the *lex situs* (i.e., the law of the place of construction) to determine how far legal effect is given to such intention.[38]

The *lex situs* may in particular seek to restrict the extent to which the buyer can obtain a title to the vessel which will prevail in the builder's liquidation against the general body of his creditors. Where, for example, the *lex situs* stipulates that the transfer of a newbuilding will be ineffective unless certain formalities, e.g., registration,[39] are observed, title will not as a matter of English law pass to the buyer if these are ignored.[40]

Given, however, that most international shipbuilding contracts stipulate that title should vest in the builder until delivery and acceptance, the impact of the *lex situs* is in practice likely to be limited. All of the principal shipbuilding jurisdictions regard delivery as an entirely appropriate moment for title in manufactured goods to pass to the purchaser and do not seek to impose restrictions on the parties' freedom to contract on such basis. It is therefore only where the buyer and the builder agree to transfer property in the vessel before delivery that restrictions imposed by the *lex situs* are likely to be of relevance (see (b)(iii) below).

(b) The effect of English law

Against this background we now consider the English law principles relating to the transfer of property in a newbuilding where the contract:

(i) makes no express provision as to transfer;
(ii) provides that title shall pass only upon her delivery and acceptance; and
(iii) provides that title should pass at some point prior to her delivery and acceptance.

As will be seen, the basic principle applying in this context is that title to goods passes when it is intended by the parties to do so.[41]

(i) No express provision in the contract

In view of the importance of this issue to both parties, the majority of shipbuilding contracts include specific and unambiguous provisions dealing with the question of the

38 See generally, Dicey & Morris, *Conflict of Laws* (14th edn.), Chapter 24.

39 As is the case in Germany in relation to newbuildings which have previously been registered.

40 *Hardwick Game Farm* v. *Suffolk Agricultural and Poultry Producers' Association Ltd* [1966] 1 W.L.R. 287, C.A.

41 Section 17(1) of the 1979 Act.

transfer of title to the vessel.[42] Where, unusually, these terms are absent, the court or arbitration tribunal determining this issue will be required to construe the contract to establish the parties' intentions. Through the mechanism of the 1979 Act, English law lays down a number of statutory rules which are to be used "in aid and supplement of"[43] this process of construction.

Section 18 Rule 5(1) of the 1979 Act stipulates in this respect that, unless a "different intention" appears:

> "Where there is a contract for the sale of unascertained or future goods by description and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. . . . "

Because goods are in a deliverable state only where the purchaser is contractually bound to take delivery,[44] it is clear that Rule 5(1) presumes that title to future goods passes upon their delivery to the purchaser. Furthermore, although the term is not defined, it seems that the unconditional appropriation of future goods must normally involve their physical delivery to the purchaser[45]; the requirement is, for example, not satisfied by the "mere setting apart or selection by the seller of the goods which he expects to use in the performance of the contract",[46] as the seller may well be entitled to deliver other goods without breaching his promise. Thus in *Mucklow* v. *Mangles* (1808)[47] payment of the price and the painting of his name on the stern did not transfer title to the purchaser of a barge which had not been completed at the date of the shipbuilder's bankruptcy.[48]

Where, therefore, the contract makes no express provision as to the passing of title, the requirements of a deliverable state and an unconditional appropriation will normally dictate that this should occur only upon delivery and acceptance. The question then arises whether terms commonly found in shipbuilding contracts, in particular those providing for payment of the price by instalments and a right in the buyer to inspect and approve the works, alter this presumption.

This issue was discussed in a number of mid-nineteenth century English cases[49] in which purchasers sought to assert proprietary rights in newbuildings against either the shipbuilder's liquidator or a subsequent buyer. Reviewing these authorities in *Seath & Co.*

42 See, e.g., Article VII.5 of the SAJ Form.

43 *Per* Lord Robertson in *Sir James Laing & Sons Ltd* v. *Barclay, Curle & Co. Ltd* [1908] A.C. 35 at page 44.

44 Section 61(5).

45 Note, however, the views of Mustill J. in *Karlshamns Olje Fabriker* v. *Eastport Navigation Corporation* [1981] 2 Lloyd's Rep. 679 (at page 685) that "the want of an unconditional appropriation is not an absolute bar to the passing of property but merely one of the factors to be taken into account when ascertaining the presumed intentions of the parties".

46 *Per* Pearson J. in *Carlos Federspiel & Co. S.A.* v. *Charles Twigg & Co. Ltd* [1957] 1 Lloyd's Rep. 240 at page 255.

47 (1808) 1 Taunt. 318.

48 See also *Laidler* v. *Burlinson* (1837) 2 M. & W. 602 *Clark* v. *Spence* (1836) 4 Ad. & E. 448. It is nevertheless strongly arguable that the builder, by designating a hull number to the newbuilding, appropriates that vessel (and no other) to the contract; this is *a fortiori* where the newbuilding is already under construction when the contract is signed.

49 *Woods* v. *Russell* (1822) 5 B. & Ald. 942; *Clark* v. *Spence*, *supra*; *Laidler* v. *Burlinson*, *supra*; *Tripp* v. *Armitage* (1839) 4 M. & W. 687; *Goss* v. *Quinton* (1842) 3 Man. & G. 825; *Reid and Stewart* v. *Fairbanks* (1853) 13 C.B. 692; *Wood* v. *Bell* (1856) 5 E. & B. 722.

v. *Moore* (1886),[50] Lord Watson ruled that they showed that an intention to pass title to the vessel:

"... ought (in the absence of any circumstances pointing to a different conclusion) to be inferred from a provision in the contract to the effect that an instalment of the price shall be paid at a particular stage, coupled with the fact that the instalment has been duly paid and that until the vessel reached that stage the execution of that work was regularly inspected by the purchaser, or someone on his behalf."

However, in *Sir James Laing & Sons Ltd* v. *Barclay, Curle & Co. Ltd* (1907),[51] payment of the price and inspection were held by the House of Lords to be no more than "marks pointing to the property passing"[52] and inconclusive as to the parties' intentions. A contract term providing that delivery of two newbuildings should not be considered completed until they had passed sea trials accordingly passed title only after the trials had been satisfactorily concluded. A similar approach was taken in *Reid* v. *Macbeth and Gray* (1904),[53] in which the shipbuilding contract was held to be for the sale of "a complete ship".[54]

The fact that the builder provides to the buyer pursuant to the contract a bill of sale or builder's certificate is not in itself conclusive evidence of an intention to pass title. Thus in *Davy Offshore Ltd* v. *Emerald Field Contracting Ltd* (1992),[55] which concerned a contract for the supply to the plaintiff purchaser of a floating production facility (FPF), a floating storage unit and various ancillary underwater works, it was held that title to the FPF did not pass upon the transfer of the bill of sale for the same but rather upon the provision by the purchaser to the contractor of certain documents required by the latter to "trigger" payment of the balance of the contract price under a related letter of credit.

(ii) Title passing upon delivery and acceptance

As indicated above, most modern shipbuilding contracts provide that title to the vessel should pass only upon her delivery and acceptance. The risk of the builder's liquidation in the period prior to delivery of the vessel is secured by a refund guarantee in favour of the buyer in the amount of his pre-delivery instalments and interest thereon.

In such cases (and subject to the *lex situs*), title to the vessel, her machinery and equipment will effectively vest in the builder's liquidator. Upon his insolvency the buyer will normally rank as an unsecured creditor of the builder for the amount of his instalments which are unrecovered under the refund guarantee or otherwise.

Depending upon the precise terms of the contract, difficult issues as to the passing of title can arise where the builder tenders the vessel for delivery but the buyer wrongfully refuses to accept her. As a matter of general law, it would seem that title to the vessel remains in such circumstances with the builder.[56] The SAJ Form nevertheless avoids any uncertainty in relation to this issue by stipulating in Article VII.5 that title (and risk) shall

50 (1886) 11 App. Cas. 350.
51 [1907] A.C. 35.
52 *Per* Lord Loreburn L.C. at page 43.
53 [1904] A.C. 223.
54 *Per* Earl of Halsbury at page 229.
55 [1992] 2 Lloyd's Rep. 142, C.A.
56 The builder's claim in such circumstances is for damages for non-acceptance of the vessel; s. 50(1) of the 1979 Act.

pass "only upon delivery and acceptance having been completed as stated above . . . ", i.e., upon the execution by both parties of the Protocol of Delivery and Acceptance.

(iii) Title passing prior to delivery and acceptance

As previously indicated, an alternative method of securing the buyer against the pre-delivery credit risk is to transfer to him title to the vessel, her machinery and equipment as these are constructed and assembled at the shipyard. The terms of the contract embodying this structure are often referred to as "continuous transfer of title" provisions. If payment of the instalments of the contract price is scheduled in terms of timing and amount such that the value of the partly-completed vessel is always greater than the aggregate of the instalments paid at that time, the buyer's investment should theoretically be secured against the risk of the builder's liquidation. In practice, however, it is extremely difficult to place a value upon a partly-constructed vessel and the equipment and materials assembled for her completion.

Although once commonly employed in contracts for the construction of vessels in the United Kingdom,[57] continuous transfer of title provisions are not used in any of the SAJ, NEWBUILDCON or CMAC Forms. They are, however, found in some of the earlier shipbuilding contract standard forms, including the pre-1999 standard form contract of the now defunct Association of West European Shipbuilders, which provided, in a so-called "variation" to the main form as follows:

"Property in the VESSEL

From and after payment by the PURCHASER of the first instalment of the price (as specified in Article 7 hereof) the VESSEL as it is constructed and every part thereof and all equipment components and materials intended for the VESSEL as soon as they arrive in the CONTRACTOR'S yard and are appropriated to the VESSEL shall be PURCHASER'S property but the CONTRACTOR or sub-contractors (as the case may be) shall at all times have a lien thereon for any unpaid portion of the price including any agreed increases therein and any interest due thereon and any other sum due and payable by the PURCHASER to the CONTRACTOR under this agreement. . . . "

Where provisions of this type are incorporated in the contract, the buyer should as a matter of English law (and subject to the caveats described below) obtain a title to the vessel good against the general body of the builder's creditors in the event of the latter's liquidation. There are nevertheless a number of significant problems associated with use of such provisions in international shipbuilding contracts.

First, as previously noted, a purported transfer by contract of title to a partly-built vessel may, regardless of the parties' wishes, be legally ineffective under the *lex situs*. In such a case the buyer's security will be worthless, as the vessel will remain in the ownership of the builder and will be used to satisfy the claims of the general body of his creditors, including the buyer, upon a liquidation. If this structure is to be employed to secure repayment of the buyer's pre-delivery instalments, it is therefore vital that advice be sought in advance as to the effect of the transfer of title provisions under the *lex situs*.[58]

57 In *Howden Bros* v. *Ulster Bank and Others* (1924) 19 Ll.L.Rep. 199, these were described by Wilson J. as "the usual terms of a shipbuilding agreement". Such terms remain common in ship conversion contracts, in which title to the vessel will obviously vest in the buyer throughout.

58 The authorities cited in this section concerned vessels under construction in England, Scotland or Northern Ireland. The requirements of the *lex situs* were not therefore in issue.

Secondly, the fact that the buyer has acquired title to the partly-built vessel does not imply the existence of a right to complete her at the shipyard in the event of the builder's liquidation. Unless the vessel's construction is sufficiently advanced that she can be moved to another yard, the buyer can therefore realise his security only by reaching agreement with the liquidator to complete her, or by selling her in an incomplete state, possibly at a scrap value.[59] Even if the contract expressly confers upon the buyer the right to complete the vessel at the shipyard, an English court or arbitration tribunal is unlikely to grant specific relief to permit this to occur unless (possibly) the vessel's construction and outfitting is very far advanced.[60] Assuming that the buyer decides in such circumstances to seek to complete the vessel elsewhere, he is likely to face substantial practical and legal difficulties in leaving the bankrupt shipyard, particularly if the vessel incorporates at that time substantial materials and workmanship contributed by unpaid suppliers and subcontractors of the builder.

Thirdly, there are significant difficulties involved in seeking to confer upon the buyer title to equipment and materials intended to be used in the construction of the vessel. Because these items will in aggregate often be worth more than the partly-built hull itself, the existence of these problems represents a serious limitation on the effectiveness of continuous transfer of title provisions as a security device.

On a practical level, the principal problem in seeking to confer title to materials and equipment upon the buyer is that these may not in any event belong to the builder. Although the builder warrants that he owns the completed vessel, no assurance is normally given at any stage prior to delivery and acceptance as to the ownership of materials and equipment intended for her construction. Furthermore, it is common in international shipbuilding projects for the builder's suppliers and subcontractors to contract with him on terms reserving to them title in the materials and equipment supplied until they have received payment in full.[61]

Assuming that the equipment and materials in question do belong to the builder, the extent to which title will pass to the buyer depends upon the *lex situs* and the terms of the contract, construed in light of its proper law.[62] The English courts have, however, historically been reluctant to construe provisions of this type expansively; they are in particular unwilling, in the absence of very clear wording, to recognise these as

59 In the context of a newbuilding under construction in the United Kingdom, the buyer may experience particular difficulty in enforcing his rights of ownership where, instead of a liquidator, an administrator is appointed pursuant to Part II of the Insolvency Act 1986; see generally Fletcher, *The Law of Insolvency* (3rd edn.), Sweet & Maxwell.

60 *Merchants' Trading Co.* v. *Banner* (1871) L.R. 12 Eq.18, see pages 202–203, *infra*.

61 Provisions to this effect are generally referred to in English law as "Romalpa" clauses after the Court of Appeal decision in *Aluminium Industrie Vaasen B.V.* v. *Romalpa Aluminium Ltd* [1976] 1 W.L.R. 676. Note that where the contract containing a retention of title clause is for the sale of goods only, s. 25(1) of the 1979 Act can in certain circumstances operate to protect a third party purchaser (i.e., in a shipbuilding context, the buyer of the vessel); where the supplier has permitted his contracting partner (i.e., the shipyard) to obtain possession of the goods and the latter has transferred title to a third party purchaser who has received them in good faith and without notice of the supplier's retention of title rights, the "Romalpa" clause will be ineffective as against the purchaser. See *Archivent* v. *Strathclyde Regional Council* (1985) 27 B.L.R. 98 and *Angara Maritime Ltd* v. *Oceanconnect UK Ltd and Another* [2010] EWHC 619. The protection does not apply in respect of a "mixed" contract for the provision of goods and services.

62 In English law title to subcontracted items not belonging to the builder may in certain circumstances pass to the buyer under s. 9 of the Factors Act 1889; this will not, however, overrule contrary provisions of the *lex situs* nor apply where the subcontract is other than a contract of sale; see *Dawber Williamson Roofing Ltd* v. *Humberside County Council* (1979) 14 B.L.R. 70.

transferring title to equipment or materials which, although intended for the vessel, have not been physically incorporated within her.

In *Wood* v. *Bell* (1856)[63] the purchaser's payment of the price by instalments, coupled with his supervision of the vessel's construction and the punching of his chosen name, "Britannia", on her keel, was held to evidence an intention that title should pass to him before her completion. A further question arose, however, as to title in engines, prefabricated plates and angle irons marked with the name "Britannia" but not yet riveted in place and quantities of planking, all of which were located at the shipyard at the time of the shipbuilders' bankruptcy. Against this background, Jervis C.J., holding that the contract was "for the purchase of a ship, not the purchase of everything in use for the making of a ship", expressed the view[64] that:

" . . . those things which have been fitted to and formed part of the ship would pass [to the purchaser], even though at the moment they were not attached to the vessel but I do not think that those things which had merely been bought for the ship and intended for it would pass. . . . Nothing that has not gone through the ordeal of being approved as part of the ship passes . . . under the contract."

This principle, although somewhat arbitrary in its application, has the considerable merit of simplicity; it was furthermore specifically approved by the House of Lords in *Seath & Co.* v. *Moore* (1886).[65] In that case, which was decided under Scottish law, the supplier to a firm of shipbuilders of engines and other machinery for five newbuildings became bankrupt while the items remained undelivered at his premises. The House of Lords held that no appropriation of the items had taken place and that title had therefore not passed to the shipbuilders. According to Lord Watson, materials intended to be used for a newbuilding cannot be regarded as appropriated "unless they have been affixed to or in a reasonable sense made part of the corpus".[66]

Subject again to the requirements of the *lex situs*, it is clear that the parties are entitled to exclude by agreement the application of the principles laid down in *Wood* v. *Bell*. However, even where the parties have specifically agreed to transfer title to materials and equipment intended for the vessel, the English courts have shown considerable reluctance to interpret such provisions as extending to materials which have not yet been physically affixed to her.

Thus, for example, in *Reid* v. *Macbeth and Gray* (1904),[67] where the vessel was required to be classed "Lloyds 100A1", the shipbuilding contract provided that:

"the vessel as she is constructed, and all her engines, boilers, and machinery, and all materials from time to time intended for her or them, whether in the building yard, workshop, river or elsewhere shall immediately as the same proceeds become the property of the purchasers. . . . "

During the course of construction, iron and steel plates intended for her were checked and approved at the maker's workshops by the classification society's surveyors; the plates were also marked with the vessel's number and notations indicating their intended position in her hull. The shipbuilders became bankrupt whilst the plates lay at various railway terminals awaiting delivery to the shipyard.

63 (1856) 6 E. & B. 355.
64 At page 362.
65 (1886) 11 App. Cas. 350.
66 At page 381.
67 [1904] A.C. 223, H.L.

In these circumstances the House of Lords again held that title had not passed to the shipbuilders. The acceptance of the plates by the classification society did not constitute an appropriation by the purchasers. Furthermore, on its true construction the contract provided for title to pass only when the plates were "applied for the use of the ship or became part of the structure of the ship".[68]

Similarly, in *Re Blyth Shipbuilding and Dry Docks Co.* (1926),[69] the parties agreed (in terms virtually identical to those of the pre-1999 AWES Form quoted above) that:

"From and after payment by the purchasers to the builders of the first instalment on account of the purchase price, the Vessel and all materials and things appropriated for her should thenceforth, subject to the lien of the builders for unpaid purchase money, including extras, become and remain the absolute property of the purchasers."

Following payment of the first two instalments of the purchase price, the shipbuilders' debenture holders appointed a receiver. A dispute thereupon arose between the receiver and the purchasers of the vessel regarding title both to her hull and to worked and unworked materials intended for her which were lying at the shipyard.

At first instance, Romer J., applying the views expressed by Lord Watson in *Seath & Co.* v. *Moore*,[70] held that, while wording of this type was sufficient to pass title to the partly-completed vessel, it did not extend to the property in either unworked or worked materials "not affixed to, and so made part of, the Vessel" even if these had been inspected and approved by the purchasers' surveyor. This decision was upheld on appeal, the Master of the Rolls (Sir Ernest Pollock) holding that the words "materials and things appropriated for her" could only refer to:

". . . things which have been fitted, or (if they have not been completely fixed on the vessel) are substantially *in situ* so that the removal of them would be to go back on the work to be done for the vessel rather than to go forward."[71]

In light of *Reid* and *Blyth* it appears that, unless very specific words indeed are employed, machinery, equipment and spare parts intended for the vessel will not be deemed appropriated to her merely by reason of their delivery to the shipyard, whether or not they have been marked with a hull number or otherwise specifically identified.

The fourth, related difficulty arising in connection with continuous transfer of title provisions concerns the continuity of the security they furnish to the buyer. Because the value of this type of security is wholly dependent upon the realisable worth of the vessel and her parts, it is likely to confer very little protection upon the buyer at the early stages of the project. Such an arrangement is therefore wholly inappropriate as a means to secure repayment of the first instalment of the contract price, which is normally payable on or shortly after the Effective Date.[72]

In *McDougall* v. *Aeromarine of Emsworth Ltd* (1958),[73] the relevant contractual term transferred title only to the vessel and such of its parts as were owned by the builder at the time of payment of the first instalment; nothing had been ordered by the builder at this

68 *Per* Lord Davey at page 231.
69 (1926) 24 Ll.L.Rep. 139, C.A.
70 *Supra*, at n. 65; see also *Gray* v. *Baker* (1856) Scott 462.
71 At page 142.
72 See pages 263–272, *infra*; the buyer will usually seek a third-party guarantee at this stage of the project.
73 [1958] 2 Lloyd's Rep. 345.

stage of the project, with the result that the provision was (*per* Diplock J.) "quite inept" for the purpose of securing repayment of the purchaser's pre-delivery instalments.

The security afforded by this type of structure may, however, also prove to be illusory at a later stage should the buyer cease to need or want the vessel. This will typically occur where the vessel is late or seriously defective, in which event the buyer may wish to exercise a right of termination when the same accrues to him. If, however, the contract provides—either expressly or impliedly—that termination will revest title to the vessel in the builder, the buyer's exercise of such right is likely to deprive him of the only security he holds for the performance of the builder's refund obligations. The buyer may therefore face the uncomfortable choice of either accepting the vessel, notwithstanding that she is very late or fails to meet the requirements of the contract, or exercising a right of termination and pursuing an unsecured claim for recovery of his pre-delivery instalments and interest.

(c) The builder's lien

If title passes to the buyer during the course of construction, the contract will normally provide that the builder should have a contractual lien on the vessel to secure the unpaid portion of the contract price. This will permit him to retain the vessel pending payment of the price but not (in the absence of express provision) to sell her.[74]

The builder also has a statutory lien for the price under s. 41(1) of the 1979 Act where he remains in possession and credit terms have not been extended to the purchaser. By virtue of s. 48(3), the builder is entitled to resell the vessel in exercise of such right of lien provided that prior notice is given to the buyer who does not within a reasonable time pay or tender the price. Although the Act does not expressly so provide, it is clearly decided that, by exercising a statutory right of sale, a seller of goods automatically terminates the sale contract but retains the right to claim damages against the defaulting purchaser.[75] Subject to any contrary provision in the contract, the builder is therefore entitled to recover from the buyer by way of damages any losses sustained by reason of the resale of the vessel to a third party.[76]

RISKS OF LOSS OR DAMAGE

Regardless of the time of transfer of title, the risk of the vessel's loss or damage normally remains with the builder until her delivery and acceptance by the buyer. Given that she is likely to remain until such time at the builder's premises and that it is the acts and omissions of his employees which are most likely to cause loss or damage, this is obviously both logical and practical. The builder will in the normal course insure against these risks.[77]

74 The builder has a common law lien for the unpaid portion of the price see, e.g., *Woods* v. *Russell* (1822) 5 B. & Ald. 942.

75 *Ward (R.V.) Ltd* v. *Bignall* [1967] 1 Q.B. 534.

76 See further generally, "*Securing the Shipbuilder's Claims*", Curtis and Cecil, Lloyd's List, 3 April 2002.

77 Where his insurances are governed by English law, the vessel must normally remain at the builder's risk for him to enjoy an insurable interest: Marine Insurance Act 1906, s. 5.

Under the SAJ Form the builder assumes the risk of loss until the delivery and acceptance of the vessel "excepting risks of war, earthquakes and tidal waves".[78] These perils are excluded from the scope of the Japanese Special Clauses for Builder's Risks and, unless a specific extension of cover is requested and paid for by the buyer in accordance with Article XII.1, the builder is not required to insure against the same. Furthermore, as the builder's obligation to repair damage during the construction period arises only in respect of an insured cause, it seems (somewhat surprisingly) that, if the extension of cover has not been requested, the buyer bears the risk of remedying any damage caused by these particular perils; each will also constitute a *force majeure* event within the meaning of Article VIII.1.

Where, unusually, the contract makes no provision for the allocation of the risk of loss or damage, this is presumed to remain with the builder until title to the vessel is transferred to the buyer. Section 20(1) of the 1979 Act provides that:

"Unless otherwise agreed, the goods remain at the seller's risk until the property in them is transferred to the buyer, but when the property in them is transferred to the buyer, the goods are at the buyer's risk whether delivery has been made or not."

It should be noted that s. 20(1) applies only in the absence of express or implied agreement between the parties to the contrary. Furthermore, the presumption probably does not apply where the buyer takes title to the vessel during construction subject to a right of rejection if she fails upon completion to meet the minimum requirements of the contract.[79]

Finally, it should be noted that under s. 20(2) of the 1979 Act:

"where delivery has been delayed through the fault of either the buyer or the seller the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such default."

Although there is little authority as to the scope of this provision, it is clearly capable of imposing upon the purchaser of a newbuilding the risk of deterioration in her value where he wrongfully fails to take delivery. In *Demby Hamilton & Co. Ltd* v. *Barden* (1949),[80] the subsection was applied to cast upon the purchaser of consignments of apple juice liability for fermentation damage resulting from his failure to take delivery.

The subsection does not, however, render the party in breach liable for all losses during the period of the delay. According to Sellers J. in *Demby Hamilton* the innocent party remains subject to an obligation to "act reasonably and, if possible, to avoid any loss".[81] If, therefore, the vessel is damaged by reason of the builder's negligence after she has been wrongfully rejected, the buyer will not be liable. The position will be otherwise where the damage or deterioration is an inevitable consequence of the delay (e.g., where rusting occurs notwithstanding that reasonable precautions have been taken by the builder to protect the vessel).

78 These exceptions are not included in either the NEWBUILDCON or CMAC Form, i.e., under these forms the builder assumes these risks.

79 *Head* v. *Tattersall* (1871) L.R. 7 Ex. 7; the view expressed by Warrington L.J. in *Re Blyth Shipbuilding Co.*, *supra* (at n. 69), that the appropriation of materials to the contract automatically transfers the risk of their loss to the buyer is (it is submitted) unwarranted by authority.

80 [1949] 1 All E.R. 435.

81 At page 438.

''DEEMED'' DELIVERY

Article VII.4 of the SAJ Form provides that, where the buyer wrongfully fails to accept delivery, ". . . the BUILDER shall have the right to tender delivery of the VESSEL after compliance with all procedural requirements . . . ".

This language is somewhat curious (in that the buyer cannot in practical terms accept delivery of the vessel until she has been tendered to him) but it is submitted that its intent is clear. Where the vessel and her documentation comply with the requirements of the contract but the buyer fails to accept her, the vessel may be deemed delivered for the purposes (*inter alia*) of assessing the builder's liability in liquidated damages for delay and the date of accrual of his right to interest on the amount of the delivery instalment. It would seem, however, that the wording of Article VII.4 does not override the "express understanding" in Article VII.5 that title and risk in the vessel remains in the builder until delivery and acceptance takes place.

REMOVAL OF THE VESSEL FROM THE SHIPYARD

Following the delivery and acceptance of the vessel, the buyer is typically allowed a short period (usually up to a week) within which to remove her from the shipyard. If the agreed period is exceeded, the SAJ Form stipulates that the buyer shall become liable to pay the builder "reasonable" mooring charges. The contract will often provide that the buyer shall be responsible for any additional costs and expenses the builder may incur as a result of delay in the vessel's departure.

Even if no express provision is made in the contract, the builder will usually be entitled to recover his losses under s. 37(1) of the 1979 Act. This provides that:

> "When the seller is ready and willing to deliver the goods, and requests the buyer to take delivery, and the buyer does not within a reasonable time after such request take delivery of the goods, he is liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods."

In *Penarth Dock Engineering Co. Ltd* v. *Pounds* (1963),[82] the defendant, having purchased a floating dock, failed to remove it from the plaintiff vendor's dockyard when requested to do so. The plaintiff claimed damages which, unusually, were assessed on the basis of the benefit obtained by the defendant in using the dockyard after he should have removed the floating dock; it was held by Lord Denning M.R. on the facts of that case to be irrelevant that the defendant had suffered no loss by reason of the plaintiff's breach of contract.

82 [1963] 1 Lloyd's Rep. 359.

Article VIII—Delays and extension of time for delivery (*force majeure*)

1. Causes of Delay:

If, at any time before the actual delivery, either the construction of the VESSEL or any performance required as a prerequisite of delivery of the VESSEL is delayed due to Acts of God; acts of princes or rulers; requirements of government authorities; war or other hostilities or preparations therefor; blockade; revolution, insurrections, mobilisation, civil war, civil commotion or riots; vandalism, sabotages, strikes, lockouts or other labour disturbances; labour shortage; plague or other epidemics; quarantines; flood, typhoons, hurricanes, storms or other weather conditions not included in normal planning; earthquakes; tidal waves; land-slides; fires, explosions, collisions or strandings; embargoes; delays or failure in transportation; shortage of materials, machinery or equipment; import restrictions; inability to obtain delivery or delays in delivery of materials, machinery or equipment, provided that at the time of ordering the same could reasonably be expected by the BUILDER to be delivered in time, prolonged failure, shortage or restriction of electric current, oil or gas; defects in materials, machinery or equipment which could not have been detected by the BUILDER using reasonable care; casting or forging rejects or the like not due to negligence; delays caused by the Classification Society or other bodies whose documents are required; destruction of or damage to the Shipyard or works of the BUILDER, its subcontractors or suppliers, or of or to the VESSEL or any part thereof, by any causes herein described delays in the BUILDER'S other commitments resulting from any causes herein described which in turn delay the construction of the VESSEL or the BUILDER'S performance under this Contract; other causes or accidents beyond control of the BUILDER, its subcontractors or suppliers of the nature (*sic*) whether or not indicated by the foregoing words; all the foregoing irrespective of whether or not these events could be foreseen at the day of signing this Contract then and in any such case, the Delivery Date shall be postponed for a period of time which shall not exceed the total accumulated time of all such delays.

2. Notice of Delay:

Within ten (10) days after the date of occurrence of any cause of delay, on account of which the BUILDER claims that it is entitled under this Contract to a postponement of the Delivery Date, the BUILDER shall notify the BUYER in writing or by cable confirmed in writing of the date such cause of delay occurred. Likewise, within ten (10) days after the date of ending of such cause of delay, the BUILDER shall notify the BUYER in writing or by cable confirmed in writing of the date such cause of delay ended. The BUILDER shall also notify the BUYER of the period, by which the Delivery Date is postponed by reason of such cause of delay, with all reasonable despatch after it has been determined. Failure of the BUYER to object to the BUILDER'S claim for postponement of the Delivery Date within ten (10) days after receipt by the BUYER of such notice of claim shall be deemed to be a waiver by the BUYER of its right to object (*sic*) such postponement of the Delivery Date.

3. Definition of Permissible Delay:

Delays on account of such causes as specified in Paragraph 1 of this Article and any other delays of a nature which under the terms of this Contract permits postponement of the Delivery Date shall be understood to be permissible delays and are to be distinguished from unauthorised delays on

account of which the Contract Price is subject to adjustment as provided for in Article III hereof.

4. Right to Rescind for Excessive Delay:

If the total accumulated time of all delays on account of the causes specified in Paragraph 1 of this Article, excluding delays of a nature which under the terms of this Contract permit postponement of the Delivery Date, amounts to Two Hundred and Ten (210) days or more, then, in such event, the BUYER may rescind this Contract in accordance with the provisions of Article X hereof. The BUILDER may, at any time after the accumulated time of the aforementioned delays justifying rescission by the BUYER, demand in writing that the BUYER shall make an election, in which case the BUYER shall, within twenty (20) days after such demand is received by the BUYER, either notify the BUILDER of its intention to rescind this Contract, or consent to a postponement of the Delivery Date to a specific future date it being understood and agreed by the parties hereto that, if any further delay occurs on account of causes justifying rescission as specified in this Article, the BUYER shall have the same right of rescission upon the same terms as hereinabove provided.

The builder's performance of the shipbuilding contract may be prevented or impeded by a variety of circumstances occurring without fault on his part. In addition to the potential impact upon the construction programme of the buyer's own breaches of contract,[1] the builder faces the prospect that a significant range of events outside his control may render the contract incapable of completion, either on time or at all. Although the doctrine of frustration may excuse the builder from performance of his obligations where these have been radically affected by supervening events, English law will not normally protect him if he is simply late in delivering the vessel as the result of events occurring beyond his control.

Given the scale and complexity of modern shipbuilding projects, it is almost unknown for the builder to be willing to assume all of the risks of delay arising without default on his part. The overwhelming majority of contracts therefore share the potential exposures between the buyer and the builder by:

(a) providing that the Delivery Date shall be extended by any periods of time during which performance of the builder's obligations is impeded or prevented by circumstances beyond his control, typically known as *force majeure* events; and
(b) entitling the buyer to rescind if claims for postponement of the Delivery Date by reason of *force majeure* delays exceed in aggregate an agreed number of days over the life of the contract.

It should be noted that the *force majeure* provisions of most shipbuilding contracts are intended to benefit the builder alone and will not protect the buyer from a failure to perform his own, more limited, obligations. However, there is no reason in principle why *force majeure* protections should not equally extend to the buyer and this is sometimes agreed. The buyer may in particular wish to provide for circumstances affecting the international banking system (e.g., strikes by bank staff) which prevent his payment of the contract price instalments.

1 The builder is particularly exposed to the risk that the buyer will fail in good time to approve plans and drawings, to pay the agreed instalments of the contract price and to furnish the buyer's supplies. Many shipbuilding contracts expressly provide, however, that the contractual delivery date shall be extended by any periods of time during which the buyer is himself in default of his contractual obligations; the builder may alternatively be entitled to rely upon the common law "prevention principle" (see pages 65–68, *supra*).

FORCE MAJEURE: GENERAL PRINCIPLES

In contrast with a number of civil law systems, English common law has not embraced a generalised doctrine of *force majeure*.[2] The phrase itself has therefore no customary definition, its meaning having "eluded lawyers for years".[3] When used without a specific definition, it should be "construed in each case with a close attention to the words which precede or follow it, and with a due regard to the nature and general terms of the contract".[4]

To allocate precisely between themselves the risks of non-performance occurring without default, the parties must therefore specify in their contract both the factual events which are to constitute *force majeure* and the extent to which their rights and obligations will thereby be altered. In most commercial agreements, the *force majeure* clause comprises a detailed list of circumstances which will temporarily absolve the affected party from the obligation to perform and which may ultimately permit either or both parties to rescind. In addition to the defined events, the clause will usually also incorporate a "sweeping-up" provision, extending its operation to any other circumstances beyond the control of the affected party which either prevent or hinder performance of his obligations.

Although the precise effect of *force majeure* provisions will accordingly vary from contract to contract, the English courts have developed certain generally applicable rules as to their interpretation and effect.

First, it is clearly established that, where a *force majeure* claim is asserted by one party to a contract, the burden lies upon him to prove both (i) the occurrence of the event on which he relies and (ii) that his performance has been adversely affected, i.e., that there is a causative link between the event and the delay in performance for which he seeks an extension of time.[5] Given that the circumstances underlying the delay are more likely to be within his own knowledge than that of his contracting partner, the imposition of this burden of proof upon the claimant is plainly both logical and fair.

Thus, in *P.J. van der Zijden Wildhandel N.V.* v. *Tucker & Cross Ltd* (1975)[6] the defendants were sellers of goods under a contract which provided for an extension of the

2 The European Commission has expressed the view (Notice 88/C259/07 O.J. C259/11) that: "*Force majeure* is not limited to absolute impossibility but must be understood in the sense of unusual circumstances, outside the control of the trader, the consequences of which, in spite of the exercise of all due care, could not have been avoided except at the cost of excessive sacrifice." The Commission makes clear, however, that the concept of *force majeure* in European law is not necessarily the same as that applied in the national laws of Member States.

3 *Per* Donaldson J. in *Thomas Borthwick (Glasgow) Ltd* v. *Faure Fairclough Ltd* [1968] 1 Lloyd's Rep. 16 at page 28.

4 *Lebeaupin* v. *Richard Crispin & Co.* [1920] 2 K.B. 714, *per* McCardie J. at page 720, approved in *Podar Trading Co. Ltd* v. *Francois Tagher* [1949] 2 K.B. 277. The term does not extend, however, to acts or omissions in anticipation or apprehension of the *force majeure* event itself; see *Hackney Borough Council* v. *Doré* [1921] 1 K.B. 431.

5 See *Ascon Contracting Ltd* v. *Alfred McAlpine Construction Isle of Man Ltd* (1999) 66 Con. L.R. 119, *City Inn Ltd* v. *Shepherd Construction Ltd* [2010] CSIH 68, a Scottish appellate decision, and *Adyard Abu Dhabi* v. *S.D. Marine Services* [2011] EWHC 848 (Comm), where the High Court confirmed the delaying event relied upon must be "an operative cause of delay to the progress of the works" (*per* Hamblen J. at paragraph 286 of his judgment). It is also clear in this context that causation must be shown by reference to the status of the project at the date of the *force majeure* event in question; see *per* Akenhead J. in *Walter Lilly & Company Ltd* v. *Mackay and another* [2012] EWHC 1773 (at paragraph 365 of his judgment) that a determination must be made of what "critically delayed the works *as they went along*" (emphasis added).

6 [1975] 2 Lloyd's Rep. 240.

Delivery Date or cancellation in the event of non-performance resulting from "war . . . or any other causes beyond their control". They failed to ship the goods owing to a default by their own supplier but were held unable to rely upon the *force majeure* exception. While this was in principle available to them as a defence, they had failed to prove that goods of a contract quality could not have been procured elsewhere.[7]

Secondly, when interpreting *force majeure* clauses, English courts and arbitration tribunals will, depending upon the precise language used, often apply the *ejusdem generis* rule of construction (as to which, see pages 160–162, *infra*).

Thirdly, although it is a matter for debate whether *force majeure* provisions are to be regarded as strictly akin to exclusion clauses,[8] they are, in common with such clauses, usually construed narrowly against the interests of the party seeking to rely upon them. In particular, the English courts have been reluctant to interpret such provisions as intended to excuse non-performance in circumstances evidencing negligence or a breach of duty by the party affected.[9]

This is of considerable practical importance in relation to shipbuilding projects, which are often tightly scheduled, with little opportunity for the builder to recover time lost through mistakes. In such circumstances, the temptation for the builder to treat failures in performance on his part, or that of his subcontractors, as events of *force majeure* may be difficult for him to resist.

Three similar, although legally distinct, situations commonly arise:

(i) the *force majeure* event is directly caused by, or comprises, a breach of contract or negligence on the part of the builder;
(ii) the *force majeure* event, although not caused by any breach of duty, would not have affected the builder's performance but for his earlier breach of contract; and
(iii) the *force majeure* event occurs concurrently with, or "overlaps", a period of default by the builder in the performance of his obligations.

(i) Delay caused by or comprising the builder's breach of contract or negligence

Unless the agreement clearly so provides, *force majeure* exceptions will not normally be construed so as to benefit a party whose breach of contract or negligence has caused the event on which he seeks to rely.

Certain early judicial decisions appear to suggest that this represents a general and immutable principle of English law, based on the general doctrine that "no man may take

7 See also *Bulman & Dickson* v. *Fenwick & Co.* [1894] 1 Q.B. 179, *Channel Island Ferries Ltd* v. *Sealink U.K. Ltd* [1988] 1 Lloyd's Rep. 323, C.A. and *Agrokor* v. *Tradigrain* [2000] 1 Lloyd's Rep. 497.

8 *Force majeure* provisions were said to be distinct from exclusion clauses in *Fairclough, Dodd & Jones Ltd* v. *J.H. Vantol Ltd* [1957] 1 W.L.R. 136. Although they appear to attract the operation of the Unfair Contract Terms Act 1977 where this is applicable, it seems unlikely that a *force majeure* clause will be held "unreasonable" within the meaning of the statute where this merely entitles one party to postpone the performance of his contractual obligations where this has become impossible owing to events beyond his control; see *Shearson Lehman Hutton Inc.* v. *Maclaine Watson* [1989] 2 Lloyd's Rep. 570 at page 612.

9 On this subject generally, see *Force Majeure and Frustration of Contract* (2nd edn.), edited by E. McKendrick, Lloyd's of London Press, 1995 and *Frustration and Force Majeure*, G. H. Treitel, Sweet & Maxwell, 2004.

advantage of his own wrong". Thus, in *Lebeaupin* v. *Richard Crispin & Co.* (1920)[10] it was said simply that "a man cannot rely upon his own act or negligence or omission or default as *force majeure*".[11] More recent authorities have, however, emphasised that the scope of the parties' right to invoke the protection of a *force majeure* clause in circumstances of their negligence or breach of contract turns in each case upon its proper construction. Where such provisions can be sensibly interpreted in a manner which does not excuse liability for negligence or breach, the court or arbitration tribunal will normally presume that this was the parties' intention.

This presumption is very similar to that applied in the context of Effective Date clauses where (in the absence of a clear intention to the contrary) a term of the contract rendering performance of the parties' obligations conditional upon certain defined events will not apply to the benefit of a party who, in breach of contract, has prevented those events from occurring.[12]

Thus, in *Sonat Offshore S.A.* v. *Amerada Hess Development Ltd and Another* (1988)[13] clauses in a drilling contract providing for hire to be paid to the contractor at specified rates in the event of "Equipment Breakdown" and "Repair", the latter covering "any damage to the rig (other than damage caused by an event of *force majeure* . . . or equipment breakdown)", were each held inapplicable where damage disabling the rig had resulted from the contractor's admitted negligence. After carefully analysing the contract, the Court of Appeal concluded that, as the two rates could clearly apply in certain circumstances not amounting to negligence, there was (in the absence of express words) no warrant for extending their scope to events of negligence.

Similarly, in *J. Lauritzen A.S.* v. *Wijsmuller B.V. (The "Super Servant Two")* (1990),[14] a contract for the ocean transportation of an oil rig provided that the carrier might perform his obligations with one of two vessels, *Super Servant One* or *Super Servant Two*, and (*per* Clause 17) that he would be entitled to cancel performance of his obligations, "in the event of *force majeure*, Acts of God, perils or danger and accidents of the sea . . . or any other circumstances whatsoever . . . which reasonably may impede, prevent or delay . . . performance".

The *Super Servant Two* was allocated to the performance of the contract but thereafter sank before the obligation to load arose; *Super Servant One* was by this stage committed to other contracts and could not be substituted. The parties accordingly entered into a without prejudice agreement to transport the rig by alternative means and the rig owners sued the carrier for the additional costs thereby incurred.

Against this background, the question arose as to whether the carrier could rely on the *force majeure* clause if the loss of *Super Servant Two* had resulted from his negligence. The carrier contended that, while the majority of the events detailed in the *force majeure*

10 *Supra*, at n. 4.

11 *Supra*, *per* McCardie J. at page 721 see also *Yrazu* v. *Astral Shipping Co.* (1904) 9 Com. Cas. 100.

12 *New Zealand Shipping Co. Ltd* v. *Société des Ateliers et Chantiers de France* [1919] A.C. 1; *Cheall* v. *Association of Professional Executive Clerical and Computer Staff* [1983] 2 A.C. 180; *Thompson* v. *ASDA-MFI plc* [1988] 1 Ch. 241, see pages 265–270, *infra*. In *Okta Crude Oil Refinery AD* v. *Mamidoil-Jetoil Greek Petroleum Co. S.A.* [2003] EWCA Civ 1031, a governmental authority's request to one party to a contract not to perform was held not to fall within the ambit of a *force majeure* clause because the party claiming its protection had itself approached the government to make such request.

13 [1988] 1 Lloyd's Rep. 145.

14 [1990] 1 Lloyd's Rep. 1.

clause represented matters outside his control, "perils or dangers or accidents of the sea" encompassed losses resulting from negligence; the clause therefore clearly envisaged that events constituting negligence should fall within its scope.

Applying principles developed in the context of exclusion clauses in the leading case of *Canada Steamship* v. *The King* (1952),[15] Bingham L.J., held that Clause 17 "was not deprived of a sensible application" if confined to events which did not involve negligence on the part of the carrier; as such, the clause was in his view limited to such events and did not extend to protect the carrier from other circumstances for which it had been alleged he or his servants were to blame. Dillon L.J. (delivering the only other judgment) concurred in this conclusion.[16]

Although neither of these decisions concerned construction contracts, it seems logical that the interpretative approach adopted by the Court of Appeal in *Sonat Offshore* and the "*Super Servant Two*" will be applied to *force majeure* clauses generally. The result would seem to be that acts of negligence or breach of duty will be construed as falling outside the ambit of *force majeure* clauses except where the parties have expressly and explicitly agreed otherwise.

(ii) The effects of a prior breach

Can a party validly declare *force majeure* delay where this would have been unnecessary but for a prior breach of contract on his part? In a shipbuilding context, this issue typically arises where the builder fails to deliver the vessel by the Delivery Date and is thereafter further delayed by the occurrence of *force majeure* events.

On one view, the builder will in such circumstances be liable in liquidated damages for the buyer's losses resulting from the delay and should not, unless the parties have expressly so agreed, also be deprived of the benefits of the contract (including the *force majeure* clause) whilst this remains in force.

However, in *Hull Central Dry Dock & Engineering Works Ltd* v. *Ohlson Steamship Ltd* (1924)[17] the opposite view prevailed in the context of a repair dispute. The contract, which incorporated an exception of liability for strikes, provided that the works should take 40 days and for liquidated damages to be paid in the event of delay. It also stipulated that "no extension of time will be allowed unless it is . . . agreed that extra repairs cannot be carried out concurrent with the contract work".

Certain additional works were ordered by the owners but no time extension was agreed. The 40-day period for the completion of the works thereafter expired with the repairs still far from finished. On the following day, a labour dispute led to a strike and lockout which delayed completion of the works for a further seven months.

The owners claimed liquidated damages for the entire period of delay. In denying liability the repairers contended (*inter alia*) that they were protected by the *force majeure*

15 [1952] 1 Lloyd's Rep. 1, [1952] A.C. 192.

16 See also *E. E. Caledonia Ltd.* v. *Orbit Valve Co. Europe* [1993] 2 Lloyd's Rep. 418, in which, in a case concerning an exclusion clause, Hobhouse J. said (at page 422) that: " . . . the parties to a contract are not to be taken to have agreed that a party shall be relieved of the consequences of its negligence without the use of clear words showing that that was the intention . . . ".

17 (1924) 19 Ll.L.Rep. 54.

clause throughout the period of the lockout. In finding in favour of the owners, Bailhache J. expressed the view that:

" . . . the [repairers] cannot rely upon the strike interfering with their work, if at the time the strike began, they had exceeded their contract time. They can only rely upon the strike clause as being an interference with the work given to them or contracted for if at the time of the strike they had committed no breach of contract."[18]

Similarly, in *Balfour Beatty Building Ltd* v. *Chestermount Properties Ltd* (1993)[19] Colman J., citing the example of flooding of a construction site when the contractor was already late in completing the contract works, expressed the view that:

"In such a case it is hard to see that it would be fair and reasonable to postpone the contractor's time. Indeed . . . it is hard to envisage any extension of time being fair and reasonable unless the contractor was able to establish that, even if he had not been in breach in overshooting the completion date, the particular relevant delaying event would still have delayed the progress of the works at an earlier date. Such cases are not likely to be of common occurrence."[20]

The principle that the builder cannot claim *force majeure* delays where he is late in delivering the vessel or otherwise in breach of contract can, however, be negated by express agreement between the parties (see further below).

(iii) "Concurrent" delays

Where the delay in performance of the contract has resulted from the impact of "concurrent" events, one of which in principle constitutes *force majeure* within the meaning of the contract, while the other comprises or evidences a default or failure of performance by the builder, it seems that an extension of time can be claimed by the builder.[21] In the leading non-marine construction decision, *Henry Boot Construction (U.K.) Ltd* v. *Malmaison Hotel (Manchester) Ltd* (1999),[22] which was approved and applied in a shipbuilding context in *Adyard*,[23] Dyson J. clearly expressed the position as follows[24]:

" . . . If there are two concurrent causes of delay, one of which is a relevant event, and the other is not, then the contractor is entitled to an extension of time for the period of delay caused by the relevant event notwithstanding the concurrent effect of the other event. Thus, to take a simple example, if no work is possible on a site for a week not only because of exceptionally inclement weather (a relevant event [for *force majeure* purposes]), but also because the contractor has a shortage of labour (and not a relevant event), and if the failure to work during that week is likely to delay the works beyond the completion date by one week, then if he considers it fair and reasonable to do so, the architect is required to grant an extension of time of one week. He cannot

18 At page 56. It is a curious feature of this case that it does not seem to have been argued that the shipowners' refusal to grant more time for the additional works should have prevented their enforcement of the liquidated damages clause; see pages 65–68, *supra*.

19 (1993) 62 B.L.R. 1.

20 At page 35.

21 See Dyson J. in *Henry Boot Construction (U.K.) Ltd* v. *Malmaison Hotel (Manchester) Ltd* (1999) 70 Con. L.R. 32 at paragraph 13 of the judgment; as affirmed in *Adyard Abu Dhabi*, *supra* at n. 5, at paragraphs 276–277 and 288 of the judgment and *Walter Lilly*, *supra* at n. 5, at paragraph 370.

22 *Ibid.*

23 *Supra*, at n. 5.

24 At paragraph 13 of his judgment.

refuse to do so on the grounds that the delay would have occurred in any event by reason of the shortage of labour".[25]

The fourth general principle of English law generally applying to *force majeure* clauses is that the party seeking to invoke the protection of such a provision must show that he has taken reasonable steps in advance to avoid the impact of the *force majeure* event in question. In *B. & S. Contracts and Design Ltd* v. *Victor Green Publications Ltd* (1984)[26] Griffiths L.J. stated that:

" . . . clauses of this kind have to be construed upon the basis that those relying on them will have taken all reasonable efforts to avoid the effect of the matters set out in the clause which entitle them to vary or cancel the contract."

This approach was endorsed in *Channel Island Ferries Ltd* v. *Sealink U.K. Ltd* (1988),[27] which concerned a joint venture agreement under which Sealink had assumed an obligation to charter two vessels on bareboat terms to a company owned by itself and CIF. The joint venture agreement provided that neither party should be liable for non-fulfilment of its obligations by reason of "strikes, lockouts . . . and any . . . incident of any nature beyond the control of the relevant party".

In consequence of the conclusion of the joint venture agreement, Sealink's officers and crew went on strike, refusing to operate any of the company's vessels, following which Sealink reached an agreement with the employees' unions under which it undertook not to charter out any of its vessels on bareboat terms. Sealink subsequently contended against CIF that it was entitled to the protection of the *force majeure* provisions of the joint venture agreement.

The trial judge, Hirst J., rejected this contention on several grounds, in particular that Sealink had failed to show that there was nothing it could reasonably have done, before or after conclusion of the joint venture agreement, to avoid the strike or mitigate its consequences; in the judge's view, Sealink had "failed improvidently to take . . . reasonable business precautions".[28] This view was upheld by Ralph Gibson L.J. in the Court of Appeal who stated that:

" . . . the accepted construction of a *force majeure* clause of this nature . . . requires that the party claiming its protection proves that there were no reasonable steps which it could have taken to avoid being prevented from performing its obligation by the incident or event said to be within the clause. The extension of that investigation to matters before the contract seems to me to be both logical and just so far as concerns actions [which] could reasonably have been taken to assist performance of obligations assumed. For example, in this case preliminary discussions with Union representatives."[29]

25 This is in contrast to the legal position where delay has been caused by concurrency of (i) builder's failure or default and (ii) the buyer's act or acts of prevention. In this situation, the balance of authority suggests that the prevention principle is not triggered because the builder is unable to show that the buyer's conduct, rather than the builder's default, prevented timely completion; see *Adyard*, *supra* at n. 5, at paragraphs 282 and 292 of Hamblen J.'s judgment as approved in *Jerram Falkus Construction Ltd* v. *Fenice Investments Inc.* [2011] EWHC 1935.

26 [1984] I.C.R. 419.

27 *Supra*, at n. 7.

28 [1987] 1 Lloyd's Rep. 559 at page 576.

29 [1988] 1 Lloyd's Rep. 323 at page 329; note, however, the reservations expressed by Parker C.J. at page 328 and see also *Hoecheong Products Co. Ltd* v. *Cargill Hong Kong Ltd* [1995] 1 W.L.R. 404, P.C.; *Chitty on Contracts* (30th edn.) paragraph 14–140.

It should, however, also be noted that the Court of Appeal in *Channel Island Ferries*, while not deciding this point, expressed the view that it is not *per se* a bar to the invocation of a *force majeure* clause that the events or circumstances relied upon were already in existence when the contract was signed.[30] This was tentatively confirmed by the High Court decision in *The "Radauti"* (1987),[31] in which Staughton J. said[32]:

"Insofar as the expression '*force majeure*' has even a general meaning in English law, I would for my part doubt whether it necessarily conveys . . . imprevisibilite. . . . Some wars may be foreseen, some strikes and some abnormal tempests or storms. I would suggest it is more a question of causation, whether the incidence of a particular peril which could have been foreseen can really be said to have caused one party's failure of performance."

Where (as in the case of Article VIII.1 of the SAJ Form) the contract itself makes clear that force majeure delay can be claimed even if the event relied upon was foreseeable at the time of its signature, this will obviously be conclusive.

STANDARD FORM WORDINGS

Article VIII of the SAJ Form defines a range of events which entitle the builder to a postponement of the Delivery Date[33] and details the procedure by which claims for postponement are to be presented. It also provides that the buyer may rescind the contract if the builder's claims for postponement of the Delivery Date by reason of *force majeure* delays aggregate 210 days or more. It should also be noted, however, that, in common with other standard shipbuilding forms, Article VIII encompasses only events causing actual delay in the completion of the vessel. Circumstances causing any other form of hindrance to the performance of the builder's obligations (including, for example, an increase in his costs of labour or materials) will not avail him unless delay also results.[34]

(a) Force majeure *events*

Article VIII.1 of the SAJ Form lists more than thirty-five *force majeure* events whose impact upon the "construction of the Vessel or any performance required as a pre-requisite of delivery" entitles the builder to a postponement of the Delivery Date. The events in question cover a wide range of circumstances, encompassing political, technical and natural (principally meteorological) risks. Much of the language used, which is mirrored

30 *Per* Parker L.J. at page 328 and Ralph Gibson L.J. at page 329; see also in this context *Matsoukis* v. *Priestman & Co.* (1915), *infra* at n. 65.

31 [1987] 2 Lloyd's Rep 276.

32 At page 282 of the report; see also *SHV Gas Supply & Trading SAS* v. *Naftomar Shipping and Trading Co. Ltd Inc.* [2005] EWHC 2528 (Comm). Note, however, that the NEWBUILDCON Form provides (at Clause 34(a)(iii)(2)) that *force majeure* events encompass only those which "were not, or could not reasonably have been, foreseen by the Builder at the date of the Contract".

33 Similar provisions are contained in the NEWBUILDCON (Clause 34) and CMAC (Article XV) forms.

34 *Brauer & Co. (Great Britain) Ltd* v. *James Clark (Brush Materials) Ltd* [1952] 2 Lloyd's Rep. 147; see also *Thames Valley Power Ltd* v. *Total Gas & Power Ltd* [2005] EWHC 2208 (Comm) paragraph 50 and *Tandrin Aviation Holdings Ltd* v. *Aero Toy Store LLC* [2010] EWHC 40 (Comm), in which (in the context of a sale of a jet aircraft) the High Court confirmed that a change in economic or market circumstances affecting the profitability or ease of performance of a contract will not normally constitute a *force majeure* event.

in other standard shipbuilding contract forms,[35] is clear as to its meaning and scope but a number of terms call for specific comment.

"Acts of God"

The expression "Act of God" has been somewhat inelegantly defined in English law as "such an operation of the forces of nature as reasonable foresight and ability could not foresee or reasonably provide against".[36] Where this exception is included in the contract, the builder must therefore prove not only the impact of a natural phenomenon upon the performance of the contract works, but also that he could not reasonably have anticipated or avoided its effects.[37]

The extent to which mere inclement weather, as opposed to specific meteorological events such as storms or lightning strikes, can constitute an Act of God has not been finally settled by the English courts. In *Matsoukis* v. *Priestman & Co.* (1915),[38] Bailhache J., having expressed the view that *force majeure* was wider in law than an Act of God, held that "bad weather, football matches and funerals" were "usual incidents interrupting work"[39] and did not fall within the terms of a clause excepting the builder from "the cause of *force majeure*, and/or strikes of workmen . . .".

The proposition that inclement weather cannot constitute an Act of God was, however, doubted in the subsequent case of *Lebeaupin* v. *Richard Crispin and Co.* (1920).[40] In light of this and other authorities,[41] the better view is that bad weather can constitute an Act of God where so extreme, judged in light of the usual conditions at the place of contractual performance, that the party affected could not reasonably have expected to encounter it.

Under the SAJ Form, a number of circumstances which might as a matter of common law constitute Acts of God (in particular floods, typhoons, hurricanes and storms) are expressly included within the scope of the protections provided to the builder. Although, as previously indicated, Article VIII.1 excludes any requirement that these circumstances should have been unforeseeable at the time the contract was concluded, they must nevertheless not have been "*included in normal planning*"[42]; it appears, therefore, that where the builder has, or should reasonably have, included in his scheduling of the vessel's construction an allowance for adverse weather conditions normally experienced at the shipyard or his subcontractors' facilities, he will not be allowed to invoke such conditions as the basis of a *force majeure* claim.

35 See Clause 34(a)(i) and (ii) of the NEWBUILDCON Form and Article XV.1 of the CMAC Form.

36 *Per* Atkin J. in *Baldwin's Ltd* v. *Halifax Corporation* (1916) 85 L.J.K.B. 1769 at page 1774.

37 This may represent an exception to the general principle that, unless the contract otherwise provides, the foreseeability as at the date of the contract of a *force majeure* event does not affect the right to claim an extension of time in respect of its impact, *supra.*

38 [1915] 1 K.B. 681.

39 The funeral was, however, that of the shipyard manager; details of the football matches are not reported.

40 [1920] 2 K.B. 714.

41 In particular *Dixon* v. *Metropolitan Board of Works* (1881) 7 Q.B.D. 418.

42 The NEWBUILDCON Form allows the builder to claim in respect of "extraordinary weather conditions" (Clause 34(a)(i)(6)) which "were not or could not reasonably have been foreseen . . . at the date of the contract" (Clause 34(a)(iii)(2)), while the CMAC Form refers merely to "abnormal weather conditions" and "typhoon" (Article XV.1).

"War or other hostilities or preparations therefor"

War has been defined in English law as the use by states of ". . . regulated violence against each other".[43] According to the Court of Appeal in *Kawasaki Kisen Kabukishi Kaisha of Kobe* v. *Bantham Steamship Co. Ltd (No. 2)* (1939),[44] the existence of a state of war is, however, to be determined in a "common sense way" without reference to the various technical definitions of the term which apply in international law; the test is whether a businessman, exercising commonsense, would say whether the nation in question had become involved in a war.[45] That no declaration of war has been made is therefore not a conclusive factor pointing to the continuance of peace nor is it determinative of the issue that the nations which are in dispute are continuing to maintain diplomatic relations with each other.

Article VIII.1 of the SAJ Form applies to "war or other hostilities or preparations therefor . . . revolution, insurrections, mobilisation, civil war" and is as such broadly framed. In an insurance context, it has been held that "hostilities or warlike operations" must involve acts "done in the context of a war"[46] and it is submitted that a similar interpretative approach would be taken to the language of the SAJ Form. An act of terrorism affecting the builder or his subcontractors, but undertaken outside the framework of an existing war, would probably not therefore qualify as a "*force majeure*" event within the meaning of this part of Article VIII.1; such an act would nevertheless probably be caught by the "sweeping up" provisions contained later in the Article,[47] provided that the builder could show that its occurrence was beyond his control.

In addition to the "threat or act of war" and "warlike operations", the NEWBUILDCON Form, unlike the SAJ and CMAC forms, includes "terrorism or the consequences thereof" within its definition of *force majeure* events.[48] "Terrorism" has been statutorily defined in the United Kingdom as the "use or threat of action" where this is designed "to influence the government or an international governmental organisation or to intimidate the public or a section of the public", and undertaken "for the purpose of advancing a political, religious, racial or ideological cause".[49]

"Strikes, lockouts or other labour disturbances"

Strikes and other forms of industrial action represent one of the commonest and most significant causes of delay in the construction of newbuildings. They are also circumstances which the builder, as the employer of the workforce at the shipyard, may sometimes be in a position to influence or control. For this reason the inclusion of "strikes, lockouts and other labour disturbances" within the scope of the *force majeure* clause frequently represents the most contentious element of the pre-contract negotiations. If, however, these are not to be regarded as *force majeure* events, the builder may be seriously

43 *Per* Matthew J. in *Driefontein Consolidated Gold Mines Ltd* v. *Janson* [1900] 2 Q.B. 339 at page 343.

44 [1939] 2 K.B. 544; the case involved a war cancellation clause in a charterparty, although the views expressed in the judgment would appear equally relevant to the interpretation of a *force majeure* clause.

45 *Per* Sir Wilfred Greene M.R. at page 559.

46 *Spinney's (1948) Ltd* v. *Royal Insurance Co. Ltd* [1980] 1 Lloyd's Rep. 406 *per* Mustill J. at page 437.

47 See pages 160–163, *infra*.

48 See Clause 34(a)(i)(3).

49 Section 1 of the Terrorism Act 2000, as subsequently amended.

exposed to the consequences of disputes not only with his own workforce but also between his subcontractors and their employees.

The term "strike" has been judicially defined as:

> " . . . a simultaneous cessation of work on the part of workmen . . . acting in combination or a concerted refusal . . . of any number of persons who are employed . . . to continue to work or to accept employment . . . ".[50]

In *Tramp Shipping Corporation* v. *Greenwich Marine Inc.* (1975)[51] a concerted refusal by workmen, seeking to secure improvements in their terms and conditions of employment, to work customary shifts was held to be a "strike" within a charterparty exceptions clause. Where, however, there is no dispute between employer and employees, but merely a refusal on the part of the latter to work because, for example, an infectious disease is prevalent at the shipyard,[52] this will not constitute a strike; it is equally neither a strike nor a lockout for the builder, responding to economic pressures rather than the existence of a labour dispute, to make part of his workforce redundant.[53]

As previously indicated[54] it may in this context be open to the buyer to contend that the builder has acted unreasonably in his dealings with his workforce and is thus precluded from asserting that a particular strike has truly resulted from events beyond his control.

In *B. & S. Contracts and Design Ltd* v. *Victor Green Publications Ltd* (1984),[55] the plaintiffs, who were specialist contractors, agreed to erect exhibition stands for the defendants. The contract incorporated a *force majeure* clause which stated that "due performance . . . is subject to variation or cancellation owing to . . . strikes . . . or any other cause beyond the [contractor's] control". In support of long-standing claims for severance pay, the plaintiffs' workforce refused to erect the stands and the defendants, fearing that they would incur substantial liabilities to the exhibitors, offered to advance half the amount in dispute to the plaintiffs, who were able and willing to meet the balance of the workforce's claim. The plaintiffs refused, however, to agree that the monies be treated as an advance, whereupon the defendants made the payment to them regardless and subsequently set off the amount involved against the plaintiffs' invoice for the contract price.

The defendants argued, *inter alia*, that the payment had been made under the threat of non-performance and was therefore recoverable from the plaintiffs as induced by duress; to this, the plaintiffs replied that their actions were not unlawful because the *force majeure* clause excused non-performance resulting from strikes.

On these facts, the Court of Appeal experienced no difficulty in deciding that the *force majeure* clause did not protect the plaintiffs. In the view of all three members of the court, the applicable test was whether the employer had acted reasonably in his dealings with his workforce. In the court's view this had not happened; indeed the plaintiffs had acted wholly unreasonably in refusing to settle their workforce's claims and the court found as

50 *Farrer* v. *Close* (1869) L.R. 4 Q.B. 602; s. 246 of the Trade Union and Labour Relations (Consolidation) Act 1992 as amended defines a strike as "any concerted stoppage of work".

51 [1975] I.C.R. 261.

52 *Stephens* v. *Harris* (1886) 56 L.J.Q.B. 516. The Court of Appeal declined to express a view on this issue but did not overrule the Divisional Court; see (1887) 57 L.J.Q.B. 203.

53 *Re Richardsons and Samuel* (1897) 66 L.J.Q.B. 868.

54 See page 153, *supra*.

55 See n. 26, *supra*.

a fact that such claims could have been met if the defendants' original offer of an advance had been accepted.

A similar approach was taken in *Channel Island Ferries Ltd* v. *Sealink Ltd* (1987),[56] in which the defendants, Sealink, were held entitled to rely upon a *force majeure* exception of strikes only if there was nothing they could reasonably have done to avoid the strike in question or to mitigate its consequences. A lockout has been statutorily defined as:

"(a) the closing of a place of employment, (b) the suspension of work, or (c) the refusal by an employer to continue to employ any number of persons employed by him in consequence of a dispute, done with a view to compelling persons . . . to accept terms or conditions of or affecting employment."[57]

Although this is not provided in the SAJ Form, it is commonly agreed that the definition of strikes and lockouts capable of generating *force majeure* delays will extend only to such events affecting the whole or a substantial part of the shipbuilding industry in the country of construction. In a similar manner, the NEWBUILDCON Form limits the definition of strikes, lockouts and other industrial action in a *force majeure* context to those of a "general nature and not limited solely to the Builder and/or the Sub-Contractors or their employees".[58]

"Labour shortage"

This expression is plainly intended to extend the scope of the exception of strikes, etc. to the more general circumstance in which sufficient skilled or unskilled labour is for any reason not available to the builder. In *Lindvig* v. *Forth Shipbuilding & Engineering Co. Ltd* (1921)[59] a *force majeure* provision excusing the builder from the consequences of "unexpected and exceptional restriction of output" was held by Roche J. to extend to "a restriction of workmen . . . that is to say . . . the men were not working as they might be expected to work, owing to changes of hours and other matters . . .".

It is nevertheless a primary obligation of the builder under the contract to procure sufficient labour to complete the vessel on time. In line with general principles, he will not therefore be entitled to rely upon the exception of a labour shortage where he has, for example, simply underestimated his requirements for the project.

"Explosions"

In *Commonwealth Smelting Ltd* v. *Guardian Royal Exchange Ltd* (1984) the term "explosion" was held to mean "an event that is violent, noisy and . . . caused by a very rapid chemical or nuclear reaction, or the bursting out of gas or vapour under pressure".[60] It did not encompass the break-up at speed of a large ventilation fan notwithstanding that this produced outward effects similar to that of a chemical explosion. The NEWBUILDCON Form makes clear that a "fire, accident or explosion" can constitute a *force majeure* event whether this occurs at the shipyard or elsewhere.[61]

56 See n. 27, *supra*.
57 Employment Rights Act 1996, s. 235(4).
58 Clause 34(a)(i)(7).
59 (1921) 7 Ll.L.Rep. 253.
60 [1984] 2 Lloyd's Rep. 608, *per* Staughton J. at page 612.
61 Clause 34(a)(i)(8).

"Shortage of materials, machinery or equipment . . . delays in delivery etc."

Ensuring the availability and timely delivery of the materials and equipment needed for the vessel's construction represents another of the builder's principal obligations under the contract. In any major shipbuilding project, the builder will be expected to supervise and co-ordinate the activities of a substantial number of suppliers and subcontractors located in a variety of different countries.

Given these circumstances, it is not unreasonable that the builder's right to claim *force majeure* delay consequent upon shortages or delays in deliveries should be restricted to situations in which these occur unexpectedly and without fault on his part. The SAJ Form expressly limits such claims to cases in which "at the time of ordering [the materials, machinery or equipment] could reasonably be expected by the BUILDER to be delivered in time".[62]

The fact that the market price of the materials in question has risen is not in itself conclusive evidence of a shortage in supply. Conversely, however, where a shortage does arise, the builder is entitled to rely upon the exclusion even if he could have acquired the materials by paying a higher price. In *Tennants (Lancashire) Ltd* v. *C.S. Wilson and Co. Ltd* (1917),[63] the defendant sellers failed, following the outbreak of the 1914–18 war, to supply magnesium chloride to the plaintiffs under a fixed price contract; the defendants had intended to cover the contract requirement from a source of supply in Germany. The evidence indicated that, provided they were prepared to default in the performance of certain other supply contracts, the defendants could have fulfilled their obligations to the plaintiffs by buying in from other sources, albeit at a significantly increased cost. The defendants sought instead to invoke the provisions of a *force majeure* clause entitling them to suspend deliveries "pending any contingency beyond the control of the . . . sellers (such as . . . war . . .) causing a short supply of . . . raw material or manufactured produce, or otherwise preventing or hindering the manufacture or delivery of the article".

Against this background the House of Lords held that, a general shortage of supply having been proved, the defendants were entitled to rely upon the *force majeure* clause notwithstanding the existence of an alternative source of supply sufficient to permit them to fulfil their obligations to the plaintiffs. Their Lordships were, however, insistent that a mere increase in price would not have been adequate to establish a shortage in supply. Expressing the view of the majority, Lord Dunedin said:

"I do not think price as price has anything to do with it. Price may be evidence, but it is only one of many kinds of evidence as to shortage. If the [sellers] had alleged nothing but advanced price they would have failed."[64]

"Defects in materials, machinery or equipment which could not have been detected by the BUILDER using reasonable care"

In addition to permitting the builder a postponement of the Delivery Date in the event of shortages or delays in delivery of materials, machinery or equipment, Article VIII.1 of the SAJ Form also protects him against the consequences of defects in such items. This

62 However, neither the NEWBUILDCON Form nor the CMAC Form contain such provisions, with the result the builder will be obliged in such circumstances to rely on the general "sweep-up" language of the *force majeure* clause; see pages 160–163, *infra*.

63 [1917] A.C. 495.

64 At page 516; see also *Peter Dixon & Sons Ltd* v. *Henderson, Craig & Co. Ltd* [1919] 2 K.B. 778.

general wording is in addition to the separate and specific exception of "casting or forging rejects or the like not due to negligence".

The SAJ Form stipulates that the defect must be "latent" in nature, in the sense that it could not have been discovered through the exercise of reasonable care. However, there is nothing in Article VIII.1 to suggest that the builder's duty is limited in time. Thus where an item installed on board the vessel is found to be defective, he will *prima facie* be entitled to an extension of the Delivery Date calculated by reference to the date on which, if the required degree of care had been employed, the defect should have been discovered (rather than the date of its installation).

"Delays in the BUILDER's other commitments . . . which in turn delay construction of the VESSEL"

The builder is also entitled under Article VIII.1 to claim a postponement of the Delivery Date where the completion of his commitments to third parties is delayed as a result of *force majeure* events and this in turn delays his performance of the contract.

In *Matsoukis* v. *Priestman & Co.* (1915)[65] the plaintiff's vessel was delayed by reason of a number of events, including delay in completion of an earlier vessel occupying the berth. Completion of this earlier vessel had itself been held up by late delivery of steel plates consequent on the Great Coal Strike of 1912. The court held that, while the effect of the strike upon the completion of the plaintiff's vessel was only indirect, the shipbuilder was excused by the terms of a *force majeure* clause from liability to pay liquidated damages for the delay involved. This was so even though at the date when the contract was made it was "obvious that a strike might take place".[66]

Similarly, in *Lockie and Craggs & Sons* (1901),[67] delay in completion of an earlier vessel occupying the berth was caused by a number of events outside the shipbuilders' control. The contract vessel was as a result commenced and completed late. The shipbuilder was held entitled to the protection of a clause which, while fixing the Delivery Date, required the parties to make "due allowance" for various specified *force majeure* events and "other circumstances beyond builders' control".

However, under the SAJ Form it is expressly provided that the builder is entitled to claim an extension of the Delivery Date only where delay in respect of other commitments has itself resulted from *force majeure* events as defined in Article VIII.1.

"Other causes or accidents beyond the control of the BUILDER, its subcontractors or suppliers . . . whether or not indicated by the foregoing words"

This wording is intended to operate as a sweeping-up provision, extending protection to the builder against any circumstances beyond his control which prevent performance of the contract but are not included within the list of defined *force majeure* events set out in the first part of Article VIII.1.

Prima facie, wording of this type attracts the operation of the *ejusdem generis* rule of construction. This provides that, where general words in a contract follow,[68] and are

65 [1915] 1 K.B. 681.

66 *Per* Bailhache J. at page 686.

67 *In the Matter of an Arbitration between Lockie and Craggs & Sons* (1901) 7 Com. Cas. 7.

68 It seems that the rule does not apply where the general language precedes specific wording; *Ambatielos* v. *Anton Jurgens Margarine Works* [1922] 2 K.B. 185.

intended to expand upon, particular language, the general words will be construed in light of the particular and will be read as limited to matters *ejusdem generis* (i.e., of the same class) as those for which specific provision has been made.

Thus, in *Herman* v. *Morris* (1919)[69] a contract for the repair, re-engining and sale of a damaged vessel, which provided for liquidated damages in the event of late delivery, excepted the vendor from the consequences of "strikes, lockouts et cetera, or any cause beyond the vendors' control". Delay was caused by reason of a decision of the vendors' engine suppliers to give priority to another contract and, in answer to the purchasers' claim for liquidated damages, the vendor sought to argue that this circumstance represented a "cause beyond [his] control". The Court of Appeal held, however, on the authority of *Re Richardsons and Samuel & Co.* (1897)[70] that these words were to be construed *ejusdem generis* with strikes and lockouts and did not as such encompass non-performance by the vendors' subcontractors; the use of the words "et cetera" made no difference to such interpretation.

The *ejusdem generis* rule is nevertheless merely a rule of construction and is, as such, capable of being displaced by terms of the contract indicating that the parties intended that it should not apply. In *Larsen* v. *Sylvester & Co.* (1908),[71] for example, it was held inapplicable to a charterparty which, in addition to excepting the charterers' liability for non-performance arising from a list of specific events, also extended to "hindrances of what kind soever (*sic*)". Similarly, in *Chandris* v. *Isbrandtsen-Moller Co. Inc.* (1950),[72] the words "or other dangerous cargo" in a charterparty clause which exempted the owner from the obligation to carry "acids, explosives, arms or ammunition or other dangerous cargo" were held, on the true interpretation of the agreement as a whole, to be unaffected by the operation of the *ejusdem generis* rule.[73] Giving judgment, Devlin J. stated[74] that:

"A rule of construction cannot be more than a guide to enable the court to arrive at the true meaning of the parties. The *ejusdem generis* rule means that there is implied into the language which the parties have used words of restriction which are not there. It cannot be right to approach a document with the presumption that there should be such an implication. To apply the rule automatically in that way would be to make it the master and not the servant of the purpose for which it was designed—namely, to ascertain the meaning of the parties from the words they have used."

It should also be noted that the *ejusdem generis* rule cannot in any event apply where it is not possible to synthesise from the given range of specific events a genus of circumstances to which the general language can be limited; *per* McCardie J. in *S.S. Magnhild* v. *McIntyre Brothers & Co.* (1920)[75]:

" . . . the rule of *ejusdem generis* cannot be applied at all unless there be some broad test for the ascertainment of genus. So far as I can see the only test seems to be whether the specified things

69 [1919] T.L.R. 574.
70 *Supra*, at n. 53.
71 [1908] A.C. 295.
72 (1950) 83 Ll.L.Rep. 385.
73 See also *Tandrin Aviation Holdings Ltd*, *supra*, at n. 34, where Hamblen J. noted (at paragraphs 44 and 46) that, although the aircraft purchase contract there in question did not require that the words "any other cause beyond the Seller's reasonable control" should be construed *ejusdem generis with* other defined *force majeure* events, this language should be construed to comprise only matters connected to the seller's (rather than the buyer's) obligations "and/or with which the seller would have been expected to be concerned; it did not encompass a failure on the part of the buyer to secure financing for the purchase of the aircraft.
74 At page 392.
75 [1920] 3 K.B. 321.

which precede the general words can be placed under some common category. By this I understand that the specified things must possess some common and dominant feature."[76]

Both of these considerations are relevant to the interpretation of Article VIII.1 of the SAJ Form. In particular, the words "whether or not indicated by the foregoing words" appear plainly to convey an intention that the rule should not apply; furthermore, even if the words do not achieve this effect as a matter of law, it is very difficult to establish amongst the broad range of defined *force majeure* events a "common or dominant feature" sufficient to constitute a genus. In claiming an extension of time for performance by reason of a particular event "beyond his control", it appears therefore that the builder is not obliged to show that this is similar in nature to one of the specific events listed in Article VIII.1. This should be contrasted to the approach taken in the NEWBUILDCON Form, which provides[77] that the builder is entitled to seek an extension of the Delivery Date in respect of "any other cause of a *similar nature* to the above beyond the control of the Builder or its Sub-contractors" (emphasis added).

Particular difficulties arise in this context where the builder claims *force majeure* delays as a result of quality or performance failures on the part of his own subcontractors. Where the failure by a subcontractor results from circumstances beyond his control, the *force majeure* clause will usually apply to excuse the builder from liability for any delay he may suffer as a consequence; thus the SAJ Form refers to "causes and accidents beyond control of the BUILDER, its subcontractors or suppliers".

It would appear that this language is to be construed conjunctively, rather than disjunctively, i.e., the builder must show that the events giving rise to the claim for extension of time were outside both his own control and that of his subcontractors.

In *John Mowlem* v. *Eagle Star and ors* (1995),[78] a management contract in respect of a property development entitled the contractor to an extension of time where works were delayed "by any cause beyond the control of the Management Contractor, his subcontractors or materials suppliers". The contractor argued that this meant "beyond the control of the Management Contractor *or* his subcontractors or materials suppliers", i.e., entitling him to an extension of time for an event outside his control even where this was within the control of one of his subcontractors.

This interpretation was, however, rejected by both the High Court and the Court of Appeal, principally on the grounds that it would in theory have permitted the management contractor to claim an extension of time in respect of events within his own control, but outside the control of a subcontractor; this was described by Hirst L.J., giving the principal judgment in the Court of Appeal, as "absurd".

A more difficult issue arises, however, if (i) the *force majeure* provisions of the contract refer merely to events beyond the builder's control and (ii) the subcontractor simply and inexcusably defaults in the proper performance of his obligations. Is the builder entitled in such circumstances to an extension of time?

While this was clearly regarded in *Herman* v. *Morris*[79] as an aspect of the shipbuilders' project risk, a more sympathetic approach was adopted in *Scott Lithgow Ltd* v. *Secretary*

76 At page 330; see also *Sonat Offshore S.A.* v. *Amerada Hess Development Ltd*, *supra*, *per* Saville J. at page 149; *Bovis International* v. *Circle Ltd* (1996) 49 Con. L.R. 12.

77 At Clause 34(a)(i)(10).

78 (1995) 44 Con. L.R. 134.

79 *Supra*, at n. 69.

of State for Defence (1989).[80] In that case a construction contract for two "Oberon" class submarines provided that the shipbuilder should be entitled to recover from the purchaser the additional costs of construction resulting from "exceptional dislocation and delay arising during the construction of the vessel due to . . . any . . . cause beyond the [builder's] control". The shipbuilder became exposed to significant additional costs by reason of defects in cables supplied by a subcontractor selected from a list approved by the purchaser.

The shipbuilder claimed these costs from the purchaser and the resulting dispute reached the House of Lords, which held that the shipbuilder was entitled to rely upon the subcontractor's default as being "a cause of delay beyond [his] control". Lord Keith, giving the only detailed judgment, expressed the view that:

> "*Prima facie* it is not within the power of a contracting party to prevent quality breaches of contract on the part of a supplier or subcontractor such as lead to delay. The contractor has no means in the ordinary case of supervising the manufacturing procedures of his supplier. He specifies his requirements but has no means of securing they are met. . . . Failures by such suppliers or subcontractors, in breach of their contractual obligations to Scott Lithgow, are not matters which, according to the ordinary use of language, can be regarded as within Scott Lithgow's control."

Lord Keith's judgment makes clear, however, that whether or not a failure on the part of a subcontractor constitutes an event beyond the builder's control is in each case an issue of fact, rather than law. Where, for example, the builder is in a position to require that his subcontractors employ proper quality assurance techniques, it seems unlikely that he can rely upon the exception where he has chosen not to take this step and a quality failure results.[81]

Scott Lithgow has been the subject of forceful criticism[82] and it is questionable whether the decision would be followed by an English court faced with similar facts; its effect is obviously to throw upon the party least able to manage this risk, i.e., the buyer, the consequences in terms of delay to the project of quality breaches by a subcontractor. The merits of the decision are, however, more obvious in circumstances in which the buyer selects the subcontractor and insists that the builder employs him in the performance of the contract works; this is particularly so where the subcontract terms have already been agreed between the buyer and a subcontractor prior to execution of the shipbuilding contract and the builder is simply required to accept a transfer by novation of the subcontract from the buyer.

(b) The impact of force majeure *events*

If a causative link can be established between the *force majeure* event and delay experienced by the builder, the extent of his entitlement to an extension of time for completion will then depend upon the application of the general principles outlined above and the precise terms of the shipbuilding contract itself.

80 (1989) 45 B.L.R. 1, H.L.

81 This issue is unlikely to arise under the SAJ Form because of the specific *force majeure* exception of "defects in materials, machinery or equipment which could not have been detected by the BUILDER using reasonable care"; see pages 159–160, *supra*; it is, however, relevant in the context of the NEWBUILDCON Form and the CMAC Form (which excuses the builder only in respect of "defects of casting and forging components; see Article XV.1).

82 See Ian Duncan Wallace Q.C., "Beyond the Contractor's Control", 1991 Construction Law Journal 3.

Article VIII.1 of the SAJ Form is in this respect curiously worded, providing no specific guidance as to the extent to which the Delivery Date is to be postponed by reason of *force majeure* events. On the contrary, the article states merely that such postponement "shall not exceed the total accumulated time of all such [i.e., *force majeure*] delays".[83]

This lack of clarity becomes important where the delay in the builder's construction programme resulting from a *force majeure* event is either more or less than the duration of the event itself. Thus a delay of one week in the supply of a particular item of subcontracted equipment may, depending upon the builder's construction programme, delay the vessel by a fortnight. Is the builder entitled to claim one or two weeks' postponement of the Delivery Date?

Although the position under the SAJ Form is not free from doubt, it is submitted that it is the extent of the delay to the construction programme, rather than the duration of the *force majeure* event itself, which is relevant. Such an interpretation is consistent with the language of the first sentence of Article VIII.1,[84] with the notification provisions of Article VIII.2, which require the builder to notify the buyer of the period "by which the Delivery Date is postponed by reason of such cause of delay", with Article VIII.4, which refers to "all delays on account of [*force majeure*] causes" and with the decision of the High Court in *K/S Stasupply A/S* v. *Dae Dong Shipbuilding Co. Ltd* (1986).[85] Furthermore, the alternative view (i.e., that it is the duration of the *force majeure* event itself which is relevant) gives rise to serious problems in relation to those *force majeure* circumstances (in particular "defects in materials . . . [and] casting or forging rejects") which are not themselves events of specific duration.

It must nevertheless be conceded that, if Article VIII.1 provides for an extension of the Delivery Date by the sum of the delays caused to the builder's construction programme, the limitation contained in the last part of the paragraph ("the Delivery Date shall be postponed for a period of time which shall not exceed the total accumulated time of all such delays") appears to be wholly redundant.

Finally, it should be noted that the SAJ Form expressly entitles the builder to claim *force majeure* delay at any time prior to the "actual delivery" of the vessel. To this extent, the standard form reverses the position at common law by allowing the builder to claim *force majeure* delay even after the Delivery Date has passed.

(c) The requirement of notice

Most shipbuilding contracts contain strict time limits within which the builder's claims for postponement of the Delivery Date must be notified to the buyer. This is primarily designed to afford the buyer an immediate opportunity to investigate the circumstances of the delay and, where appropriate, to challenge the builder's claim. The time limit provisions are, however, also of significance in permitting both parties to maintain an accurate running total of the builder's claims for extension of the Delivery Date; this may

83 The CMAC Form, which similarly defines numerous *force majeure* events which may either delay construction or "any performance required hereunder as a prerequisite of delivery" also provides for an extension of the time for delivery "for a period of time which shall not exceed the total accumulated time of all such delays"; see Article XV.1. The NEWBUILDCON Form states merely that "the Delivery Date shall be extended if any of the following events cause actual delay to the delivery of the Vessel"; see Clause 34(a).

84 "[i]f . . . either the construction of the VESSEL, or any performance required as a prerequisite of delivery of the VESSEL is delayed due to. . . . "

85 Unreported, Q.B.D., 23 October 1986, see pages 167–168, *infra*.

be needed (*inter alia*) to establish the date of accrual in the buyer's favour of rights to rescind the contract for delay.

The legal effect of non-compliance with such a time-limit is unclear. On one view, breach by the builder of his obligation to notify in time sounds only in damages; the builder remains entitled to assert his claim for postponement, although he is liable to the buyer in damages for any loss sustained as a result of the late notification.[86] Given, however, the primary purpose for which a time-limit for notification is incorporated in standard form contracts (i.e., to afford the buyer an immediate opportunity to investigate and, if necessary, challenge the claim), the better view is that failure to notify in time bars the claim completely.

In *Bremer Handelsgesellschaft mbH* v. *Vanden Avenne-Izegem P.V.B.A.* (1978),[87] a contract for the sale and purchase of American soya beans included provisions excusing the sellers' liability in the event either of a prohibition of soya bean exports by the US authorities or the occurrence of defined *force majeure* events. Both clauses required that the seller should give notice of such circumstances to the buyer but, while the *force majeure* clause detailed precisely the mechanism and time-scale applicable to such notices, the prohibition of export clause merely stated that notice should be given to the buyer "without delay". The buyers thereafter alleged that a notice of *force majeure* delay had been given by the sellers "out of time" and was therefore invalid.

Against this background the House of Lords held that the notice requirement arising under the export prohibition clause was an innominate term of the contract but that the equivalent provision in the *force majeure* clause was a condition. In their Lordships' view, the distinction between the two provisions lay in the fact that the terms of the export prohibition clause were extremely vague and did not in particular lay down a precise time-frame within which notices of delay had to be given; in contrast, the more detailed provisions of the *force majeure* clause[88] constituted, in the words of Lord Wilberforce,[89] a "complete regulatory code", accurate compliance with which was essential to avoid "commercial confusion" in light of the possibility of a chain of on-sellers and on-purchasers. In consequence, the sellers' failure to give timely notice would, but for their Lordships' further decision that the buyers had in practice waived such requirement, have precluded the sellers from invoking the *force majeure* clause.

Although the existence of a chain of sale contracts would be very unusual indeed in a shipbuilding context, it is submitted that the same principles ought to apply and that, in order to avoid "commercial confusion" between the parties, the right to claim "*force majeure*" extensions should normally be held conditional upon the builder giving timely notices of the events on which he seeks to rely.[90] This was the approach adopted in a

86 For an alternative approach, see *Stanley Hugh Leach* v. *Merton Borough Council* (1985) 32 B.L.R. 51. Interpreting the terms of a standard form, non-marine construction contract, Vinelott J. held that the contractor's breach of contract in failing to issue to the employer's architect timely notice of a delaying event disentitled the contractor from an extension of time for those periods during which the delay might have been avoided had a timely notice been given.

87 [1978] 2 Lloyd's Rep. 109, H.L.

88 Notice of any *force majeure* event delaying shipment of the goods was required to be given with seven days of its occurrence and a claim for extension of shipment period was to be furnished within two "business days" of the last date of the originally agreed contractual period for shipment.

89 At page 116.

90 It should, however, be re-emphasised that all depends upon the intention of the parties as evidenced by the contractual language they have agreed.

shipbuilding context in *Adyard*,[91] where the High Court held that the builder's claim for a permissible delay extension failed because he had not given timely notice of the "cause of delay" under standard shipbuilding contract *force majeure* provisions.

The NEWBUILDCON Form leaves no doubt that any *force majeure* claim by the builder for extension to the Delivery Date is conditional upon compliance with the notice provisions contained in Clause 34.[92]

Under Article VIII.2 of the SAJ Form, notice of a claim for postponement of the Delivery Date must be given to the buyer within 10 days from the date of commencement of the circumstances relied upon. The builder is also required to issue a further notice within 10 days of the ending of the alleged *force majeure* event and must, either contemporaneously or at a "later time but with all reasonable despatch", specify "the period of time by which the Delivery Date is postponed by reason of such delay".

It should be noted that time runs in each case from the date of commencement or cessation of the alleged *force majeure* event, rather than from the date on which the builder first learns of the same; the builder may therefore be unable to give the required notice in time if the event has its immediate impact outside the shipyard, perhaps by affecting a subcontractor or supplier rather than the builder directly. The SAJ Form wording is for this reason often amended to provide that time shall run only from the date on which the builder first learns of the *force majeure* event in question.

Article VIII.2 also stipulates that, where the buyer fails to acknowledge the builder's notification within 10 days of receipt, he is deemed to have waived any right to object to the builder's claim for postponement of the Delivery Date.[93] Even where such an acknowledgment is given, the buyer's conduct may nevertheless preclude him from contending that the builder's notice was formally defective. Thus, in *Finance for Shipping Ltd* v. *Appledore Shipbuilding Ltd* (1981),[94] where the contract required that notice of *force majeure* claims should be given after the occurrence of the event on which they were based, prospective notices of delay were almost certainly defective. The purchaser's equivocal response to the notices was, however, held by the Court of Appeal to give rise to an "arguable defence" that he had waived his rights to treat these as invalid.

(d) Permissible delay

The SAJ Form incorporates within Article VIII a definition of Permissible Delay, being delay resulting from *force majeure* events within paragraph 1 as well as "any other delays of a nature which under the terms of this Contract permits (*sic*) postponement of the Delivery Date". As previously indicated, Permissible Delay does not count for the purposes of assessing the builder's liability in liquidated damages pursuant to Article III.1(e) for delay in delivery of the vessel.

91 *Supra*, at n. 5. See also, in a non-marine context, *Steria Ltd* v. *Sigma Wireless Communications Ltd* [2007] EWHC 3454 (TCC). Note, however, that this case also decided that, where a notice requirement is ambiguous, it should not be construed as constituting a condition of the claim for extension in circumstances in which the claimant might be deprived of an extension of time he would otherwise have enjoyed.

92 Clause 34(a)(iii)(3).

93 Under the CMAC Form the buyer is allowed 30 days (see Article XV.2), no time-limit is specified in the NEWBUILDCON Form.

94 [1982] Com. L.R. 49, C.A.

(e) Excessive delay

The buyer will usually require that the contract should permit him a right to rescind in the event of excessive delay in delivery howsoever occurring. This objective can be achieved by incorporating in the contract a right of rescission exercisable either:

(a) on a fixed future date, often called the "drop dead" date, which is not capable of extension by reference to *force majeure* delays[95] or
(b) when the builder's aggregate claims for postponement of the Delivery Date by reason of *force majeure* delays exceed an agreed figure.

The SAJ Form adopts the second approach, a right of rescission arises in the buyer's favour under Article VIII.4 where *force majeure* delays amount to 210 days or more. Specifically, the right of rescission is triggered:

"If the total accumulated time of all delays on account of the causes specified in Paragraph 1 of this Article, *excluding delays of a nature which, under the terms of this Contract, permit postponement of the Delivery Date*, amounts to Two Hundred and Ten (210) days or more . . . " (emphasis added).

Given that "delays on account of causes specified in Paragraph 1" expressly permit postponement of the Delivery Date, it is difficult to understand the scope of the exclusion intended by the wording italicised above. This difficulty can probably be overcome only if the wording is read as referring to the other types of Permissible Delay (arising, for example, by reason of the buyer's default) which, while extending the Delivery Date, do not arise from *force majeure* events and are not therefore intended to count towards the 210-day limit.

It should also be noted that, on a strict reading of Article VIII.4 of the SAJ Form, the buyer's right of rescission appears to accrue if there occur 210 days of delay "on account of the causes specified in paragraph 1", regardless of whether the builder has in fact claimed an extension of the Delivery Date for any or all of the same. It is clear, however, from *K/S Stasupply A/S* v. *Dae Dong Shipbuilding Co. Ltd*[96] that the reference to "delay" must be taken to mean delay for which the builder is actually seeking a postponement of the Delivery Date.

In *Stasupply*, the contract, which was on terms identical to those of the SAJ Form, provided that the purchasers should be entitled to rescind if the "total accumulated time of all [*force majeure*] delays . . . amounts to 100 days or more . . .". The purchasers, who were seeking to justify their purported rescission of the contract, contended that in computing the relevant period of delay, account should be taken of all non-overlapping events of delay regardless of their impact on the vessel's completion. The shipbuilders, who argued that the effect of individual delays would vary depending upon their impact upon the critical path of the vessel's construction, contended that "all delays" meant delays which actually extended the time needed for her completion.

Hobhouse J. preferred the shipbuilder's interpretation of the article, holding that:

" . . . there can be no doubt that what is being referred to is delay in the sense of being delayed by a certain period. It is delay which involves comparison with a norm[97] and if the norm is achieved,

95 This date will nevertheless usually be extended by any periods in which the buyer is in default of his own obligations.

96 *Supra*, at n. 85.

97 That is, delivery upon the date originally agreed in the contract.

then there has been no delay in the sense that that word is used in this Contract. That fits in with both the commercial and factual reality of using critical path analysis. . . . In my judgment the ordinary meaning of 'the total accumulated time of all delays' is the total of the delays which are causing and are going to cause delay in the delivery of the vessel."

This decision, while plainly correct, highlights a difficulty for the buyer in seeking to use clauses of this type as the basis for rescission of the contract. If it is the effect upon the vessel's completion, rather than the duration of the event initially causing the delay, which counts for the purposes of such a clause, it follows that the builder may, by retrospectively waiving claims for *force majeure* delay, effectively determine whether or not a right of rescission will accrue to the buyer.

Finally, it should be noted that Article VIII.4 of the SAJ Form incorporates a similar election provision to that contained in Article III.1(c). As from the date on which the buyer's right of rescission first accrues, the builder may require him to elect either to exercise such right or to waive the same by consenting to delivery on a future date specified by the builder. The wording closely follows Article III.1(c) except that the latter refers to the buyer's duty to elect between rescission and postponement of the vessel's delivery to an "agreed", rather than a "specific", future date; where Article VIII.4 is applicable, it is clearly intended that the builder alone shall be entitled to determine when the vessel will be capable of completion and delivery.

Where the buyer initially elects to maintain the contract, Article VIII.4 provides that "if any further delay occurs on account of causes justifying rescission as specified in this Article", a right of rescission will once more accrue in his favour. Although the "causes justifying rescission" are wholly undefined, it is submitted that on its true construction the article entitles the buyer to a new right of rescission if any *force majeure* delays thereafter prevent the builder from delivering the vessel on the revised Delivery Date.

(f) Frustration

The doctrine of frustration applies under English law to discharge both parties to a contract from further performance where, as the result of supervening events, fulfilment of its obligations becomes impossible or illegal or would involve something radically different from that originally envisaged. According to Lord Simon of Glaisdale in *National Carriers Ltd* v. *Panalpina (Northern) Ltd* (1981)[98]:

"Frustration of a contract takes place where there supervenes an event (without default of either party and for which the contract makes no provision) which so significantly changes the nature (not merely the expense or onerousness) of outstanding contractual rights and/or obligations from what the parties could reasonably contemplate at the time of its execution that it would be unjust to hold them to [it] . . . ".[99]

There is, as such, relatively limited scope for the application of the principles of frustration in the context of shipbuilding projects. This is because, as pointed out by Lord Simon, the doctrine does not apply where the contract itself makes specific provision for

98 [1981] A.C. 675.

99 At page 701. See also *Edwinton Commercial Corporation and another* v. *Tsavliris Russ (Worldwide Salvage and Towage) Ltd (The "Sea Angel")* [2007] EWCA Civ 547, *per* Lord Justice Rix (at paragraph 111 of his judgment): " . . . mere incidence of expense or delay or onerousness is not sufficient . . . there has to be . . . a break in identity between the contract as provided for and contemplated and its performance in the new circumstances".

circumstances which might otherwise frustrate it[100] or where the alleged frustrating event causes merely an increase in the costs of performance of either party's contractual obligations.[101] While it is, for example, well established that the destruction, without fault of the parties, of machinery under construction[102] or of the premises in which the same is being built[103] will normally frustrate an agreement for the sale of such items, most shipbuilding contracts include specific provisions dealing both with the total loss of the vessel and with damage to the shipyard; under the SAJ Form, these terms are contained in Articles XII.2(b) and VIII.1.

In practice, the majority of the cases in which the doctrine of frustration has been successfully invoked in a shipbuilding context concerned wartime situations in which newbuildings had either been requisitioned or their construction prohibited altogether.[104]

Where, unusually, a shipbuilding contract governed by English law is legally frustrated, the court or arbitration tribunal having jurisdiction in the matter is empowered under s. 1(2) of the Law Reform (Frustrated Contracts) Act 1943 to order the return of all or part of the buyer's pre-paid instalments of the contract price to the extent that the same is necessary to "do justice" between the parties. As a matter of discretion, provision may, however, also be made for a deduction from such sums to reflect expenses incurred by the builder in the period until termination of the contract.

In *Gamerco SA* v. *ICM/Fair Warning (Agency) Ltd* (1995)[105] a contract between a concert promoter and a company representing a rock group was frustrated when the stadium at which a concert was to be performed was closed due to the discovery of structural defects. The promoter had previously made an advance payment to the company, which it sought to recover, whilst the company sought to set off against the same expenses it had itself incurred in promoting the concert.

On the promoter's claim pursuant to s. 1(2) of the 1943 Act for recovery of his advance, it was held to be for the company to demonstrate the fairness of the deduction it was seeking to make and that its expenses had been incurred specifically for the purposes of performance of the contract. Subject to proof of the same, the court enjoyed a very wide discretion to determine the issue in a manner which was just and equitable between the parties. In the event no deduction was permitted.

100 See *Select Commodities Ltd v Valdo SA (The "Florida")* [2006] EWHC 1137 (Comm), which confirmed that a clause dealing "fully and completely" with the effects of an alleged frustrating event will normally operate to exclude the doctrine of frustration. This will be particularly so if the event has already occurred prior to signature of the contract or where it is foreseen and specifically addressed in the contract; see, respectively, *McAlpine Humberoak Ltd* v. *McDermott International Inc.* (1992) 58 B.L.R. 1 and *Gold Group Properties Ltd* v. *BDW Trading Ltd* [2010] EWHC 323 at 78.

101 *Davis Contractors Ltd* v. *Fareham UDC* [1956] A.C. 696; see also *Chaucer Estates* v. *Fairclough Homes* [1991] EGCS 65 (where the imposition by a local authority of certain statutory obligations upon the contractor, which increased his costs of performance, was held not to frustrate the construction contract he had concluded with a property developer); and see also *Tandrin Aviation Holdings Ltd* (see n. 34, *supra*).

102 *Appleby* v. *Myers* (1867) L.R. 2 C.P. 651.

103 See, by analogy, *Taylor* v. *Caldwell* (1863) 3 B. & S. 826.

104 See, e.g., *Dale S.S. Co. Ltd* v. *Northern S.S. Co. Ltd* (1918) 34 T.L.R. 271; *Federal Steam Navigation Co. Ltd* v. *Dixon & Co. Ltd* (1919) 64 S.J. 67; *Fisher Renwick* v. *Tyne Iron Shipbuilders Co.* (1920) 3 Ll.L.Rep. 201 and 253; *Cantiere San Rocco S.A. and Another* v. *Clyde Shipbuilding and Engineering Co. Ltd* (1923) 16 Ll.L.Rep. 327, H.L; for a discussion of the doctrine of frustration in the specific context of shipbuilding in Korea, see Curtis and Potenza, "Korean hostilities raise alarm over shipbuilding contracts", Lloyd's List, 30 June 2010.

105 [1995] 1 W.L.R. 1226.

Article IX—Warranty of quality

1. Guarantee:

Subject to the provisions hereinafter set forth, the BUILDER undertakes to remedy, free of charge to the BUYER, any defects in the VESSEL which are due to defective material and/or bad workmanship on the part of the BUILDER and/or its subcontractors, provided that the defects are discovered within a period of twelve months after the date of delivery of the VESSEL and a notice thereof is duly given to the BUILDER as hereinafter provided.

For the purpose of this Article, the VESSEL shall include her hull, machinery, equipment and gear, but excludes any parts for the VESSEL which have been supplied by or on behalf of the BUYER.

2. Notice of Defects:

The BUYER shall notify the BUILDER in writing, or by cable confirmed in writing, of any defects for which claim is made under this guarantee as promptly as possible after discovery thereof. The BUYER'S written notice shall describe the nature and extent of the defects. The BUILDER shall have no obligation for any defects discovered prior to the expiry date of the said twelve (12) months period, unless notice of such defects is received by the BUILDER no later than thirty (30) days after such expiry date.

3. Remedy of Defects:

(a) The BUILDER shall remedy, at its expense, any defects against which the VESSEL is guaranteed under this Article, by making all necessary repairs or replacements at the Shipyard.

(b) However, if it is impractical to bring the VESSEL to the Shipyard, the BUYER may cause the necessary repairs or replacements to be made elsewhere which is deemed suitable for the purpose, provided that, in such event, the BUILDER may forward or supply replacement parts or materials to the VESSEL, unless forwarding or supplying thereof to the VESSEL would impair or delay the operation or working schedule of the VESSEL. In the event that the BUILDER proposes to cause the necessary repairs or replacements to be made to the VESSEL at any other shipyard or works than the Shipyard, the BUYER shall first, but in all events as soon as possible, give the BUILDER notice in writing or by cable confirmed in writing of the time and place such repairs will be made, and if the VESSEL is not thereby delayed, or her operation or working schedule is not thereby impaired, the BUILDER shall have the right to verify by its own representative(s) the nature and extent of the defects complained of. The BUILDER shall, in such case, promptly advise the BUYER by cable, after such examination has been completed, of its acceptance or rejection of the defects as ones that are covered by the guarantee herein provided. Upon the BUILDER'S acceptance of the defects as justifying remedy under this Article, or upon the award of the arbitration so determining, the BUILDER shall immediately pay to the BUYER for such repairs or replacements a sum equal to the reasonable cost of making the same repairs or replacements in the Shipyard.

(c) In any case, the VESSEL shall be taken at the BUYER'S cost and responsibility to the place elected, ready in all respects for such repairs or replacements.

(d) Any dispute under this Article shall be referred to arbitration in accordance with the provisions of Article XIII hereof.

4. Extent of BUILDER's Responsibility:

(a) The BUILDER shall have no responsibility for any other defects whatsoever in the VESSEL than the defects specified in Paragraph 1 of this Article. Nor shall the BUILDER in any circumstances be responsible or liable for any consequential or special losses, damages or expenses including, but not limited to, loss of time, loss of profit or earning or demurrage directly or indirectly occasioned to the BUYER by reason of the defects specified in paragraph 1 of the Article or due to repairs or other works done to the VESSEL to remedy such defects.

(b) The BUILDER shall not be responsible for any defects in any part of the VESSEL which may subsequent to delivery of the VESSEL have been replaced or in any way repaired by any other contractor, or for any defects which have been caused or aggravated by omission or improper use and maintenance of the VESSEL on the part of the BUYER, its servants or agents or by ordinary wear and tear or by any other circumstances beyond the control of the BUILDER.

(c) The guarantee contained as hereinabove in this Article replaces and excludes any other liability, guarantee, warranty and/or condition imposed or implied by the law, customary, statutory or otherwise, by reason of the construction and sale of the VESSEL by the BUILDER for and to the BUYER.

5. Guarantee Engineer:

The BUILDER shall have the right to appoint a Guarantee Engineer to serve on the VESSEL for such portion of the guarantee period as the BUILDER may decide. The BUYER and its employees shall give the Guarantee Engineer full cooperation in carrying out his duties as the representative of the BUILDER on board the VESSEL. The BUYER shall accord the Guarantee Engineer the treatment comparable to the VESSEL'S Chief Engineer and shall provide him with accommodations (*sic*) and subsistence at no cost of the BUILDER and/or the Guarantee Engineer.

The BUYER shall pay to the BUILDER the sum of.....per month as a compensation for a part of the costs and charges to be borne by the BUILDER in connection with the Guarantee Engineer and shall also pay the expenses of repatriation to Tokyo, Japan, by air on termination of his service.

Pertaining to the detailed particulars of this Paragraph, an agreement will be made according to this effect between the parties hereto upon delivery of the VESSEL.

Following delivery and acceptance, the builder will wish as far as possible to limit the extent of his continuing responsibility for the vessel and, in particular, for any deficiencies in the contract works. The buyer will invariably seek to ensure that defects which have not been ascertained and rectified prior to his acceptance of the vessel will not expose him to unforeseen future costs or liabilities.

These conflicting interests are reconciled in most shipbuilding contracts by the inclusion of a builder's guarantee or warranty of the vessel, her machinery and equipment, which commitment is counterbalanced by terms excluding any further or alternative liability upon the builder for the consequences of defective performance. However, even if (contrary to usual practice) the builder's warranty is not accompanied by an express exclusion of the builder's other potential liabilities for defects, it is arguable that the warranty still benefits both the buyer and the builder. As has been pointed out by the Court of Appeal,[1] clauses of this kind typically confer:

1 *Per* May L.J. in *BHP Petroleum Ltd* v. *British Steel plc* [2000] 2 Lloyd's Rep. 277 at page 288.

" . . . additional rights and obligations requiring the contractor or supplier to undertake additional work to rectify defects which appear within a defined time after completion usually without additional payment. They may be seen as benefiting both parties. The employer is entitled to have the defect rectified without having to engage and pay another contractor to carry out the rectification: the contractor or supplier is entitled to carry out the rectification himself which may normally be expected to be less expensive for him than having to reimburse the cost to the employer of having it done by others. Without a clause of this kind, the contractor or supplier would normally have no right to do work after completion. . . ."[2]

THE NATURE OF THE BUILDER'S WARRANTY

Under most large-scale shipbuilding contracts, the builder agrees to provide a warranty of the vessel, her machinery and equipment for at least twelve months from the date of her delivery and acceptance; the agreed time-frame is usually referred to as the "warranty period". In the event of a defect occurring during such period the builder will rectify the same at his own cost but on the basis that any incidental expenses and losses, including in particular any loss of use of the vessel arising from either the defect or its repair, will be borne by the buyer. As indicated previously, it is usually agreed that the builder's warranty is to operate to the exclusion of any other contractual or statutory warranties regarding the vessel's condition or performance.

Thus, in paragraph 1 of Article IX of the SAJ Form the builder promises that, for a period of one year from the date of delivery, he will rectify any defects in the vessel, her machinery and equipment resulting from deficiencies in the materials employed in her construction or bad workmanship on the part of the builder or its sub-contractors. The builder's promise expressly does not extend, however, to deficiencies either in the buyer's supplies or in other materials provided by the buyer for the vessel's construction.

Under Clause 35 of the NEWBUILDCON Form, the builder extends a twelve-month guarantee in respect of "Defects", which are defined as "any deficiencies or defects in the design, construction, material and/or workmanship" on his part or that of his subcontractors.[3] In addition, if guarantee works are required which result in the vessel lying idle continuously for a period of more than thirty days, the guarantee period is extended by the total number of such idle days regardless of whether guarantee works were carried out during the same.[4]

The equivalent provisions of the CMAC Form cover "the Vessel, her hull and machinery and all parts and equipments thereof that are manufactured or furnished or supplied . . . including material, equipment . . . against all defects which are due to defective materials, and/or poor workmanship".[5] Article XIX of the form describes the warranty period as extending for 12 months following the vessel's delivery, although

2 See also *per* Evans L.J. in *Pearce & High Ltd* v. *Baxter* [1999] B.L.R. 101: "The cost of employing a third party repairer is likely to be higher than the cost to the contractor of doing the work himself would have been. So the right to return in order to repair the defect is valuable to him."

3 See the Definitions Section of the NEWBUILDCON Form.

4 Clause 35(f). It would appear that this provision applies regardless of whether or not the guarantee works are performed by the builder. To the extent that the guarantee works are delayed by the acts or omissions of a contractor employed by the buyer to undertake the same, it is surprising that these should extend the guarantee period.

5 Article XIX.1.

Article XX states that she is guaranteed for twelve months "from the month of delivery to the last day of the twelfth month",[6] i.e., for potentially more than twelve months, which would seem likely to be the operative provision.

It should be noted in this context that particular issues arise in relation to the builder's guarantee liability arising from defects in design. In the absence of express words in the contract, the extent of this liability is likely to depend upon the proper interpretation of the contract as a whole, i.e., if this imposes upon the builder a responsibility for the vessel's design in the pre-delivery period, it is very likely that this will extend to the obligation to remedy design faults discovered during the warranty period.[7]

Under the NEWBUILDCON Form, this issue is clearly addressed. The builder is obliged to design the vessel in accordance with good international shipbuilding and marine engineering practice,[8] and the contractual definition of "Defects", which is relevant for the purposes of the guarantee clause, includes defects in design.

In contrast, Article IX of the SAJ Form, in keeping with the remainder of the contract, contains no express provision for the allocation of design risks.[9] The Article, which combines a specific imposition of responsibility for defective workmanship and materials with a broad-ranging exclusion of other liabilities, would appear on its face to protect the builder from design liabilities and to cast upon the buyer alone the risk that, following delivery and acceptance, the design of the vessel or of any of her equipment proves to have been inadequate. On one view, this weighting of the contract in favour of the builder is balanced by the provisions of Article V (which permits the buyer's representatives the right to approve all plans and drawings during the construction period) and of Article III (which imposes upon the builder a liability in liquidated damages for deficiencies in speed, fuel consumption, deadweight, etc.).

However, in *Aktiebolaget Gotaverken* v. *Westminster Corporation of Monrovia* (1971)[10] the High Court, considering a contract incorporating the Swedish Shipbuilders' Association General Regulations 1956, which imposed upon the builder warranty obligations in respect of "material used and work performed", held that these encompassed design errors. According to Donaldson J.:

> "The contract, as varied, required Gotaverken to supply watertight hatch covers. This required good workmanship both in the design and the execution, and if there were design errors, I see no reason why these should not be characterised and attract liability as bad workmanship. The alternative view would be that Gotaverken escaped all liability . . . which seems an improbable result for the parties to have intended."[11]

It therefore seems clear that the builder is liable under the SAJ Form for guarantee defects resulting from deficiencies in design. However, in order to avoid uncertainty on this issue, the form is in practice often amended to provide so expressly.

6 Article XX.1.

7 In *The "Elf"*, *infra*, the shipbuilders conceded that the obligation to rectify "defective workmanship" discovered during the warranty period was capable of encompassing design errors; this issue did not accordingly need to be decided.

8 Clause 1(a).

9 See as to design liabilities generally, pages 19–21, *supra*.

10 [1971] 2 Lloyd's Rep. 505.

11 At page 512.

LIMITATIONS UPON THE BUILDER'S WARRANTY

Under most modern shipbuilding contracts, the builder's warranty is typically subject to a number of important qualifications.

Defects existing on delivery

First, the builder's guarantee obligations normally only encompass defects discovered after the date of delivery and acceptance of the vessel.[12]

If, therefore, the defect in question is one which has been identified, but not repaired, during the course of construction, there will normally be no entitlement for the buyer to call for its rectification pursuant to the provisions of the builder's warranty; see *Aktiebolaget Gotaverken* v. *Westminster Corporation of Monrovia and Another* (1971),[13] a ship repair case in which the contractual cut-off point was the vessel's departure from the shipyard following completion of the works.

This can give rise to potential problems for the buyer in circumstances in which the builder refuses to acknowledge the existence of a specific defect in the vessel at the time of her delivery. Assuming that the buyer is in such circumstances either unwilling or unable to refuse delivery, there is a theoretical risk that his rights to seek repair of the defect may be lost, particularly if the contract provides that acceptance of the vessel will be "final and binding so far as conformity of the VESSEL to [the] Contract and Specifications is concerned".[14]

However, in *China Shipbuilding Corporation* v. *Nippon Yusen Kabukishi Kaisha and another* (2000)[15] Thomas J. held that the effect of wording of this type is limited and operates merely to prevent the buyer from refusing delivery of the vessel once she has been accepted pursuant to Article VI of the SAJ Form following her sea trials; it does not prevent him from asserting after delivery the existence of specific defects previously notified to the builder. It seems unlikely in light of this decision that, in circumstances in which the buyer makes clear that his acceptance of the vessel operates without prejudice to his rights in respect of the defect, an English court or arbitration tribunal would hold that such rights are nevertheless deemed waived or otherwise abandoned. Depending upon the terms of the contract (and subject in particular to any exclusion or limitation of liability in respect of "indirect or consequential" losses[16]) the buyer would, it is submitted, be entitled to pursue by way of a claim in damages any costs incurred in repairing defects discovered before delivery which the builder has in breach of contract refused to remedy.

This issue obviously does not arise where the contract does not limit the builder's warranty obligations to those defects discovered during the warranty period. Article XIX.1 of the CMAC Form, for example, merely provides for a 12-month guarantee of the vessel and her equipment; it does not specifically require that a defect must be discovered during

12 See Article IX.1 of the SAJ Form (as considered *in China Shipbuilding Corporation* v. *Nippon Yusen Kabukishi Kaisha and another* [2000] 1 Lloyd's Rep. 367 at page 372) and Clause 35(a)(i) of the NEWBUILDCON Form.

13 *Supra*, at n. 10; the purchaser fell foul of this point in *McDougall* v. *Aeromarine of Emsworth Ltd* [1958] 2 Lloyd's Rep. 345.

14 Article VI.5 of the SAJ form.

15 *Supra*, at n. 12.

16 *Infra*, at pages 185–186.

the warranty period, although issues of waiver may conceivably arise if the buyer takes delivery of the Vessel without reserving his position with regard to defects known to him at that time. In practice, if the defect is outstanding upon completion of sea trials but insufficiently serious to justify the buyer's rejection of the vessel, the parties will usually reach agreement between them at the time of delivery that this should be treated as a warranty item. Such an agreement may be either made expressly or implied from all the circumstances. In *J. Samuel White & Co. Ltd* v. *Coombes, Marshall & Co. Ltd* (1922)[17] the shipbuilders' conduct during the trials was held to constitute a tacit representation that a steering defect could (and would) be rectified by them during the warranty period.

Where the parties have specifically agreed that the defect should be treated as a warranty item, the Protocol of Delivery and Acceptance will typically be "claused" with wording to the effect that the buyer's execution of the same is subject to the builder's commitment to rectify the defect as soon as possible thereafter.[18]

Time limits

Secondly, the builder's commitment applies only to defects discovered before expiry of the warranty period, notice of which has been given to the builder within thirty days of such expiry date. The buyer and the builder will, however, often agree that the vessel should at the buyer's option be drydocked within a specified period from the date of delivery and that the warranty period should be extended in respect of her underwater parts to encompass faults discovered upon such inspection and notified by the buyer within a limited time thereafter.

Article IX.2 of the SAJ Form does not define by whom the discovery of defects in the vessel must be made and this appears to be irrelevant to the builder's liability,[19] provided that the buyer gives a prompt and timely notice to him. While this will depend in each case upon the correct construction of the relevant warranty clause, it seems clear from the decisions in *China Shipbuilding*[20] and the earlier case of *Eagle Line Inc.* v. *Namura Shipyard Co. Ltd (The "Elf")* (1985)[21] that failure to make the discovery within the warranty period is normally fatal to the buyer's claim. A similar conclusion was reached in *BHP Petroleum Ltd* v. *British Steel plc* (2000)[22] where the Court of Appeal held that a contract for the supply of steel pipeline incorporating a twenty-four month warranty period excluded the suppliers' liability for defects which became apparent more than two years after delivery.[23]

17 (1922) 13 Ll.L.Rep. 199.

18 Clause 27(d) of the NEWBUILDCON Form provides that the vessel can be delivered with minor "Delivery Defects" on condition that the builder (1) undertakes to remedy these as soon as possible at his cost and expense, (2) agrees in writing to indemnify the buyer for any loss incurred as a consequence thereof, including (without limitation) loss of time, and (3) provides the buyer with a guarantee; see pages 113–115, *supra*.

19 This is also the case under the NEWBUILDCON Form (Clause 35(a)) and the CMAC Form (Article XIX.2).

20 *Supra*, at page 372 of Thomas J.'s judgment.

21 Commercial Court, 25 March 1985, (1985) 145 LMLN 4.

22 *Supra*, at n. 1.

23 The Court held that the time limit protected the supplier in respect both of claims under the warranty clause *and* for damages for alleged breach of its quality obligations.

Loss of use

Thirdly, as previously noted, subject to the issue of damage to the vessel caused by the defect,[24] the builder's obligation is only to remedy the defect itself. A serious failure of the vessel, her machinery or equipment is at minimum likely to lead to a loss of use and income while the repairs are being undertaken, but it is a widely recognised principle of modern shipbuilding that the builder should not be liable to bear any downtime or other incidental costs incurred by the buyer as a result thereof.

Article IX.1 of the SAJ Form, read in conjunction with Article IX.4, expressly excuses the builder from any such liability. Similar provisions are contained in the NEWBUILDCON[25] and the CMAC[26] Forms, although it is questionable whether the language used in the latter is fully effective in achieving this objective.[27]

Replaced parts

Fourthly, it should be noted that the SAJ Form does not provide in express terms for a warranty either of machinery or parts replaced by the builder within the warranty period or of repair works undertaken during such period. Such an obligation can, however, probably be implied, there being no reason to suppose that the defects in the vessel "due to defective material and/or bad workmanship . . ." within the meaning of Article IX.1 should be limited to items installed or work undertaken by the builder prior to delivery.

Furthermore, Article IX.4 excludes from the scope of the warranty defects "which may subsequent to delivery have been replaced or in any way repaired by any other contractor", suggesting clearly that works undertaken by the builder himself will continue to be guaranteed.[28] The overall 12-month time limit will nevertheless continue to apply unless the builder has expressly agreed to guarantee such replacement items or repair works for a period calculated from the date of installation or completion of the same; the builder will often agree to a separate warranty of six months from the date of installation or completion of the replacements or repairs, this not to extend in any event beyond 18 months from the date of delivery of the vessel.

The NEWBUILDCON Form provides at Clause 35(e) that repairs and replacements effected pursuant to the builder's warranty obligations shall be guaranteed by the builder for "an additional Guarantee Period" as stated in Box 21 of the Form "from the date of completion of such repairs or replacements provided such work has been performed by the Builder or its Sub-contractors".

Subcontractors' warranties

Mention should also be made of the common practice of excluding from the scope of the builder's warranty specific elements either of the contract works or of the materials and

24 *Infra*.

25 See Clause 37(b), which excludes the Builder's liability "in contract, tort (including negligence) breach of statutory duty or otherwise" for . . . any loss, damage or expenses caused as a consequence of [a guarantee defect](which shall include, but not be limited to, loss of time, loss of profit or earnings or demurrage directly or indirectly incurred by the Buyer)"

26 See Article XIX.

27 The provisions of Article XIX.4 are in any event subject to an obvious typographical error (in that the word "*not*" is missing between the words "*shall*" and "*in any circumstances*" in the final sentence).

28 This is also the case under the CMAC Form; see Article XIX, subparagraphs 1 and 4.

equipment used in the vessel's construction; this particularly occurs where the work or materials are to be undertaken or supplied by subcontractors or manufacturers whom the buyer is contractually entitled to nominate.[29] The practice is very common in the context of major subcontracted items, e.g., the vessel's main or auxiliary engines, or where the completion of the vessel gives rise to technical risks which the builder is not prepared to accept.

Prior to the entry into effect of the Contracts (Rights of Third Parties) Act 1999, the buyer was in such circumstances obliged to either negotiate with the subcontractor or manufacturer to obtain a direct contractual warranty in respect of the work or equipment in question, or require that the builder should agree to assign to him the benefit of any subcontractor's or supplier's warranty issued in the builder's favour.[30]

The general question of the extent to which the benefit of a manufacturer's warranty can effectively be assigned in English law is discussed below.[31] In relation to a subcontractor's warranty it is, however, important to bear in mind that whether this can effectively be assigned by the builder to the buyer will depend upon its particular terms and the law by which it is governed, which may well be different from the law of the shipbuilding contract. From the buyer's perspective, it is vital therefore that he should assure himself not only of the width of the warranty, but also of the extent to which it is capable of assignment, before he agrees to accept this in lieu of the builder's own covenant.

Since the entry into effect of the 1999 Act, the buyer's position has, however, been simplified, at least in respect of subcontracts governed by English law. As detailed further below,[32] the buyer may now in certain circumstances be entitled to enforce the subcontract warranty provisions directly. It will certainly be worthwhile for the buyer to insist in the shipbuilding contract that the builder should conclude all significant subcontracts under English law and on terms that make clear that the buyer is entitled to enforce the warranty provisions thereof directly against the subcontractor.

The builder will no doubt wish in such circumstances to make clear that his own warranty does not extend to parts of the vessel, her machinery and equipment which have been independently guaranteed to the buyer by the supplier or manufacturer or in respect of which the buyer is entitled to avail himself of the benefit of the 1999 Act.

DAMAGE CAUSED TO THE VESSEL

In the context of guarantee liabilities, a particular issue arises regarding the extent of the builder's liability for damage to the vessel and her equipment caused by a defect which is subject to his post-delivery warranty. A defect contained in a main engine component may, for example, cause a crankcase "explosion", the consequences of which may be far more extensive than the defect itself.[33]

29 In the NEWBUILDCON Form (see the Definitions Section) and CMAC Forms (Article XIX.1), the builder's warranty expressly extends to its subcontractors.

30 Under the NEWBUILDCON Form (Clause 35(g)), the buyer can, following expiry of the Guarantee Period or the builder's failure to rectify guarantee defects, require that the builder assigns all subcontractor and supplier guarantees and warranties to the buyer.

31 See pages 181–182, *infra*.

32 See pages 188–191, *infra*.

33 By way of example, on 11 September 1947 a crankcase explosion affecting the newly repaired passengership "*Reina del Pacifico*" killed 28 crew members and injured 23 others in one of the worst engineering disasters in maritime history. The accident, which occurred in UK waters, led directly to the development and introduction of crankcase relief valves and oil mist detectors for marine diesel engines.

From the buyer's perspective, he will normally wish the builder to remedy not merely the defect but also its physical consequences. The builder is, however, likely to be conscious of the significant potential consequences of assuming such a liability and will wish to avoid becoming in any respect an insurer of the vessel after delivery.

Under the SAJ Form, the builder's undertaking in the post-delivery period is merely to remedy guarantee defects and no commitment is made with respect to damage to the vessel; given the exclusionary language of Article IX.4 of the Form,[34] it seems unlikely that the builder's liability will be engaged in this respect.

In contrast, the NEWBUILDCON Form imposes upon the builder an obligation to undertake repairs or replacements not only to rectify the guarantee defect itself, but also any damage "caused as a direct and immediate consequence" of the defect[35]; the builder's liability with respect to such damage is, however, always subject to the general exclusion of responsibility for "any loss, damage or expenses caused as a consequence of such defect".[36]

The drafting of the relevant provisions of the CMAC Form is somewhat contradictory, but the language of Article IX.4 ("The BUILDER shall be liable to the BUYER for defects and damages caused by any of the defects specified in Paragraph 1 of this Article . . . ") appears to indicate that the builder assumes this risk.

THE REQUIREMENT OF NOTICE

Defects in the vessel or her machinery may become seriously aggravated if not rectified immediately. In order to protect the builder against this prospect, the buyer is obliged pursuant to Article IX.2 of the SAJ Form to give notice in writing of the same "as promptly as possible after the discovery thereof".

Breach of this obligation will expose the buyer to a liability in damages if the effect of the delay is to increase the builder's costs of replacement or repair but will probably not in itself invalidate the warranty claim.[37]

In contrast, however, the further requirement that the buyer's notice be given no later than 30 days from the expiry date of the warranty period is absolute; failure to give the notice in time will normally bar the claim.[38]

Similar provisions are contained in both the CMAC[39] and NEWBUILDCON Forms.[40]

THE OBLIGATION TO REMEDY

Article IX.3 of the SAJ Form provides in the first instance that any replacements or repairs undertaken pursuant to the builder's warranty should be effected at the shipyard. As a

34 *Infra.*
35 Clause 35(b).
36 Clause 37(b)(ii); *infra*.
37 *Aktiebolaget Gotaverken* v. *Westminster Corporation*, *supra* at n. 4.
38 See *The "Elf"*, *supra* at n. 10.
39 Article XIX.2. The buyer is required to give notice of the nature of both the defect and the extent of the damage caused thereby.
40 Clause 35(a)(i).

practical matter, however, most warranty works will have to be scheduled to accommodate the vessel's trading commitments and the prospects that she will be able to return to the shipyard to undertake the same are usually somewhat limited.

As in other standard newbuilding contracts,[41] the SAJ Form makes provision for this circumstance by stipulating that, subject to the builder's right of prior inspection of the alleged defects, the buyer shall be entitled to undertake the works of repair or replacement at "any other shipyard or works"; in such event, the buyer is entitled to recover from the builder a sum "equal to the reasonable cost of making the same repairs or replacements at the Shipyard". The buyer must, however, make the vessel available at his cost at the chosen place of repair and must bear all associated costs for "opening up" the vessel and effecting other preparatory works.[42]

The logic of limiting the builder's obligation to the hypothetical costs of the repairs or replacements that would have pertained at the shipyard may be questioned. If it is accepted that particular warranty works cannot reasonably be undertaken at the shipyard, there is no obvious reason for limiting the buyer's recovery to the costs which would have been incurred in undertaking the work at that yard.[43] Furthermore, this formula may provide only an illusory protection for the builder as these hypothetical costs may be very difficult for him to prove, especially where his workforce is dedicated to shipbuilding and lacks the facilities or expertise to undertake the task of preparing detailed repair estimates.

A particular issue arises in this context as to whether the "reasonable costs" to which the builder's reimbursement obligation is limited should include a notional profit element. If not, the buyer will be obliged to pay a market price for the works (i.e., cost plus repairer's profit margin) but entitled to reimbursement only to the extent of the builder's estimated costs (i.e., with no mark-up). Unfortunately, the SAJ Form provides no guidance on this question. Given, however, that Article IX.3 purports to this extent to limit the builder's liability for defective or inadequate performance, the wording is as a matter of general principle likely to be construed against the builder and in the buyer's favour.[44] If so, the reference to "reasonable cost" will be taken to mean the price, including provision for a reasonable profit, that the builder would have charged on an arm's length basis to undertake the replacements or repairs.

The NEWBUILDCON Form is in broadly similar terms. Where it is "impractical" to bring the vessel to the builder's shipyard or where the builder cannot "supply necessary replacement parts and materials without impairing or delaying [her] operation or working",[45] the buyer is permitted to undertake "necessary repairs or replacements to rectify any Guarantee Defects or damage to the Vessel caused as a direct and immediate consequence of such Guarantee Defects"[46]; provided that he has been given a prior right

41 Clause 35(d) of the NEWBUILDCON Form and Article XIX.3 of the CMAC Form.

42 There is no such obligation in either the NEWBUILDCON or CMAC Forms.

43 Nevertheless, in *J. Samuel White & Co. Ltd* v. *Coombes, Marshall & Co. Ltd* (1922) *supra* at n. 17, the purchasers' claim for the costs of rectifying defects in the vessel's boilers was settled not on the basis of the actual expenditure incurred but on the estimated (lesser) cost to the shipbuilders if they had undertaken the works; this was not, however, strictly a warranty claim as the purchasers sought damages for breach of the implied obligation to deliver a seaworthy vessel.

44 This is an application of the so-called *contra proferentem* rule; see *Hollins* v. *J. Davy Ltd* [1963] 1 Q.B. 844.

45 It will be clear that one or both criteria are likely to met in a broad range of operational circumstances.

46 Clause 35(c).

of inspection of the defects, the builder is then obliged to reimburse the buyer the "reasonable cost and expenses"[47] of the remedial work.

Under the NEWBUILDCON Form, the builder can, at the time of their replacement, request that any replaced parts be returned to him at his cost and expense,[48] in which event title to the same will revert to him. This is not a contractual option open to him under either the SAJ or the CMAC Forms. There is no express time limit under any of the SAJ, NEWBUILDCON or CMAC Forms within which the warranty works must be effected. It is, however, clear by implication that the builder's obligations must be performed within a reasonable timescale and that damages may flow from an unjustified delay in meeting such obligation.

The buyer's claim for damages will be stronger still in the unusual circumstance that the builder is unable or unwilling to remedy the defect at all; the builder's undertaking is in this respect unqualified, Article IX.3 providing that he "shall remedy . . . any defects . . . by making all necessary repairs or replacements".

A situation in which the shipbuilders were unable to repair arose in London arbitration proceedings in 1988 in connection with two Korean-built "PROBO" class Product/Oil/Bulk/Ore Carriers, whose hatch covers were found to be leaking following delivery. Despite extensive efforts by both the shipbuilders and the purchasers, no satisfactory solution could be found to the problem and the vessels were in due course converted into product carriers by the relatively simple expedient of sealing their hatch covers.

Against this background a London arbitration tribunal awarded damages against the shipbuilders for breach of their contractual obligations to remedy the defects. The award covered both the costs of conversion of the vessels, including the purchasers' loss of their use during the works, and the diminution in the vessels' value as the result of their enforced change of use.

Finally, it should be noted that in the case of a breach of the obligation to repair, the *prima facie* measure of damages will be the cost of effecting the repairs[49] but only if repairing the vessel is a reasonable step for the buyer to take in all the circumstances; where the cost of the works is wholly disproportionate to the improvements to the vessel conferred by the repairs, such cost cannot normally be recovered and that the purchaser is restricted to a claim based upon loss of the vessel's market value resulting from the defect.[50]

TO WHOM IS THE BUILDER'S OBLIGATION OWED?

The warranty contained in Article IX of the SAJ Form, in common with that in other standard shipbuilding contracts, represents no more than a contractual commitment given by the builder to the buyer to repair and remedy defects; a breach will normally give rise only to a claim in damages. However, because the builder's warranty obligations arise

47 Clause 35(d)(i).

48 Clause 35(d)(ii).

49 *East Ham Corporation* v. *Bernard Sunley & Sons Ltd* [1966] A.C. 406.

50 *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1995] 3 W.L.R. 118, H.L.; see also *Sealace Shipping Co Ltd* v. *Oceanvoice Ltd* [1991] 1 Lloyd's Rep. 120, a case relating to the sale of a secondhand vessel and *Southampton Container Terminals Ltd* v. *Schiffahrisgesellsch "Hansa Australia" GmbH & Co.* [2001] EWCA Civ 717, which concerned a claim for damage to a crane which had not been replaced or repaired.

only following delivery of the vessel to the buyer,[51] these may on occasion be triggered after the buyer has effectively divested himself of an interest in the vessel. This problem arises, for example, where the buyer sells the vessel in her first year or, more commonly, where the vessel is leased or bareboat chartered by a third party from the time of delivery under the building contract. In such circumstances, can the purchaser or bareboat charterer acquire a right to enforce the warranty against the builder directly?

There are two possible mechanisms which may avail the third party purchaser or bareboat charterer seeking to overcome this problem.

First, under the Contract (Rights of Third Parties) Act 1999 it is in certain circumstances possible for a third party to an English law contract to enforce performance of the same directly. The Act, which represents a substantial exception to the English law doctrine of privity of contract, allows a third party to enforce any term of the contract to the extent that (a) "the contract expressly provides that he may" or (b) the term "purports to confer a benefit upon him" and, on a true construction of the contract, the parties have intended that it should be enforceable by him.[52] The third party need not be in existence when the contract is concluded, as long as his identity can be ascertained at the time the right or benefit is sought to be enforced.

Accordingly, where an English law shipbuilding contract states that its warranty provisions may be enforced by any bareboat charterer or purchaser or, alternatively, it is clear that these provisions are intended to benefit such parties, they will be entitled to enforce performance of the warranty directly against the builder. Section 1(5) of the Act provides in this respect that, for the purpose of exercising such rights, "there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been party to the contract". The third party's rights are additional to, and not in substitution for, the rights of the buyer under the contract, although it is difficult to envisage circumstances in which the buyer would wish to exercise such rights in parallel with those of his bareboat charterer or purchaser.

The second, more cumbersome method open to the third party wishing to enforce the builder's warranty directly is to take an assignment of the rights of the buyer under the shipbuilding contract. Under English law the benefits (but not the burdens) of a contract are generally capable of assignment by either party in favour of a third party. Where such an assignment is expressed in absolute terms and a notice in writing of the same is given to the other contracting party, such assignment will satisfy the requirements of s. 136 of the Law of Property Act 1925 and the assignee will be entitled to enforce the contract directly against the other contracting party; where these formalities have not been satisfied, the assignee may nevertheless still be entitled effectively to enforce the contract in equity by requiring the assignor to sue on his behalf. These basic principles apply, however, only to the extent that the contract itself does not prohibit the assignment of its benefits.[53]

The SAJ Form contains just such a prohibition in Article XIV, which provides as follows[54]:

51 The builder's repair obligations prior to delivery are contained in Article IV.3 of the SAJ Form.

52 Section 1(1).

53 See generally pages 245–253, *infra*.

54 Similar provisions can be found at Clause 45(b)(ii) of the NEWBUILDCON Form and Article XXIV.2(2) of the CMAC Form, which permit the contract to be assigned, transferred or novated subject to certain conditions.

"Neither of the parties hereto shall assign this Contract to a third party unless prior consent of the other party is given in writing. . . . This Contract shall enure to the benefit of . . . the legitimate assigns of either of the parties hereto."

There is nothing to limit the operation of Article XIV to the period prior to delivery of the vessel and, in light of the decision of the House of Lords in *Linden Gardens Trust Ltd* v. *Lenesta Sludge Disposals Ltd and Others* (1994),[55] it is clear that, unless the builder is prepared to consent, the benefit of the warranty provisions of the contract cannot be effectively assigned to a purchaser or bareboat charterer following delivery of the vessel to the buyer. However, the *Linden Gardens* decision also establishes that the buyer may in such circumstances be entitled to enforce for the benefit of the on-purchaser (or bareboat charterer) claims against the builder for breach of the builder's warranty obligations[56]; the buyer will hold any damages received from the builder on trust for, and subject to a duty to account to, the on-purchaser (or bareboat charterer).

If the on-purchaser (or bareboat charterer) is not prepared to rely on this somewhat circuitous method of redress, the alternative solution is for him to seek from the buyer a warranty in identical terms to that contained in the shipbuilding contract.[57] Subject to any question of remoteness of loss, the builder's failure to remedy a defect is likely to entitle the buyer to an indemnity in respect of any damages he himself will have become liable to pay to the on-purchaser.

EXCLUSIONS

Significant costs and liabilities may obviously arise in the event that a newbuilding proves to be defective because of shortcomings in her design or construction. Apart from the costs of the remedial works themselves, there may be substantial expenses associated with loss of use of the vessel or, in the event of a casualty occurring, arising out of personal injury or damage to the property of third parties. While these exposures will often be borne in the first instance by the buyer, he is likely, wherever these have resulted from a defect in the vessel, to wish to pass on the costs and liabilities involved to the builder.

Most shipbuilders are, however, unable to accept a potentially unlimited exposure for design or construction defects and the overwhelming majority of shipbuilding contracts accordingly include terms expressly excluding or limiting the builder's post-delivery liabilities.[58] Although typically to be found within the warranty clauses of the contract, such terms are quite distinct therefrom both in nature and effect. (Where, unusually,

55 [1994] 1 A.C. 85, H.L.

56 See pages 247–249, *infra*.

57 The BIMCO Standard Bareboat Charter, "Barecon 2001", follows a middle path in this regard by providing that: " . . . the Charterers . . . having . . . accepted the Vessel . . . will not thereafter raise any claims against the Owners in respect of . . . defects, if any. Nevertheless, in respect of any repairs, replacements or defects which appear within the first twelve months from delivery the Owners shall endeavour to compel the Builders to repair, replace or remedy any defects. . . . However, the Owners' liability to the charterers shall be limited to the extent the Owners have a valid claim against the Builders under the guarantee clause of the Building Contract. . . . "

58 The existence of warranty obligations assumed by the builder does not normally imply the parties' agreement to displace other contractual and common law remedies and these must be expressly excluded if the builder is to be protected; see *Hancock* v. *B. W. Brazier (Anerley) Ltd* [1966] 1 W.L.R. 1317; *Pearce & High Ltd* v. *Baxter*, *supra*.

exclusion clauses of this type are not contained in the body of the contract, it is incumbent upon the builder to bring to the buyer's attention their precise nature and scope. In *Gordon Allison & Co.* v. *Wallsend Slipway & Engineering Co. Ltd* (1927),[59] a contract for the supply to a shiprepairer of cylinder liners was expressed to be subject to the manufacturer's "usual strike and guarantee clauses"; this was held to be insufficient notice for the purpose of incorporating into the contract the manufacturer's customary exclusion of liability for consequential losses resulting from any defect.)

In keeping with usual shipbuilding practice, Article IX.4 of the SAJ Form contains a number of crucially important exclusions of the builder's liability for defects in the vessel. The burden of proof lies upon the builder to establish that, on their true interpretation, one or more of these exclusions applies to restrict or eliminate his liability.[60]

(a) Express terms of the contract

First, Article IX.4(a) makes clear that the builder is not liable for any defects other than those set out in Article IX.1, i.e., "defects due to defective material and/or bad workmanship" which are discovered and notified to the builder within the prescribed time limits.[61]

In *China Shipbuilding*,[62] this wording had been amended to provide that the Builder should have no obligation "under this guarantee" for any defects whatsoever other than those defined in Article IX.1. Welding defects in the vessels became apparent only after expiry of the warranty period. In order to overcome their time-bar problem, the purchasers sought instead to claim damages for breach of the shipbuilder's contractual obligations regarding the build quality of the vessels and their compliance with Class rules and regulations.

Thomas J. held, however, that such claim failed on the grounds that the relevant wording constituted a "comprehensive code" of responsibility for post-delivery defects and excluded the builder's liability for any breach of the express quality terms of the contract.[63] The wording of the first sentence of Article IX.4(a) of the SAJ Form, which is expressed in general terms and is not referenced to the Builder's liabilities "under this guarantee", is even stronger from the builder's perspective and on this basis effective to exclude most claims for breach of the express terms of the contract relating to defects discovered after delivery of the vessel.[64]

However, as previously indicated, where the defect has been detected prior to delivery, particularly if the buyer has given notice to the builder under Article IV.3 of the SAJ Form,[65] but the same remains unremedied at delivery, it seems unlikely that the builder

59 (1927) 27 Ll.L.Rep. 285, C.A.

60 *The Glendarroch* [1893] P 231. In *Riva Bella SA* v. *Tamsen Yachts GmbH* [2011] EWHC 1434 (Comm), which concerned a contract for the resale of a newbuilding yacht, Eder J. held that the words "the warranties expressed herein are the only warranties given (either expressed or implied) in regard to this transaction" were ambiguous and insufficient to exclude claims by the buyer for breach of the express terms of the contract.

61 Similar wording is contained in Clause 37(b) of the NEWBUILDCON Form and Article XIX.4 of the CMAC Form.

62 *Supra*, at n. 12.

63 Other than arising under the guarantee clause itself.

64 See also Clause 37(b) of the NEWBUILDCON Form, which is in even stronger terms.

65 *Supra*, pages 174–175. Note the different position in respect of the NEWBUILDCON Form in Clause 27(d) and in Article XIX.1 of the CMAC Form.

would be entitled to rely upon the provisions of Article IX.4(a) to exclude his liability in damages for direct losses resulting therefrom. If this was not so, the buyer would have no remedy at all (other than to reject the vessel in its entirety, assuming this is open to him) in respect of the defects identified before delivery which the builder has refused to acknowledge and rectify.

In *China Shipbuilding* a further issue arose as to whether the exclusion contained in Article IX.4(a) applied only to exclude "inadvertent" breaches of the shipbuilder's quality obligations, rather than those knowingly and deliberately commissioned. The case was unusual in that the purchasers pleaded that the shipbuilder had known, and concealed the existence, of welding defects in the vessels prior to the time of their delivery; for procedural reasons, the case proceeded in its preliminary stages on the assumption (which the shipbuilder strenuously denied) that this allegation was true.

At first instance, the arbitration tribunal held that the existence of this allegation made no difference to the application of the exclusion clause, which operated to defeat the purchasers' claims under the contract even if it could be shown that the shipbuilder had "deliberately" breached its quality obligations and had thereafter concealed such breach. On appeal to the High Court, however, the purchasers broadened their claim and sought to rely upon a number of factors, including the supposed importance of the contract terms allegedly breached and the potential seriousness of the consequences, to support their contention that the exclusion clause was not intended to apply in such circumstances.

Against this background, Thomas J. expressed the view, based upon somewhat inconclusive prior English case law,[66] that it was conceivable that the exclusion of liability contained in Article IX.4(a) might not protect the shipbuilder in circumstances in which some or all of the buyer's allegations were proven to be correct. He declined, however, to decide this issue and remitted the matter to arbitrators for their determination.

The arbitrators' further award on these issues was issued but not published and remains confidential to the parties to the dispute. It is, however, submitted that, given the uncertainty which would be caused if the parties were required in each case to determine whether the builder's breach of contract was sufficiently "deliberate" or "serious" to overcome the express exclusion of liability, there is a strong industry case for interpreting clauses of this type[67] in broad terms and as protecting the builder in all circumstances short of actual fraud.[68] On this basis, the protection would apply in any circumstances except where the buyer was able to establish beyond all reasonable doubt that the builder had knowingly committed a breach of contract and deliberately concealed such breach with full knowledge of the potential significant consequences of his actions.[69]

66 Principally the House of Lords' decision in *Suisse Atlantique Société d'Armement Maritime S.A.* v. *Rotterdamsche Kolen Centrale* [1967] 1 A.C. 361.

67 See in a similar vein, Clause 37(b) of the NEWBUILDCON Form and Article XIX.4 of the CMAC Form.

68 In *AstraZeneca UK Ltd* v. *Albemarle International Corporation and Albemarle Corporation* [2011] EWHC 1574 (Comm), the High Court (Flaux J.) reiterated that there is no distinction in English law between "deliberate" and "unintentional" breaches of contract and that a contractual exclusion clause is perfectly capable, in the absence of clear wording to the contrary, of applying to a deliberate breach of contract, even if this is repudiatory in nature.

69 Note that the purchasers in *China Shipbuilding* did not allege fraud against the shipbuilder. A separate remedy in tort for deceit may potentially be available to the buyer in such circumstances.

(b) Consequential or special losses

The second principal limitation in Article IX.4 upon the builder's liability for defects is the specific exemption of all "consequential or special losses, damages or expenses" whether these arise out of the defects themselves or out of the works undertaken to remedy the same.[70] Losses of "time, profit, earning or demurrage" fall expressly within the contractual definition of "consequential or special losses".[71]

It is, however, strongly arguable that the SAJ Form does not exclude certain losses directly resulting from defects falling within its warranty provisions. In *Croudace Construction Ltd* v. *Cawoods Concrete Products Ltd* (1978),[72] a term in a contract for the supply of masonry blocks that the suppliers should not be liable for "any consequential loss or damage caused by reason of late supply . . ." was held by the Court of Appeal not to exclude their liability for any loss directly and naturally flowing in the ordinary course of events from late delivery. A claim by the customer to be indemnified against his liability for breach of a related contract consequent upon the delay in supply was therefore not precluded by the exclusion clause.

On this basis it would appear that, where the existence of a guarantee defect has caused the buyer direct loss (other than of "time, profit, earning or demurrage"), the limitation will not operate to protect the builder and the same will in principle be recoverable under Article IX. By analogy with *Croudace*, such a situation may, for example, arise where the defective application of paint coatings results in the contamination of liquid cargoes carried in the vessel's tanks; by the same token, the buyer's liability for damage to the vessel or injury to a passenger or crew member consequent upon the failure of a defective item of machinery is likely to be direct rather than consequential and therefore not excluded by the terms of Article IX.4.

In *China Shipbuilding*,[73] the purchasers sought to contend that welding defects had caused a diminution in the market value of the newbuildings even after repairs had been effected and that this was not "consequential loss" within the meaning of the relevant exclusion clause in the contract, which was similar to Article IX.4(a). This issue did not need to be decided on the facts of that case[74] but, in light of the authorities discussed above, it seems that there is no reason in principle why a loss of market value should not be categorised as "direct" and therefore recoverable where this results from a defect which is subject to the builder's warranty under the SAJ Form.[75]

70 Clauses of this type do not excuse the shipbuilder's breach of contract in delivering a defective vessel but exempt him from financial liability for the same; *Anglomar Shipping Co. Ltd* v. *Swan Hunter Shipbuilders Ltd and Swan Hunter Group Ltd (The "London Lion")* [1980] 2 Lloyd's Rep. 456. The language was said by Thomas J. in *China Shipbuilding*, *supra*, at page 372 of the judgment to make clear "that no claim could lie for matters such as consequential loss or damage which the buyer suffered by reason of [a] defect within Article IX.1".

71 In the absence of specific wording to the contrary (such as in the SAJ Form) loss of profits is normally "direct" rather than consequential in nature, see *Chiemgauer Membran und Zeltbau GmbH* v. *New Millennium Experience Co. Ltd* [2000] CILL 1595.

72 [1978] 2 Lloyd's Rep. 55 see also *Saint Line Ltd* v. *Richardsons Westgarth & Co. Ltd* [1940] 2 K.B. 99; *Hotel Services Ltd* v. *Hilton International Hotels (U.K.) Ltd* [2000] B.L.R. 235; *Civil and Marine Slag Cement Ltd* v. *Cambrian Stone Ltd*, TCC, 8 June, 2000 and *Ease Faith Ltd* v. *Leonis Marine Management Ltd* [2006] EWHC 232 (Comm).

73 *Supra*, at n. 12.

74 This was because, in circumstances in which Article IX had been held effective to exclude any claim for breach of the express terms of the contract, the purchasers could only assert a claim under the builder's guarantee and were time-barred from doing so.

75 Loss of market value was awarded to the purchasers in the PROBO arbitration proceedings; *supra* at page 180.

It should be noted in this context that in *Markerstudy Insurance Co. Ltd* v. *Endsleigh Insurance Services Ltd* (2010)[76] the High Court confirmed an earlier court decision[77] that a contractual exclusion of liability for "indirect loss or consequential loss (including but not limited to loss of goodwill, loss of business, loss of anticipated profits or savings and all other pure economic loss)" was only of limited effect in English law; in his judgment, Steel J. held that this language excludes such types of loss only to the extent that they are indirect or consequential in nature. In the specific context of the SAJ Form, however, the use of the words "directly or indirectly occasioned to the BUILDER" would appear to extend the scope of the exclusion to all forms, direct or consequential, of the various types of loss specifically enumerated in Article IX.4(a).

The exclusion of the builder's responsibility for defects contained in the NEWBUILDCON Form is very broad, Clause 37 (b) providing that:

"Except to the extent expressly provided in Clause 35 (Builder's Guarantee), the Builder shall have no liability in contract, tort (including negligence), breach of statutory duty or otherwise for (i) any Defect discovered after delivery of the Vessel or (ii) any loss, damage or expenses caused as a consequence of such Defect (which shall include, but not be limited to, loss of time, loss of profit or earnings or demurrage directly or indirectly incurred by the Buyer)".

It should be noted that this exclusion is expressed to apply notwithstanding negligence on the part of the builder, thereby overcoming the presumption usually applied in English law that clauses of this type are not intended to apply where the party in breach has acted negligently.[78] The equivalent language of Article XIX.4 of the CMAC Form does not expressly refer to negligence by the builder but by providing that:

"Upon the delivery of the Vessel to the BUYER, in accordance with the terms of the Contract, the BUILDER shall thereby and thereupon be released of all responsibility and liability whatsoever and howsoever arising . . . "

the same result is very probably achieved.[79]

(c) Circumstances outside the builder's control

The third element of the protection afforded to the builder arises under sub-paragraph (b) of Article IX.4, which states that his warranty does not apply in respect of defects repaired by other contractors, those "caused or aggravated" by misuse or resulting from wear and tear or "other circumstances whatsoever beyond the control of the BUILDER".[80] In the event of a warranty claim being made by the buyer, the burden of proving these exculpatory circumstances rests upon the builder. Furthermore, where the warranty claim has resulted from a combination of defective initial workmanship or materials and a lack of maintenance on the part of the buyer, the court or arbitration tribunal should establish which was the "dominant cause" of the failure and excuse the builder only if his initial breach of contract was causatively of lesser significance than the failure to maintain.[81]

76 [2010] EWHC 281 (Comm).

77 *Ferryways NV* v. *Associated British Ports* [2008] EWHC 225 (Comm).

78 See *Canada Steamship Lines Ltd* v. *The King* [1952] 1 Lloyd's Rep. 1, [1952] A.C. 192 approved in *Smith* v. *South Wales Switchgear Co. Ltd* [1978] 1 W.L.R. 165 and *HIH Casualty and General Insurance Ltd* v. *Chase Manhattan Bank* [2003] UKHL 6.

79 See *Joseph Travers & Sons Ltd* v. *Cooper* [1915] 1 K.B. 73 and *Frans Maas (UK) Ltd* v. *Samsung Electronics (U.K.) Ltd* [2004] EWHC 1502 (Comm) where the courts found that the words "howsoever arising" excluded liability for negligence.

80 See Clause 37(c) of the NEWBUILDCON Form and Article XIX.4 of the CMAC Form.

81 *Ackerman* v. *Protim Services Ltd* [1988] 2 E.G.L.R. 259, C.A.

(d) Implied terms of the contract

Finally, and very importantly, subparagraph (c) of the Article provides that the builder's warranty shall replace and exclude "any other liability, guarantee, warranty and/or condition imposed or implied by the law, customary, statutory or otherwise".[82] It should be noted that the wording of the subparagraph does not purport to encompass those obligations expressly assumed by the builder under the contract, which remain unaffected[83]; the sub-paragraph instead shields the builder from the impact of a number of terms which would otherwise be implied into the contract by either common law or the 1979 and 1994 Acts. These are:

(a) that the builder is entitled to sell the vessel, or will be so entitled at the time property is to pass to the buyer[84];
(b) that the vessel will be sold free of any charges and encumbrances except those disclosed to the buyer before the contract was concluded[85];
(c) that the vessel is seaworthy[86] and otherwise of "satisfactory quality",[87] i.e., "as fit for all the purposes . . . for which goods of that kind are commonly supplied as it is reasonable to expect having regard to any description applied to them, the price (if relevant) and all the other relevant circumstances"[88];
(d) where the buyer has made known to the builder that the vessel is to be purchased for a particular purpose, that she is reasonably fit for that purpose unless the buyer has not relied upon (or should not reasonably have relied upon) the builder's skill or judgment.[89]

Subject to certain qualifications introduced by the Unfair Contract Terms Act 1977, the parties to a contract for the sale of goods are, however, entitled by agreement to exclude the implication of these terms and most shipbuilding contracts incorporate specific provisions to this effect; sub-paragraph IX.4 (c) of the SAJ Form and Clause 37(d) of the NEWBUILDCON Forms are, for example, clearly adequate to achieve such an objective.[90]

82 See also Clause 37(d) of the NEWBUILDCON Form and Article XIX.4 of the CMAC Form.

83 See *Andrews* v. *Singer* [1934] 1 K.B. 17; *China Shipbuilding Corporation* v. *Nippon Yusen Kabukishi Kaisha*, *supra*, and *Cenargo Ltd.* v. *Izar Construcciones Navales S.A.* [2002] EWCA Civ 524, C.A. *per* Longmore L.J.

84 Section 12(1) of the 1979 Act (as amended by the 1994 Act).

85 Section 12(2)(a) (as amended by the 1994 Act).

86 *Samuel White & Co. Ltd* v. *Coombes, Marshall & Co. Ltd* (1922) 13 Ll.L.Rep. 122 *McDougall* v. *Aeromarine of Emsworth Ltd* [1958] 2 Lloyd's Rep. 345 and *Dixon Kerly Ltd* v. *Robinson* [1965] 2 Lloyd's Rep. 404.

87 Section 14(2) of the 1979 Act as amended by the 1994 Act, see pages 118–120, *supra*.

88 Section 14(2)(A) of the 1979 Act as inserted by s. 1(2)(a) of the 1994 Act.

89 Section 14(3) of the 1979 Act, see pages 120–121, *supra*.

90 See *per* Thomas J. in *China Shipbuilding*, *supra*, at page 372 of the judgment. The wording of Article XIX.4 of the CMAC Form, which makes no express reference to the exclusion of statutory "conditions", is arguably inadequate to encompass the statutory conditions of satisfactory quality and fitness for purpose (see *Wallis, Son & Wells* v. *Pratt & Haynes* [1911] A.C. 394, *Cammell Laird and Co. Ltd* v. *The Manganese Bronze and Brass Co. Ltd* [1934] A.C. 402, and *KG Bominflot Bunkergesellschaft für Mineralöle mbH & Co.* v. *Petroplus Marketing AG (The "Mercini Lady")* [2010] EWCA Civ 1145 C.A.): however, in *Air Transworld Ltd* v. *Bombardier Inc.* [2012] EWHC 243 (Comm), a broad-ranging exclusion clause which did not expressly refer to "conditions" was adjudged effective in excluding the statutory implied terms.

Except where the Unfair Contract Terms Act applies, the implied terms derived from the 1979 and 1994 Acts are therefore likely to be of only limited relevance to most shipbuilding projects governed by English law.

THE UNFAIR CONTRACT TERMS ACT 1977

The Unfair Contract Terms Act 1977 ("UCTA") applies certain restrictions upon the rights of contracting parties to exclude or restrict liabilities to each other either expressly arising under the contract or implied as a matter of law. The Act nevertheless does not apply to so-called "international supply contracts" (s. 26) or to contracts which are governed by English law solely by reason of the parties' choice and which would, but for that choice, have been governed by the law of a country outside the United Kingdom (s. 27(1)).

International supply contracts are defined by s. 26 of UCTA as those made by parties whose places of business are in different states in respect of which:

(a) the acts of offer and acceptance giving rise to the contract have been done in different states; or
(b) the contract provides for the goods to be delivered to the territory of a state other than that within whose territory the acts of offer and acceptance were done.

Thus, for example, an agreement signed in London between a European purchaser and a Japanese shipbuilder for the construction of a vessel in Japan will clearly be categorised as an international supply contract and UCTA will not apply. The situation will be otherwise if the contract is concluded in Japan, although in such event the operation of the statute will probably be excluded by s. 27(1) if the contract is governed by English law only by reason of the parties' choice.[91]

As such, it is unlikely that UCTA will affect the majority of shipbuilding contracts undertaken outside the United Kingdom, particularly where the buyer and the builder have no connection with this country.

Where, however, UCTA does apply, three particular provisions are relevant.

First, s. 2 of the statute invalidates any term of a contract excluding or restricting liability for death or physical injury resulting from negligence and permits terms excluding or restricting other forms of loss or damage arising from negligence only to the extent that these satisfy an overriding statutory requirement of reasonableness.

Secondly, where the contract is concluded on one of the parties' written standard terms of business, s. 3 of UCTA permits that party to enforce its exclusion or limitation clauses only to the extent that these satisfy the statutory requirement of reasonableness. In *British Fermentation Products Ltd* v. *Compair Reavell Ltd* (1999),[92] which concerned the sale of an air compressor under the Institution of Mechanical Engineers' model form of contract,

91 In *Amiri Flight Authority* v. *BAE Systems plc* [2003] EWCA Civ 1447, where an English company had sold an aircraft to the ruler of the United Arab Emirates under a contract signed in Abu Dhabi, Mance L.J. commented that "The words 'delivered to the territory of a State' import movement from elsewhere into that state". Despite acknowledging that the contract was highly international in nature, the Court of Appeal found the aircraft was manufactured and delivered in England and was not therefore an "international supply contract" within the meaning of the Act.

92 (1999) 66 Con. L.R. 1.

the court noted that the Act provides no guidance as to whether the expression "written standard terms of business" encompasses industry-wide model contracts such as the SAJ, NEWBUILDCON or CMAC Forms. The Technology and Construction Court held, however, that such an industry form would not constitute a party's "written standard terms of business" in any particular case in the absence of proof that "the Model Form is invariably or at least usually used by [such] party . . .", which impliedly indicates that such model forms may satisfy the requirements of the Act.

Thirdly, s. 6 of UCTA[93] renders any attempt by the seller of goods to exclude or restrict the statutory terms implied by s. 14 of the 1979 Act and s. 1 of the 1994 Act[94] wholly ineffective against a person "dealing as a consumer" and subject to the requirement of reasonableness as against a person who is not "dealing as a consumer". Liability for breach of the seller's implied obligations under s. 12 of the 1979 Act (as amended by the 1994 Act) to convey a good title free of encumbrances and charges cannot be excluded as against either category of purchaser.

The test of reasonableness

The test for establishing whether a contractual term satisfies the requirement of reasonableness under the Act is whether this is "a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made".[95] In addition, Schedule 2 to the Act defines a number of considerations to be taken into account in determining the reasonableness of contract terms.[96] These are as follows:

(a) the strength of the bargaining positions of the parties relative to each other, taking into account (*inter alia*) alternative means by which the customer's requirements could have been met;
(b) whether the customer received an inducement to agree to the term or, in accepting it, had an opportunity of entering into a similar contract with other persons but without having to accept a similar term;
(c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
(d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
(e) whether the goods were manufactured, processed or adapted to the special order of the customer.

While all of the above considerations are relevant to the determination of "reasonableness", there is little doubt that, in a commercial context such as shipbuilding, the issue of

93 As supplemented in the case of "consumer sales" by European Council Directive 93/13/EEC.
94 That is, the implied conditions of satisfactory quality and fitness for purpose.
95 Section 11(1).
96 Although Schedule 2 does not expressly provide that these considerations are relevant in relation to the issue of reasonableness under section 3 of the Act, the courts have held them to be of general application; see *Schenkers Ltd* v. *Overland Shoes Ltd* [1998] 1 Lloyd's Rep. 498, C.A.

the relative bargaining strength of the parties is the most significant. In *Photoprint Ltd* v. *Forward Trust Group Ltd* (1993)[97] the court held that:

"... where the parties are of equal bargaining power and ... well able to look after themselves ..., the courts should not be astute either to cut down the clear effect of exclusion clauses or to change the balance and assumptions of risk provided for in such a contract."[98]

It is in practice rare in a shipbuilding context for the situation to arise in which both (a) UCTA applies and (b) the builder possesses significantly greater bargaining strength than the buyer.[99] In consequence, there is very limited judicial authority relevant to the application of the Act and little guidance to be derived from the case law as to the standard of reasonableness which will be applied.

In *Stag Line Ltd* v. *Tyne Shiprepair Group Ltd (The "Zinnia")* (1984)[100] a contractual term stipulating that a shiprepairer should neither be liable for "economic loss" nor for "special indirect or consequential loss or damage" was, in the context of a claim arising out of deficient repair works, held to be reasonable and therefore not invalidated by UCTA. The judge (Staughton J.) indicated, however, that a further clause under which the repairers were obliged to undertake warranty works only if the vessel was returned to their yard was in his view "capricious" in its effect and accordingly unreasonable.

In *Rasbora Ltd* v. *J.C.L. Marine Ltd* (1977),[101] a case decided by reference to a slightly different test in the Sale of Goods Act 1893, the court held that an exclusion of the builder's liability for "any loss, damage, injury and expense howsoever arising" was ineffective in circumstances in which, as a consequence of defective electrical engineering, a "Moonraker" power boat foundered 27 hours after delivery. The decision was based upon a finding that this was a "consumer sale"[102] but the court expressed the view that, even if the sale had been to a commercial purchaser, reliance upon the exclusion would have been prevented on the grounds that this was not "fair and reasonable".

The court nevertheless appears to have reached this view on the grounds that the buyer would otherwise have been left without a remedy, which rather begs the question; the test applied under UCTA, with its emphasis upon extraneous factors such as the availability of an alternative source of supply, would not (it is submitted) automatically lead to the same result today.

In *Edmund Murray Ltd* v. *BSP International Foundations Ltd* (1992)[103] a contract for the sale of a small land drilling rig incorporated the seller's standard conditions which provided (at Condition 12.1) that the seller would repair or replace without charge any faulty materials or workmanship where the defect had become known within six months from the date of delivery. The standard terms also stipulated (at Condition 12.5) that the six month guarantee replaced and excluded any other express or implied warranties as to quality and that the seller would not be liable for any loss, damage or injury or for any consequential or special loss or damage due to stoppage or breakdown (Condition 12.6).

97 [1993] 12 Tr. L.R. 146.

98 See also *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] A.C. 827 *per* Lord Wilberforce; *Granville Oil & Chemicals Ltd* v. *Davis Turner & Co. Ltd* [2003] EWCA Civ 570 and *Watford Electronics Ltd* v. *Sanderson FL Ltd* [2001] EWCA Civ 317.

99 Most commercial entities will be assumed to have equal bargaining power, see *Watford Electronics Ltd* v. *Sanderson FL Ltd*, *supra*.

100 [1984] 2 Lloyd's Rep. 211.

101 [1977] 1 Lloyd's Rep. 645.

102 Notwithstanding that the purchaser was a company.

103 (1992) 33 Con. L.R. 1.

The unit broke down repeatedly and, for the purposes of determining a preliminary issue, it was assumed that it was unfit for certain intended purposes which the purchasers had made known to the sellers at the time of contracting.

Against this background, the Court of Appeal held that Condition 12.5 did not satisfy the requirement of reasonableness on the grounds that Condition 12.1 restricted the sellers' obligation to repair or replace only to defects which were caused by faulty materials or workmanship. Because Condition 12.1 provided no remedy to the buyer if the rig was mechanically sound but unfit for its purpose due to design or failure to comply with the detailed specifications, it could not in the Court's view be reasonable to exclude terms which would otherwise be implied to protect the buyer against these risks.

As to Condition 12.6, the Court of Appeal held that, although the exclusion of liability for consequential loss was fair and reasonable, the exclusion of the sellers' liability for any other (i.e., direct) loss or damage due to stoppage or breakdown of the goods was unreasonable. The Court's decision was again founded on the view that, if the exclusion applied to direct losses, the buyer would be left with no remedy in circumstances in which the unit was unfit for its purpose by reason of design or failure to meet the contractual specifications.

It should be emphasised, however, that the application of UCTA to any particular contract must be judged on its own merits and in light of all of the relevant circumstances as defined in the statute at the time the contract is made.[104] In *Balmoral Group Ltd* v. *Borealis (UK) Ltd* (2006),[105] the Court considered *obiter* that an exclusion clause contained in a contract for the sale of oil storage tank components would be statutorily "unreasonable" within the meaning of UCTA to the extent that it placed upon the buyer the exclusive risk of a latent defect in such components.

THE GUARANTEE ENGINEER

The contract will often provide for a guarantee engineer to sail with the vessel during all or part[106] of the warranty period. In *Anglomar Shipping Co. Ltd* v. *Swan Hunter Shipbuilders Ltd (The "London Lion")* (1980)[107] the duties of the engineer were described by Mocatta J. as being:

" . . . to act as the Builder's Representative aboard and to give the purchaser and his employees full co-operation to enable them to obtain the most efficient use of the vessel's machinery and equipment."[108]

As such, the guarantee engineer will primarily assist the buyer's crew in familiarising themselves with the vessel and in rectifying minor defects falling within the scope of the

104 See, by way of example, *British Fermentation Products Ltd* v. *Compair Reavell Ltd*, *supra* at n. 92, where the purchaser's remedies, although not extending to a claim for damages, were much broader than in *Murray* and the vendor's limitation of liability was upheld as reasonable.

105 [2006] EWHC 1900 (Comm).

106 It will usually be for the builder to decide how long the engineer should stay on board; however, the NEWBUILDCON Form (Clause 36(a)) provides that the Guarantee Engineer will "attend on board for such portion of the Guarantee Period as the Buyer may reasonably require", whilst the CMAC Form limits the period of attendance of the Guarantee Engineer (of which there may be up to two) to a period of three months from delivery (Article XX.2).

107 [1980] 2 Lloyd's Rep. 456.

108 At page 463.

builder's warranty; he will often be specifically authorised to receive on the builder's behalf formal notice of all warranty claims.

Article IX.5 of the SAJ Form is largely self-explanatory. This is often supplemented by terms confirming that the guarantee engineer remains at all times the employee of the builder,[109] and stipulating that the builder shall indemnify the buyer for all claims for his death or personal injury whilst on board the vessel; the indemnity does not, however, normally apply to claims arising as a consequence of negligence on the part of the buyer, his crew or other employees.

109 See, for example, Clause 36(c) of the NEWBUILDCON Form.

Article X—Rescission by buyer

1. Notice:

The payments made by the BUYER prior to the delivery of the VESSEL shall be in the nature of advances to the BUILDER. In the event that the BUYER shall exercise its right of rescission of this Contract under and pursuant to any of the provisions of this Contract specifically permitting the BUYER to do so, then the BUYER shall notify the BUILDER in writing or by cable confirmed in writing, and such rescission shall be effective as of the date notice thereof is received by the BUILDER.

2. Refund by BUILDER:

Thereupon the BUILDER shall promptly refund to the BUYER the full amount of all sums paid by the BUYER to the BUILDER on account of the VESSEL, unless the BUILDER proceeds to the arbitration under the provisions of Article XIII hereof.

In such event, the BUILDER shall pay the BUYER interest at the rate of ..... per cent (%) per annum on the amount required herein to be refunded to the BUYER, computed from the respective dates on which such sums were paid by the BUYER to the BUILDER to the date of remittance by transfer of such refund to the BUYER by the BUILDER, provided, however, that if the said rescission by the BUYER is made under the provisions of Paragraph 4 of Article VIII hereof, then in such event the BUILDER shall not be required to pay any interest.

3. Discharge of Obligations:

Upon such refund by the BUILDER to the BUYER, all obligations, duties and liabilities of each of the parties hereto to the other under this Contract shall be forthwith completely discharged.

The substantial cost and time involved in the construction of a commercial newbuilding almost always dictate that the buyer will pay a significant proportion of the contract price before taking delivery; these payments will usually be made by instalments linked to the progress of the vessel's construction. As previously indicated, this has the dual benefit of committing the buyer to the project and providing the builder with a source of financing for his construction costs.[1]

Such an arrangement nevertheless exposes the buyer to significant credit risks. His financial exposure commences upon payment of the first instalment, at a time when little or nothing has been done towards the construction of the vessel and continues to increase over a period of months or years until delivery takes place. Given these circumstances it is obviously vital from the buyer's viewpoint to ensure that the contract incorporates a mechanism by which his advances can be recovered simply and quickly should the builder default in the performance of his obligations. In the event that the builder seriously

1 See pages 40–42, *supra*.

breaches the contract, the buyer will not usually wish to rely upon proving a claim in damages as the means by which to recover the payments he has made.

It is therefore usual for the parties to agree that, upon the occurrence of certain defined events of builder's default, the buyer will be entitled to rescind, i.e. to exercise an express right to bring the contract to an end. If the buyer exercises this right, the builder must refund to him the aggregate of the instalments of the contract price paid to the date of rescission, together with interest at an agreed rate. The parties may also make specific provision as to the status of the buyer's supplies following rescission.

The buyer will usually demand that the builder should provide a guarantee to secure his refund obligations prior to, or as a condition of, the Effective Date.[2] The buyer's need for such a guarantee will obviously be reduced where title to the vessel passes to him as she is constructed.[3] Even in this situation, however, the buyer will normally wish to be secured until such time (usually not before keel-laying) as the value of the partly-constructed vessel equates to the aggregate of the instalments he has already paid.

THE BUYER'S RIGHT TO RESCIND

Most shipbuilding contracts define a number of events as entitling the buyer to rescind. These generally fall into five distinct categories:

(a) delay in delivery;
(b) failure of the vessel to meet the technical requirements of the contract;
(c) "financial" defaults;
(d) total loss of the vessel prior to delivery; and
(e) other defaults.

(i) Delay in delivery

Subject to any extensions of time allowed to him to reflect Permissible Delays,[4] the builder's failure to deliver the vessel on the Delivery Date constitutes a breach of contract which, upon the expiry of any grace period, will entitle the buyer to claim liquidated damages at the agreed rate. In the event of unauthorised delays in delivery exceeding an agreed total,[5] the buyer will further be entitled to an option to rescind the contract. If this right is not exercised upon its accrual, the builder will usually be entitled to require the buyer to elect whether to do so immediately or to agree to an extension of the time allowed for delivery.[6]

(ii) Technical deficiencies in the vessel

The contract will also stipulate certain minimum performance criteria for the vessel, usually relating to her speed, deadweight or cubic capacity and main engine fuel

2 See pages 289–293, *infra*.
3 As in *Coal Distributors Ltd* v. *National Westminster Bank* (1981), see page 299, *infra*.
4 See page 166, *supra*.
5 Or, alternatively, an exceptional level of *force majeure* delay.
6 See pages 71–73, *supra*.

consumption. A limited failure to satisfy the criteria will expose the builder only to a liability to pay liquidated damages at the stipulated rate. However where the deficiency exceeds an agreed maximum tolerance, the buyer will normally be entitled to reject the vessel and rescind the contract.

(iii) "Financial" defaults

The risk that the buyer will lose the value of the investment represented by his advance instalments is most acute where the builder encounters financial problems before the vessel has been finished; if these problems lead to the builder's liquidation, the buyer will normally rank only as an unsecured creditor of the builder and will be fortunate to recover the amounts he has paid on account of the contract.[7] Provided this is still being performed, however, there is no right at common law for the buyer to terminate the contract simply because the builder is experiencing financial difficulties or, indeed, has entered into liquidation.[8]

It is therefore not uncommon for the parties to agree that the buyer will be entitled to rescind the contract if the builder commits, either by act or by omission, any of a range of defined financial defaults. The precise nature of the events triggering the buyer's right to rescind will depend in each case upon a variety of factors, including in particular the bankruptcy laws of the builder's domicile.

However, in the majority of agreements these will include:

(a) the appointment of a receiver over all or a substantial part of the builder's assets;
(b) the builder's voluntary winding-up or compulsory liquidation; or
(c) the conclusion of a scheme of arrangement (or other voluntary composition) between the builder and his creditors.

Depending upon the builder's size and financial strength, the contract may also deem to be events of default certain lesser indications of actual or impending financial difficulty, e.g., a failure to settle or secure material third party claims within an agreed grace period.

Curiously, the SAJ Form makes no provision whatsoever for financial defaults on the part of the builder[9]; an adverse change in the builder's financial circumstances is relevant only where this ultimately leads to the occurrence of other events of default (e.g., excessive delay in delivery of the vessel). Where this is required by the buyer, the right to rescind for financial default is therefore incorporated by the inclusion of negotiated wording additional to the standard form. Such an amendment is not, however, required under the NEWBUILDCON Form which, reflecting more modern shipbuilding practice,

7 Note that under the UK Cross-Border Insolvency Regulations 2006 (SI 2006/1030), giving effect to an UNCITRAL Model Law on Cross-border Insolvency, the English courts are entitled to recognise foreign insolvency proceedings even if the debtor has no legal presence in the English jurisdiction. The courts can accordingly stay (i.e., suspend) legal action taken in England against assets of the debtor to the extent that such action is incompatible with the objectives of the foreign insolvency proceedings.

8 *British Waggon Co.* v. *Lea* (1880) 5 Q.B.D. 149.

9 Or, indeed, by the buyer, see pages 209–210, *infra*.

provides[10] for an express right in the buyer to terminate the contract if an insolvency event occurs in relation to either the builder or its refund guarantor.[11]

(iv) Total loss of the vessel

The contract will normally also be capable of rescission where the vessel becomes a total loss prior to delivery. It is rare, however, for the buyer to enjoy an exclusive option in such circumstances, the contract usually providing for mutual rights of rescission in the event of a total loss.[12] Under Article XII.2 of the SAJ Form, the parties must agree either to proceed with the reconstruction of the vessel or to abandon the project, in which event the builder is required to refund the buyer's pre-paid instalments (but without interest thereon), following which the contract is "deemed rescinded". It should be noted that in this situation the rescission takes effect only after the builder's refund has been made and is not in itself the event triggering the obligation to make the repayment. The NEWBUILDCON[13] and CMAC Forms[14] contain similar provisions.

Where, unusually, the parties have made no provision for such an occurrence, the contract may be frustrated if the vessel becomes a total loss before delivery.[15]

(v) Other defaults

These will vary from agreement to agreement depending upon a number of factors. The contract may, for example, provide for an event of default if the builder subcontracts a material portion of the contract works without the buyer's consent.

It is also not unusual in very complex projects to provide for interim completion targets or "milestones" in the vessel's construction programme which must be achieved within defined time limits. This allows the buyer the option to terminate the contract at an early stage where the project has fallen seriously behind schedule. Exceptionally, it may be agreed that a right of rescission will arise where, at an interim stage, the buyer "reasonably determines" that the contract timetable cannot be met.[16] Difficulties often arise in this context in relation to the factors which the buyer must take into account in reaching his determination.

Such a situation arose in *Pacific Ocean Shipping Corporation & anr* v. *Sembawang Corporation Ltd (The "Solitaire")* (1998),[17] which concerned a substantial ship conversion project in respect of a pipe-laying vessel. The contract entitled the claimant

10 At Clause 39(d).

11 Article XXIII of the CMAC Form defines certain events of "builder's default", including insolvency, but fails to provide for the contractual consequences of their occurrence. In particular, there is no express link to Article XXVII 1 ("Buyer's Termination"), which sets out a separate list of circumstances involving the builder, including the insolvency of his refund guarantor, whose occurrence will entitle the buyer to terminate the contract. The parties are, however, each entitled to terminate for the insolvency of the other under Article XXVII.4.

12 See pages 231–232, *infra*.

13 At Clause 38(b)(ii).

14 At Article XXVIII.2(2).

15 See pages 168–169, *supra*.

16 See, e.g., Article XXIII.1 of the CMAC Form which defines as a builder's default: "the failure of the Builder to prosecute the Contract work with such diligence and in such manner as will disable it (sic) to complete the Vessel construction by the Delivery Date stipulated in the Contract"

17 Commercial Court, 4 June 1998, Tuckey J.

shipowner to terminate in the event that the contractor failed to perform the works to the required quality standard and "at a progress rate deemed sufficient by the [shipowners] to provide a reasonable assurance that the WORK would be completed in accordance with the CONTRACT provisions".

The shipowner exercised this right, with the consequence that a London arbitration tribunal, and thereafter the High Court on appeal, was required to decide whether the "reasonable assurance" to which the shipowner was entitled related to completion of the works by the contractual Delivery Date. The contractor argued that, in circumstances in which the contract provided for liquidated damages to be payable for delay in redelivery, the shipowner was entitled only to reasonable assurance of completion by the date on which the contractor's maximum liability in liquidated damages for delay would be reached.

The Commercial Court (Tuckey J.) preferred the former interpretation, holding that the period in which liquidated damages were payable should not be taken into account for the purposes of the shipowner's determination. In the court's view the relevant question was whether " . . . by paying or being liable to pay liquidated damages the [contractor] completes the contract in accordance with its provisions as to time during the period covered by such payment. The contract does not say so".

It should also be noted that the arbitration tribunal in this matter subsequently held that the determination to be undertaken by the shipowner should be made on the assumption that the contractual Delivery Date would be extended by the aggregate of all agreed and disputed variation orders in existence at the time the determination fell to be made. The shipowner was not, however, required by the arbitration tribunal to take into account the contingency that "future" variation orders might well also extend the contractual Delivery Date and this finding was subsequently upheld on appeal by the Commercial Court.[18]

Finally, it may also be agreed that the buyer should be entitled to rescind the contract if the builder suspends construction of the vessel for a defined minimum period; see, for example, Clause 39(a)(ii) of the NEWBUILDCON Form.[19] The builder will usually wish to ensure that this will not occur where the suspension of works has resulted from the occurrence of any of the contractually agreed "*force majeure*" events.

THE EFFECT OF THE BUYER'S RESCISSION

Where the buyer lawfully exercises a right of rescission of the contract, this usually brings to an end the parties' respective obligations to construct and purchase the vessel. It will normally have a number of other legal consequences.

The builder's obligation to refund

Under most shipbuilding contracts, the most significant consequence of the buyer's rescission is that the builder then becomes obliged, "immediately" or "promptly", to refund to the buyer the monies previously paid by him under the contract.

18 Commercial Court, 11 July 2000, Walker J.
19 See pages 281–282, *infra*.

Pursuant to the SAJ Form the builder is required upon rescission to refund "the full amount of all sums paid by the BUYER to the BUILDER on account of the VESSEL". This broad language ensures that the buyer is entitled to be repaid not only the amount of his advance instalments of the contract price, but also any further monies paid to the builder in respect of modifications to the specifications. Similar language is also contained in the NEWBUILDCON[20] and CMAC[21] Forms.

The builder will normally also be required to pay interest on the instalments of the contract price paid by the buyer from the respective dates on which they received by the builder; this will be calculated at either a fixed rate or a floating rate which is usually linked to the buyer's cost of borrowing and expressly provided for in the contract.

Where, however, rescission follows a total loss, interest may often either not be payable at all[22] or be payable at a lower rate. The rationale for this practice may be that it is difficult for the builder to obtain insurance coverage for interest repayments[23]; in major projects, the practice nevertheless represents a significant financial exposure for the buyer, who will often insist that the standard form be amended to provide for interest to be paid.[24]

Whether or not interest is payable, the buyer's entitlement upon rescission of the contract to require repayment of his pre-delivery instalments of the contract price will often have drastic financial consequences for the builder, particularly in a declining newbuilding market. Even where there is a realistic prospect of his disposing of the vessel elsewhere, the builder may in such circumstances face serious cash flow difficulties. Accordingly, where the exercise by the buyer of an alleged right to rescind is disputed by the builder, it is common for the contract to seek to preserve the *status quo* until such dispute is resolved.

Many shipbuilding contracts provide in this respect that, if the buyer's claim to rescind is challenged by the builder, the latter's refund obligation will be suspended until the dispute is resolved by arbitration or litigation in accordance with the dispute resolution provisions of the contract.[25] Provided that the builder acts in good faith, such an arrangement will ensure that his refusal to make the refund in disputed circumstances will not constitute a breach of his contractual obligations.

Under Article X.2 of the SAJ Form, the buyer's refund obligation is absolute "unless the BUILDER proceeds to arbitration under the provisions of Article XIII". There is no time limit for the commencement of proceedings by the builder, although it is reasonable to assume that he must take this step promptly upon receipt of the buyer's notice of rescission. The builder's obligation to refund the buyer's instalments will then be

20 See Clause 39(e).

21 See Article XXVII 5.

22 See Article XII.2 of the SAJ Form and Article XXVIII of the CMAC Form. Note, however, that this is not the position under the NEWBUILDCON Form, Clause 38(b)(ii)(2) of which requires the builder to refund to the buyer "*the full amount of sums paid by the Buyer to the Builder together with interest thereon*."

23 The insured value of the vessel under the Institute Clauses for Builders' Risks (1/6/88) is fixed by reference to the contract price, the wording making no provision for payment of interest on such value in the event of a total loss.

24 Article X.2 of the SAJ Form also disallows interest on the buyer's instalments where his rescission is based upon "excessive" claims for *force majeure* delay within Article VIII.4.

25 Note, however, that neither the NEWBUILDCON nor the CMAC Form address this issue. Curiously, the NEWBUILDCON Form nevertheless permits the refund guarantor to defer payment under the refund guarantee in the event of a dispute between the parties as to the validity of the buyer's rescission of the contract; see Annex A(iii).

conditional upon the arbitration tribunal constituted pursuant to Article XIII determining that the notice of rescission was validly given.

In *Nanjing Tianshun Shipbuilding Co. Ltd and Jiangsu Skyrun International Group Co. Ltd* v. *Orchard Tankers Pte Ltd* (2011),[26] the shipbuilding contract provided that the builder should be entitled to dispute the buyer's notice of cancellation by instituting arbitration proceedings "if such institution of arbitration is made within thirty . . . days of the Buyer's cancellation and/or rescission". In these circumstances, the High Court held that the builder's failure to commence arbitration proceedings within such time limit barred absolutely its right to contest the cancellation, as opposed merely to waiving its right to arbitrate, with the result that the instalments fell immediately repayable.

Damages

Even assuming he is refunded his advance instalments with interest, the buyer may nevertheless suffer significant financial prejudice by reason of his rescission of the contract. This may comprise "reliance loss" (i.e., expenditure thrown away as a consequence of the ending of the project) and/or "loss of bargain" (typically the difference between the contract price and the market price of an equivalent new-building).

It is, however, vital to appreciate that such losses are not normally recoverable from the builder pursuant to the express terms of the contract. It is instead the almost invariable (although often overlooked) practice of international shipbuilding contracts to limit the builder's obligations upon the buyer's rescission to repayment of his pre-delivery instalments and interest thereon, i.e., the buyer is not permitted in addition to claim damages.[27] Under the SAJ Form, such limitation is clearly stated in Article X.3, although the Article provides expressly that the builder's "release" is conditional upon the discharge in full of his refund obligations.[28]

Until recently, it was widely believed that the exercise by the buyer of a contractual right to terminate, coupled with the making of a demand for repayment of his pre-delivery instalments of the contract price, precluded him from exercising any common law right to terminate for repudiatory breach and therefore from claiming damages for the loss of the contract; it was thought that the exercise of the buyer's contractual rights constituted an "affirmation" of the contract which was inconsistent with electing to treat it as at an end, at least as regards the parties' primary obligations thereunder.

This view is, however, now plainly untenable in light of the decision of the Court of Appeal in *Stocznia Gdynia S.A.* v. *Gearbulk Holdings Ltd* (2009).[29]

In *Stocznia*, the parties had originally contracted for six newbuilding bulk carriers, although the builder effectively abandoned construction of three vessels at an early stage. Article 10 of the contracts provided that the buyer should be entitled to rescind for late

26 [2011] EWHC 164 (Comm).

27 Note that in the "reverse" situation, i.e., where the builder rescinds the contract consequent upon the buyer's default, each of the SAJ, NEWBUILDCON and the CMAC Forms oblige the buyer to make good the builder's losses to the extent that these are not recouped from the proceeds of sale of the vessel; see Article XI.4(e) of the SAJ Form, Clause 39(f) of the NEWBUILDCON Form and Article XXVII.6 of the CMAC Form.

28 Note, however, that neither the NEWBUILDCON nor the CMAC Form expressly limit the builder's obligations to those remedies expressly provided for in the Contract.

29 [2009] EWCA Civ 75.

delivery and/or in the event of a "major breach by the [builder] of its obligation hereunder to proceed with the construction of the Vessel . . . ". Rescission by the buyer entailed " . . . the consequences hereafter provided", namely, the accrual of a right to repayment of his pre-paid instalments of the contract price with interest thereon.[30]

The buyer in due course rescinded the contracts under Article 10 for late delivery and made demand upon the builder and its guarantor for the refund of his instalments; subsequently, however, the buyer also sought to treat the builder's conduct as a repudiation of the contracts, for which the buyer sought substantial damages. The builder contended in these circumstances that the contractual mechanism (i.e., the buyer's express right to rescind for delay in delivery) represented an exclusive code for termination for breach, alternatively that, by electing to invoke the contractual mechanism, the buyer had waived any right to treat the builder in repudiatory breach and claim damages for loss of bargain.

This view was, however, rejected by the Court of Appeal. In the Court's view, Article 10 of each contract, which also provided for the payment by the builder of liquidated damages for minor delays and deficiencies in the vessel's performance, incorporated a contractual restatement of the buyer's common law right to treat any significant failure in performance by the builder as a repudiatory breach of contract. According to Moore-Bick L.J., giving the only judgment:

"The primary purpose of art 10 . . . is to provide an agreed measure of compensation for breaches of contract by way of delay in delivery and deficiencies in capacity and performance which, although important, do not go to the root of the contract. For these the parties have agreed the payment of liquidated damages . . . and to that extent their agreement displaces the general law, at least as regards the measure of damages recoverable for a breach of that kind. However, they have also agreed that there comes a point at which the delay or deficiency is so serious that it should entitle [the buyer] to terminate the contract. In my view they must be taken to have agreed that at that point the breach is to be treated as going to the root of the contract. In those circumstances the right to terminate the contract cannot sensibly be understood as anything other than embodying the parties' agreement that [the buyer] has the right to treat the contract as repudiated, with . . . the usual consequences . . . In my view it is wrong to treat the right to terminate in accordance with the terms of the contract as different in substance from the right to treat the contract as discharged by reason of repudiation of common law. In those cases where the contract gives a right of termination they are in effect one and the same."[31]

This reasoning is plainly determinative of the issue (although it should be noted that the contracts in *Stocznia* did not include the language contained in Article X.3 of the SAJ Form, which expressly bring to an end "all obligations, duties and liabilities of each of the parties" upon the builder's refund of the buyer's instalments and interest). The Court's decision is nevertheless somewhat questionable. The fact that the parties have agreed that liquidated, rather than general, damages should be applicable in respect of "minor" breaches of contract[32] is, it is submitted, no reason why they should be taken as having agreed to treat an express right to terminate as being the contractual "embodiment" of their common law rights, with all of the distinct legal consequences that this entails.

Furthermore, although the alternative course of limiting the buyer's remedies to recovery of his instalments and interest is plainly harsh in the extreme circumstances in

30 The contracts contained no provision limiting the buyer's remedies to such repayment.

31 See paragraph 20 of the judgment.

32 It should be noted that, by providing a limit on the builder's liability, liquidated damages clauses confer benefits on *both* parties to the agreement; see page 65, *supra*.

which the builder has deliberately abandoned the project, a logical consequence of the Court of Appeal's decision is that substantial damages can also be claimed for significantly less egregious breaches by the builder, including, for example, the builder's failure to achieve the guaranteed speed or fuel consumption of the vessel to the extent entitling the buyer to rescind under the express terms of the contract. There is, it is submitted, no reason[33] for assuming that the parties had agreed in this situation that, in addition to rejecting the vessel, the buyer should be entitled to pursue substantial, and possibly uncapped, claims in damages against the builder for loss of bargain.[34]

Less controversially, the Court of Appeal in *Stocznia* also disposed of the builder's argument that, by electing to rescind the contract under its express terms, the buyer had waived its common law rights. The Court made clear that it is only in certain circumstances that an election must be made if the contract and the common law provide an injured party with alternative remedies which have different financial and practical consequences. Where, however:

> "the contract provides a right to terminate which corresponds to a right under the general law (because the breach goes to the root of the contract or the parties have agreed that it should be treated as doing so)"

it is clear from *Stocznia* that no election is needed and the innocent party (i.e., the buyer in that case) can exercise both his contractual and common law remedies by simply making clear that he is treating the contract as discharged.[35]

Buyer's supplies[36]

The contract may sometimes stipulate that, upon its rescission, title to the buyer's supplies shall pass to the builder. It may also be agreed (either expressly or impliedly) that the builder should in such circumstances pay a market price for the same. If a term transferring title to the buyer's supplies is not included in the contract and these have already been physically incorporated in the vessel, the builder may face substantial extra expense and delay in removing and replacing the items in question prior to selling the vessel.

Article X of the SAJ Form nevertheless makes no mention of the effect of rescission on the buyer's supplies and it would appear that these remain the property of the buyer.[37] The effect of rescission is to terminate the builder's bailment and to require him to deliver up the items in question to the buyer at the shipyard. This should be contrasted with the provisions of Article XI of the SAJ Form, which state that in the case of the buyer's default, title to his supplies passes to the builder immediately upon the latter's rescission of the contract.

33 Certainly, no reason is asserted by the Court of Appeal, which treated this as a matter of impression only.

34 And this would, at least in the author's view, be contrary to long established shipbuilding practice.

35 See paragraph 44 of Moore-Bick L.J.'s judgment.

36 See generally pages 257–260, *infra*.

37 Both the NEWBUILDCON Form (at Clause 39(e)) and the CMAC Form (at Article XXVII.5) address this issue by obliging the builder to return the buyer's supplies, or, if they cannot be returned, to pay to the buyer an amount equal to the value thereof.

Title to the vessel

The remedies available to the buyer following rescission may be more extensive where title to the vessel vests in him rather than in the builder; as previously indicated, this situation is unusual in modern shipbuilding contracts, although it will always prevail in the context of ship conversion projects. Where the buyer has title to the vessel and the value of his instalments is reflected in the partly-constructed vessel, the effect of rescission may be either:

(a) to revest title in the builder following reimbursement of the pre-delivery instalments paid by the buyer plus interest thereon[38]; or
(b) to terminate the builder's contractual entitlement to undertake the contract works and to permit the buyer to remove the vessel from the shipyard (see further below).

The issues of title and the right to possession of the vessel raised by clauses of this type are nevertheless likely (both as a matter of practice and of law) to be determined by the *lex situs* rather than the governing law of the contract.[39] This is particularly so where the builder has entered into liquidation proceedings and his affairs have accordingly fallen under the supervision of the local bankruptcy courts. Where provisions of this nature are to be used, it is therefore again vital from the buyer's perspective that advice as to local law and practice be obtained before the contract is concluded.

Rights to complete the contract works

In situation (b) above, i.e., where the effect of rescission is merely to terminate the builder's entitlement to complete the works, the contract will sometimes also allow the buyer to enter the shipyard and complete the contract works at his own risk and expense using facilities and materials available at the shipyard for such purpose; any costs so incurred by the buyer will then be deducted from the contract price.

The enforceability of such clauses is once more likely in practice to depend upon the *lex situs* rather than the governing law of the contract. For their part, however, the English courts have shown some reluctance to intervene to protect such rights, particularly if the builder is in liquidation.

Thus, in *Merchants' Trading Co.* v. *Banner* (1871),[40] certain shipowners concluded a conversion contract for the lengthening of their vessel by a firm of shipbuilders on terms that, if the latter refused or failed to perform their obligations, the owners would be entitled to enter the shipyard and complete the works themselves. After the works had commenced and the vessel had been cut into two parts, the shipbuilders became bankrupt and the trustee in bankruptcy refused to permit the shipowners to complete the works.

The shipowners thereupon sought a declaration that they were entitled to complete the alterations and that their workmen should be permitted both to enter the yard for such purposes, making use of any materials and equipment intended for the vessel. Lord

38 The buyer's assumption of title during construction will not prevent this from revesting in the builder upon rescission; see *McDougall* v. *Aeromarine of Emsworth Ltd* [1958] 2 Lloyd's Rep. 345; *Nelson* v. *William Chalmers & Co. Ltd*, 1913 S.C. 441.

39 See page 136, *supra*.

40 (1871) L.R. 12 Eq. 18.

Romilly M.R. held that the court could not grant specific performance of the conversion contract as a whole and would not therefore enforce performance of any particular obligation assumed by the shipbuilders thereunder. He also refused to grant the shipowners' application for an injunction restraining the trustee from selling the shipyard.[41]

This decision was, however, reached against a factual background in which the conversion contract had only been partially performed and the shipbuilders were in liquidation. In *BMBF (No. 12) Ltd* v. *Harland & Wolff Shipbuilding & Heavy Industries Ltd* (2001),[42] the High Court enforced the buyer's contractual right to take over and complete a nearly finished newbuilding in circumstances in which the builder was continuing in business. The decision is also significant in that, on the wording of the contract in question, the Court of Appeal held that, by exercising a right to enter into possession, the buyer assumed an obligation to complete the vessel in accordance with the shipbuilding contract. The buyer could not therefore deny a liability to pay the delivery instalment of the price merely because the builder had not completed her or because she had been completed by the buyer differently from the original contract and specifications.

In *Harland & Wolff*, the newbuilding contract related to a sophisticated deepwater drillship. The parties had agreed that, in specific circumstances defined as constituting builder's default, which included events both within and without the builder's control,[43] the buyer could either rescind the contract and recover his pre-paid instalments or (under Clause 15.2(ii) of the contract) "take possession of the VESSEL in its unfinished state and complete the VESSEL in accordance with this Contract and the Specifications either at the BUILDER'S Yard or elsewhere, at the OWNER'S sole option". If, in the latter case, the cost of completing the vessel was more than the amount of the outstanding instalments, the builder was to be liable to the buyer for such difference, together with interest.

The builder tendered the vessel for delivery on the contractual date but the buyer refused to accept the tender, alleging that she was not in a deliverable condition. The buyer then gave notice under Clause 15.2(ii) to take possession of the vessel and, notwithstanding that an arbitration tribunal had been appointed, applied to the High Court for a mandatory injunction[44] compelling the builder to comply with such notice.

This application was granted by the High Court against the provision of security by the buyer, who duly took possession of the vessel and moved her to a shipyard in the United States where further works were undertaken prior to the commencement of her first employment. This having occurred, the builder claimed the amount of the delivery instalment, which the buyer refused to pay, contending that its liability to do so had been discharged by the exercise of its rights under Clause 15.2(ii).

This argument, although originally upheld by the High Court on appeal from the arbitration tribunal, was rejected by the Court of Appeal. The Court held that, in

41 Note, however, *James Jones & Sons Ltd* v. *Earl of Tankerville* [1909] 2 Ch. 440, a purchaser who was contractually entitled to enter the vendor's land to cut down the timber he had bought, was granted an injunction to restrain the vendor from interfering with such operations. The distinction may be that the purchaser in *James Jones* needed neither the assistance nor the facilities of the vendor to complete the contract.

42 [2001] 2 Lloyd's Rep. 227, C.A.

43 Events outside the builder's control included *force majeure*, total loss of the vessel or her requisition by the British Government.

44 Under s. 44 of the Arbitration Act 1996.

circumstances in which the buyer had exercised a contractual right to take possession,[45] it remained obliged to complete the vessel in accordance with the contract terms and to pay to the builder upon such completion the outstanding (delivery) instalment of the contract price less any additional costs of completion and liquidated damages accrued due when possession was taken. To the extent that the costs of completion exceeded the balance due under the contract, the builder was expressly obliged to pay the difference to the buyer; furthermore, although the contract did not expressly so provide, the buyer was impliedly entitled to deduct from the delivery instalment the costs of completion of the vessel where these were less than the amount of such instalment.

Although, as was pointed out by Clarke L.J. this solution "represent[s] a fair balance between the interests of the parties. The owner ends up with a vessel completed in accordance with the contract. It pays the contract price but no more . . . ",[46] there are nevertheless elements of the Court of Appeal's decision which are troubling. It is in particular difficult to reconcile the contractual requirement in *Harland & Wolff* that the final instalment of the contract price should be payable upon delivery of the vessel at the builder's shipyard with the concept of a form of "deemed delivery" at another shipyard in a different jurisdiction.[47] Furthermore, and perhaps more fundamentally, the imposition upon a buyer of an obligation in such circumstances to complete the vessel appears to render the buyer's option to enter into possession commercially worthless, at least in the early stages of the vessel's construction. As was strongly argued on behalf of the buyer, it will be rare indeed, in the extreme circumstances in which this type of remedy is likely to be exercised, that the buyer will wish to complete the vessel at another shipyard precisely in accordance with the original contract and specifications.

The *Harland & Wolff* decision appears, however, to depend very substantially upon the fact that the buyer's rights to enter into possession could, as indicated above, be triggered by circumstances which were not within the builder's control. It is arguable in these circumstances that, where a right to take possession of a partially constructed vessel can only be exercised in circumstances constituting a serious breach of contract by the builder, a different view will be taken of the buyer's obligations with regard to completion and payment of the outstanding balance of the contract price. The decision nevertheless plainly highlights the potential complexity of "takeover" provisions of this type and the need, from both parties' perspective, to address clearly and in detail in the contract the various commercial and technical issues arising in such a situation.

Finally, it should be noted that, even assuming that the buyer is permitted to enter into possession of the vessel, a contractual right to use materials belonging to the builder does not transfer to him title to the same.[48] In the event of the builder's subsequent liquidation, the liquidator may (depending upon the *lex situs*) therefore be in a position to defeat the buyer's rights by disclaiming the contract[49] and claiming the builder's materials for the benefit of the general body of his creditors.

45 The hearing took place on the assumption that the buyers had validly exercised their rights to take possession, although this was not conceded by the builder.

46 At page 246.

47 Further difficulties arise in relation to the date of commencement (and scope) of the builder's warranty obligations in circumstances in which the vessel has been completed by the buyer or a third party shipyard.

48 See *Baker* v. *Gray* (1856) Scott 462.

49 In English law these rights accrue to a liquidator under s. 178 of the Insolvency Act 1986. The other party to the contract may require the liquidator to elect whether or not to disclaim s. 178(5).

THE BUYER'S COMMON LAW REMEDIES

In addition to his contractual rights of rescission, the buyer may be entitled to common law remedies for breach of contract by the builder.

Acceptance of the builder's repudiatory breach

Where the builder seriously defaults in the performance of his obligations, it may in certain circumstances be open to the buyer to treat his conduct as a repudiatory breach of the contract and claim damages for his loss of bargain. As indicated above, by deciding that the buyer's exercise of an express right of rescission of the contract will not prevent him from also pursuing his common law remedies, the Court of Appeal decision in *Stocznia* has rendered such claims much less problematic (and accordingly more likely to be asserted).

Where the buyer accepts the repudiation and thereby elects to bring the contract to an end, the builder's primary obligation to construct the vessel will cease and be replaced by a secondary obligation to pay damages in respect of the losses caused by such breach which were reasonably foreseeable when the contract was signed.[50] It is also clear in these circumstances that, whether or not such a right is exercisable under the express terms of the contract, the buyer is also entitled to recover the amount of his pre-paid instalments of the contract price. According to Moore-Bick L.J. in *Stocznia*[51]:

"On discharge of the contract of this kind the buyer who has paid the whole or part of the price in advance is entitled, in the absence of any agreement to the contrary, to recover what he has paid by reason of a total failure of consideration. He therefore has the right to recover in restitution any payments he has made in respect of the price, a right which is quite distinct from any right he may have (if he is the injured party) to recover damages for the loss of his bargain . . . There is no inherent inconsistency . . . in recovering instalments of the price under [the contract] and recovering damages for loss of bargain at common law."

It is beyond the scope of this book to consider in detail the circumstances in which one party to a commercial contract is entitled to treat the other as in repudiatory breach.[52] In general, however, this will occur only where the breach or breaches in question either relate to a term which is properly categorised as a contractual condition[53] or are otherwise sufficiently serious as to deprive the other party of all or a substantial part of the benefit of the agreement.[54] A repudiatory breach is, for example, likely to occur where the builder simply abandons the shipbuilding project[55] or, deliberately and without the justification of *force majeure* circumstances, fails to progress the vessel's construction such that her delivery is bound to be significantly delayed.

It is unlikely, by contrast, that the builder will commit a repudiatory breach either by tendering a "non-conforming" vessel following the completion of sea trials[56] or by not

50 *Photo Productions Ltd* v. *Securicor Transport Ltd* [1980] 1 Lloyd's Rep. 545. The arbitration provisions of the contract will, however, survive; *Heyman* v. *Darwins Ltd* [1942] A.C. 356.

51 At paragraph 40 of his judgment.

52 For a detailed study of this topic, see *Chitty on Contracts* (30th edn.), Chapter 24, and Treitel, *The Law of Contract* (13th edn.), Chapter 18.

53 See pages 108–109, *supra*.

54 See *Hongkong Fir Shipping Co. Ltd* v. *Kawasaki Kisen Kaisha Ltd* [1961] 2 Lloyd's Rep. 478, C.A.

55 As in *Stocznia*, *supra*.

56 See pages 122–123, *supra*.

completing the project by the agreed Delivery Date. Construing a contract under which the shipbuilder agreed to "build the vessel to her proper turn . . . and . . . deliver [her] in October 1920", Roche J. held in *Lindvig* v. *Forth Shipbuilding & Engineering Co. Ltd* (1921)[57] that:

> " . . . this clause as to date of delivery is not a condition of the contract so as to entitle the Plaintiff in the event of non-performance . . . to treat the contract as broken in such an essential as to entitle him to treat it as repudiated."[58]

Where the buyer lawfully accepts the builder's repudiatory breach and brings to an end both parties' primary obligations, it may nevertheless still be open to the builder to rely upon express wording in the contract limiting his secondary liability in damages. In an attempt to protect the builder, the contract may include language such as Article X.3 of the SAJ Form providing that, upon repayment by the builder of the buyer's pre-paid instalments of the contract price and interest, the parties shall have no further liabilities to each other[59]; alternatively, and more commonly, the parties may instead agree in no circumstances shall the builder's liabilities extend to "consequential" or "indirect" losses sustained by the buyer as a consequence of the former's breach of contract.[60]

Assuming that the builder's liability is unrestricted, the normal measure of damages for the buyer's loss of bargain will, as previously indicated, be the difference between the contract price and the market price of an equivalent newbuilding judged as at the Delivery Date.[61] This is nevertheless a *prima facie* rule only and is capable of being displaced as necessary to meet the primary objective of placing the parties in the position they would have enjoyed if the contract had been performed.[62]

As an alternative to his proven loss of bargain, the buyer may in certain circumstances be entitled to recover his "reliance loss", e.g., wasted design and supervision costs. He will not, however, usually be entitled to recover both his loss of bargain and his reliance loss for the simple reason that he could not have earned the profits of the venture without making the capital investment needed to permit performance of his own contractual obligations.[63]

Specific performance

Where the victim of a breach of contract does not wish to bring the agreement to an end but rather to ensure its performance, it is sometimes open to him to seek the English law remedy of a decree of specific performance, i.e., an order that the party in breach should fulfil his contractual obligations. Both the High Court and London arbitration tribunals are empowered[64] to make such orders. Specific performance is, however, a discretionary

57 (1921) 7 Ll.L.Rep. 253.

58 At page 255.

59 It will be a matter of interpretation of the language used whether this is effective to protect the builder from claims for damages for repudiatory breach or, alternatively, merely brings to an end his express obligations under the contract.

60 But note the interpretation placed upon the words "consequential loss or damage" in *Croudace Construction Ltd* v. *Cawoods Concrete Products Ltd* [1978] 2 Lloyd's Rep. 55, see pages 185–186, *supra*.

61 Section 51(3) of the 1979 Act.

62 See generally on this subject, Treitel, *The Law of Contract* (13th edn.), Chapter 20.

63 *Cullinane* v. *British "Rema" Manufacturing Co. Ltd* [1954] 1 Q.B. 292.

64 The authority of arbitration tribunals to order specific performance derives from s. 48(5)(b) of the Arbitration Act 1996.

remedy and is granted only exceptionally; it is in particular not available where a judgment in damages would adequately compensate the victim of the breach.[65] For this reason, the remedy will not normally be available to enforce performance of a payment obligation.

The remedy of specific performance in the context of sales of goods is primarily governed by s. 52 of the 1979 Act,[66] which applies only to contracts in respect of "specific" or "ascertained" goods. Ascertained goods are not defined in the Act, although it has been said[67] that these are "goods identified in accordance with the agreement after the time a contract of sale is made", which definition (it is submitted) encompasses a newbuilding, at least in the later stages of her construction.

It is, however, clear that the remedy of specific performance is not normally available to the purchaser under a shipbuilding contract to compel the builder to complete and deliver the vessel.[68] Although sometimes made in the context of sales of second-hand ships,[69] the English courts have taken the view that orders for specific performance cannot adequately be supervised in the context of large-scale shipbuilding projects. Thus in *Gyllenhammar & Partners International Ltd* v. *Sour Brodogradevna Split* (1989)[70] Hirst J., referring to the detailed specifications for the vessel, stated that these evidenced:

" . . . a very complex contract requiring extensive co-operation between the parties on a number of matters, particularly modifications, optional variations, and, perhaps most important of all, matters of detail (some by no means unimportant) left undefined in the specification. In my judgment these factors, coupled with the consideration that the work would take place in a foreign yard, outside the Court's jurisdiction, would tell strongly against an order for specific performance being in principle appropriate in the present case."[71]

This represents a serious potential exposure for the buyer. Where, against the background of a rapidly rising newbuilding market, the builder refuses to complete or deliver the vessel, the lack of a remedy of specific performance may leave the buyer with the unsatisfactory choice of claiming damages by way of arbitration proceedings or seeking to incentivise the builder by agreeing either to an increase in the price or to other changes in the contractual arrangements sought by the builder.

65 In *Eximenco Handels A.G.* v. *Partrederiet Oro Chief and Levantes Maritime Corporation (The "Oro Chief")* [1983] 2 Lloyd's Rep. 509, Staughton J. indicated that the seller's inability to meet a judgment in damages against him would be a factor militating in favour of the making of an order for specific performance.

66 Note, however, the granting of the remedy outside the framework of the 1979 Act (and at the behest of the seller) in *Astro Exito Navegacion S.A.* v. *Southland Enterprise Co. Ltd (The "Messiniaki Tolmi")* [1983] 2 A.C. 787, see page 131, *supra*.

67 *Per* Atkin L.J. in *Re Wait* [1927] Ch. 606 at page 630.

68 In *Merchants' Trading Co.* v. *Banner* (1871) L.R. 12 Eq. 18, an agreement for the lengthening of a vessel was held to be "a contract which the Court cannot possibly perform" (*per* Lord Romilly M.R. at page 23). This is probably overstating the position in light of the subsequent decision in *James Jones & Sons Ltd* v. *Earl of Tankerville* [1909] 2 Ch. 440.

69 See, e.g., *C.N. Marine Inc.* v. *Stena Line A/B and Regie Voor Maritiem Transport (The "Stena Nautica") (No. 2)* [1982] 2 Lloyd's Rep. 336.

70 [1989] 2 Lloyd's Rep. 403.

71 At page 422. Where the requirement of supervision is no longer present, i.e., because the contract works are substantially completed, it is nevertheless submitted the situation will be akin to the sale of a second-hand ship and that an order for specific performance should in principle be available to the buyer; this was in fact the effect of the decision in *Harland & Wolff*, *supra* at n. 42. However, note also the refusal of such a remedy in *Société des Industries Metallurgiques S.A.* v. *Bronx Engineering Co. Ltd* [1975] 1 Lloyd's Rep. 465.

Article XI—Buyer's default

1. Definition of Default:

The BUYER shall be deemed to be in default of performance of its obligations under this Contract in the following cases:

(a) If the BUYER fails to pay any of the First, Second and Third Installments to the BUILDER within three (3) days after such Installment becomes due and payable under the provisions of Article II hereof; or

(b) If the BUYER fails to pay the Fourth Installment to the BUILDER concurrently with the delivery of the VESSEL by the BUILDER to the BUYER as provided in Article II hereof; or

(c) If the BUYER fails to take delivery of the VESSEL, when the VESSEL is duly tendered for delivery by the BUILDER under the provisions of Article VII hereof.

2. Interest and Charge:

If the BUYER is in default to payment (*sic*) as to any Installment as provided in Paragraph (a) and (b) of this Article, the BUYER shall pay interest on such Installment at the rate of ..... per cent (.....%) per annum from the due date thereof to the date of payment to the BUILDER of the full amount including interest; in case the BUYER shall fail to take delivery of the VESSEL as provided in Paragraph 1(c) of this Article, the BUYER shall be deemed in default of payment of the Fourth Installment and shall pay interest thereon at the same rate as aforesaid from and including the day on which the VESSEL is tendered for delivery by the BUILDER.

In any event of default by the BUYER, the BUYER shall also pay all charges and expenses incurred by the BUILDER in consequence of such default.

3. Effect of Default:

(a) If any default by the BUYER occurs as provided herein before, the Delivery Date shall be automatically postponed for a period of continuance of such default by the BUYER.

(b) If any default by the BUYER continues for a period of fifteen (15) days, the BUILDER may, at its option, rescind this Contract by giving notice of such effect to the BUYER by cable confirmed in writing. Upon receipt by the BUYER of such notice of rescission, this Contract shall forthwith become null and void and any of the BUYER'S Supplies shall become the sole property of the BUILDER.

In the event of such rescission of this Contract, the BUILDER shall be entitled to retain any Installment or Installments theretofore paid by the BUYER to the BUILDER on account of this Contract.

4. Sale of VESSEL:

(a) In the event of rescission of this Contract as above provided, the BUILDER shall have full right and power either to complete or not to complete the VESSEL as it deems fit, and to sell the VESSEL at a public or private sale on such terms and conditions as the BUILDER thinks fit without being answerable for any loss or damage.

(b) In the event of the sale of the VESSEL in its completed state, the proceeds of the sale received by the BUILDER shall be applied firstly to payment of all expenses attending such sale and otherwise incurred by the BUILDER as a result of the BUYER'S default, and then to payment of all unpaid Installments of the Contract Price and interest on such Installments at the rate of ..... per cent (.....%) per annum from the respective due dates thereof to the date of application.
(c) In the event of sale of the VESSEL in its incompleted (*sic*) state, the proceeds of sale received by the BUILDER shall be applied firstly to all expenses attending such sale and otherwise incurred by the BUILDER as a result of the BUYER'S default, and then to payment of all costs of construction of the VESSEL less the Installments so retained by the BUILDER and compensation to the BUILDER for a reasonable loss of profit due to the rescission of this Contract.
(d) In either of the above events of sale, if the proceeds of sale exceeds the total of amounts to which such proceeds are to be applied as aforesaid, the BUILDER shall promptly pay the excess to the BUYER without interest, provided however, that the amount of such payment to the BUYER shall in no event exceed the total amount of Installments already paid by the BUYER and the cost of the BUYER'S Supplies, if any.
(e) If the proceeds of sale are insufficient to pay such total amounts payable as aforesaid, the BUYER shall promptly pay the deficiency to the BUILDER upon request.

Under the majority of shipbuilding contracts the principal obligations assumed by the buyer are to pay the various instalments of the contract price as they fall due and to accept delivery of the vessel when duly tendered by the builder. Because the timely performance of these promises is of crucial importance to the builder, it is usual for the parties to agree upon the effect of a default by the buyer, rather than merely leaving the builder to pursue his common law remedies for breach of contract. Such common law remedies will, however, normally continue to remain available to the builder.

THE DEFINITION OF DEFAULT

The nature and scope of the events defined as constituting buyer's default will vary from one shipbuilding contract to another, depending largely upon the buyer's financial standing and the extent to which payment of the price is guaranteed or otherwise secured. Almost all shipbuilding contracts provide at minimum, however, that the buyer will be in default if he fails to make timely payment of any instalment of the contract price.

Article XI of the SAJ Form stipulates that the buyer shall be deemed in default:

(a) where any of the pre-delivery instalments of the contract price are not paid within three days of their due date;
(b) where the fourth instalment is not paid upon delivery of the vessel; or
(c) where the buyer fails to take delivery when the vessel has been "duly tendered" by the builder in accordance with the terms of Article VII.

It is at first sight difficult to see why the SAJ Form should provide for both defaults (b) and (c); if the buyer has paid the final instalment of the contract price, it is almost inconceivable that he would fail to take delivery of the Vessel.[1] If, however, the buyer delays in fulfilling his obligation to accept delivery, the existence of default (c) permits the builder to recover under Article XI.2 any additional costs he may in the interim have

1 This may be a drafting error. Default (b) should more logically refer to a failure to secure payment of the delivery instalment as required by Article II.4(d); this is sometimes expressly provided (see overleaf).

sustained in safeguarding or maintaining the vessel from the date she was first validly tendered for delivery. This claim will be additional to the builder's claim for "reasonable mooring charges" under Article VII.6.

The standard wording of the SAJ Form is often amended to incorporate additional events of buyer's default. In particular, where the contract provides for the delivery instalment to be deposited in an account at the builder's bank prior to the scheduled date of delivery and released to the builder against presentation of a duly executed Protocol of Delivery and Acceptance, it will normally be a default for the buyer not to furnish the deposit on the agreed terms. The contract may also incorporate a number of general events of default relating to the buyer's financial position (and similar to those discussed in the previous chapter in the context of default by the builder).

The defined events of buyer's default under CMAC Form[2] are similar to those contained in the SAJ Form. However, the NEWBUILDCON Form provides for a different regime, at least in the period prior to the builder's termination of the contract, which is arguably more favourable to the buyer. In particular, this form contains no specific definition of "buyer's default", such issue being primarily addressed in the terms of the remedies of suspension and termination of the contract available to the builder (see further below).

NOTICE OF DEFAULT

It should be noted that the Buyer's Default provisions of the SAJ Form are automatic in operation, i.e., there is no requirement upon the builder to give notice of default to the buyer in order for the builder's remedies to begin to accrue.[3]

In contrast, Article XXII.2 of the CMAC Form contains a requirement that the builder should "*notify the BUYER in writing on the date of occurrence of the default as per Paragraph 1 of this Article and the BUYER shall forthwith acknowledge in writing to the BUILDER that such notification has been received*." The giving of notice of default by the builder to the buyer is a condition precedent to the former's right to terminate the contract.[4]

There are no such equivalent provisions under the NEWBUILDCON Form, which (as indicated) addresses the issue of buyer's default only in terms of the remedies available to the builder. The builder's right to terminate the contract for default is nevertheless always conditional upon prior notice being given to the buyer (see below).

THE EFFECT OF DEFAULT

Under most international shipbuilding contracts, the occurrence of an event of default on the part of the buyer has a number of specifically defined effects upon the performance of the parties' contractual obligations; this is in other words not an issue which normally falls to be determined by English common law principles.

2 See Article XXII.1.
3 This provision is in practice often modified to require the builder to give notice of default to the buyer.
4 Article XXII.4(2)(i).

First, where the default consists of a failure to pay any instalment of the contract price, the buyer usually becomes obliged to pay interest thereon at an agreed default rate from the due date until payment in full (including interest) is made to the builder.[5] The contract will usually define the default rate of interest to be applied, which will typically reflect the cost to the builder of borrowing in the currency of the contract to "fund" the buyer's late payment. The SAJ Form stipulates a fixed rate of default interest, although this language is often amended to provide for a floating, rather than a fixed, rate calculated at a margin over London or New York interbank borrowing rates.

In contrast, the NEWBUILDCON Form makes no specific provision, at least prior to termination, for the payment by the buyer of default interest on late instalments of the contract price. This issue is instead addressed in the general provisions of Clause 18 of the form, which state that:

"if either Party fails to pay any sum due in accordance with the terms of this Contract, the other Party shall have the right to charge interest from the due date at the rate stated in Box 30".

Secondly, irrespective of the nature of the default, the buyer may become contractually liable to meet the builder's charges and expenses incurred as a consequence of the default.[6] This is specifically the case under Article XI.2 of the SAJ Form, which provides for a broad ranging indemnity in favour of the builder, there being no requirement upon him (as would be necessary in a claim for damages) to demonstrate that the costs for which he seeks indemnity were reasonably to have been contemplated when the contract was signed as the foreseeable consequences of such a default.[7] Under Article XI.2 the builder is, for example, entitled to recover arrangement or commitment fees (in addition to interest charges) incurred on monies borrowed to finance the buyer's late payments.[8] Where, alternatively, the default consists in the buyer's failure to take delivery of the vessel following a valid tender, the builder will normally recover the costs of maintaining and insuring the vessel for his own account until her acceptance.

The position under the NEWBUILDCON Form is more favourable to the buyer. Prior to termination of the contract, the builder has no right to recover its additional costs (other than default interest[9]) incurred as a result of the buyer's default. This appears somewhat arbitrary, given that the builder is specifically entitled, if he subsequently terminates the contract for the buyer's default, to recoup such cost and expenses from the proceeds of sale of the vessel,[10] but this is probably a reflection of the BIMCO "origins" of this contract form. There is, of course, nothing in the NEWBUILDCON Form to prevent the builder, in circumstances in which he has not terminated the contract, from recovering his costs and expenses as damages for the buyer's breach of contract, although any such claim

5 See Article XI.2 of the SAJ Form and Article XXII.3 of the CMAC Form.

6 The equivalent provisions of Article XXII.3.2 of CMAC Form are poorly drafted and appear incomplete, with the result that the draftsman's intentions on this issue are not clear.

7 This is an indemnity of the type discussed in *The Eurus* [1998] 1 Lloyd's Rep. 351; the builder must show causation, but not foreseeability of loss.

8 In *Parbulk AS* v. *Kristen Marine S.A. and Another* [2010] EWHC 900 (Comm), [2011] 1 Lloyd's Rep. 220, the High Court held that "proven expenses", which were expressly recoverable for breach of certain MOAs for the sale and leaseback of four newbuildings, included "swap costs", i.e., cancellation costs payable under arrangements made by the seller to "hedge" its exposure to floating interest rate liabilities under its financing for the original purchase of the vessels. It is submitted that such costs would equally be recoverable under the builder's indemnity in Article XI.2.

9 See *supra.*

10 See Clause 39(f).

will be subject to the usual English common law rules regarding remoteness, and mitigation, of loss.

As exemplified by Article XI.3(a) of the SAJ Form, the third typical consequence of an event of buyer's default is that the Delivery Date of the vessel is automatically extended for the period of such default, whether or not the vessel's construction has been prejudiced.[11] Where the default comprises non-payment of an instalment of the contract price, such a provision may have the practical effect of conferring a windfall benefit upon the builder, as time for completion of the vessel is extended even if the non-payment has caused no delay. For this reason, the standard SAJ Form wording is often amended to provide that the Delivery Date shall be postponed only to the extent that the buyer's default has actually delayed the builder's construction programme.

Under the NEWBUILDCON Form, however, the buyer is again well protected from the consequences of his own default. The form contains no provision for automatic extension of the Delivery Date by reason of the buyer's default and, short of termination of the contract, limits the builder's remedies to a right to suspend the work should the buyer fail for fifteen Banking Days (i.e., approximately three weeks) to pay any pre-delivery instalment of the contract price.[12] Furthermore, the builder's suspension of the work is characterised under the NEWBUILDCON Form as Permissible Delay in respect of which the builder must:

"notify the Buyer within 10 running days of the occurrence of any event of delay on account of which the Builder asserts that it may have the right to claim an extension of the Delivery Date".[13]

It seems bizarre that, in circumstances in which the buyer has failed to perform his obligations to the builder, the NEWBUILDCON Form appears to envisage that the latter's rights should be limited to an entitlement to suspend the works after fifteen Banking Days' continuing default, and to claim Permissible Delay thereafter.[14] This may be particularly problematic for the builder in circumstances in which the buyer refuses to take delivery of the newbuilding with the intention of seeking to terminate the contract shortly thereafter for alleged delay—in such circumstances, the absence of a right in the builder to an automatic extension of the Delivery Date, commencing immediately upon the date of the buyer's refusal to take delivery, may well leave the builder with only common law remedies, at least in the short term, and prove seriously disadvantageous to him in seeking to enforce delivery and payment.

It should in this context be noted that the buyer's default does not in itself excuse the builder from his own obligations to construct the vessel.[15] Accordingly, until such time as he rescinds the contract, the builder may himself be in breach if he suspends work on the basis of the buyer's default; this is particularly so where, as in *Hyundai Heavy Industries*

11 See also Article XXII.4(1) of the CMAC Form.

12 Clause 39(c).

13 Under Clause 34(b).

14 Note, however, that, although the exercise by the builder of a right of suspension for the buyer's default is included in the definition of "Permissible Delays" in Clause 34 of the NEWBUILDCON Form, any such periods are not taken into account when calculating the 180 days of such delays which the builder is permitted to claim before the buyer becomes entitled to cancel the contract under Clause 39(a)(iii).

15 This principle applies even where the breach constitutes a repudiation of the contract unless the builder chooses to accept the same, thereby terminating both parties' primary obligations; see *Fercometal S.A.R.L.* v. *Mediterranean Shipping Co. S.A.* [1989] 1 A.C. 788. Nor does such a right of suspension arise at common law; see *Channel Tunnel Group* v. *Balfour Beatty* [1992] Q.B. 656 at 666, C.A.

Co. Ltd v. *Papadopoulos and Others* (1980),[16] the contract contains a specific warranty by the builder that the construction of the vessel shall proceed continuously from keel-laying until delivery.[17] In the normal course, however, the builder is unlikely in such circumstances to incur a significant liability to the buyer because the latter's default will either expressly extend the Delivery Date or, in accordance with common law principles, preclude him from claiming liquidated damages for any delay in delivery.[18]

Fourthly, where the default continues for a period of fifteen days, the builder is entitled to terminate the contract by giving notice to the buyer. In such event, the SAJ Form assumes that the vessel will be sold by the builder, in either a completed or uncompleted condition, to recoup the losses he has sustained. Under the NEWBUILDCON Form, however, the builder's express right to terminate only arises in respect of the buyer's failure to make any payment due within twenty-one "Banking Days" and is subject both (i) to five "Banking Days" notice having been given to the buyer; and (ii) the buyer having failed to remedy the default before notice of termination is given to him.[19]

Finally, where the contract provides for a builder's credit,[20] the buyer's default provisions will usually also extend to cover non-payment of any instalment of the contract price, or interest thereon, falling due after delivery. The contract will in such circumstances typically provide for a right in the builder to accelerate the entire outstanding debt; any security granted in favour of the builder to ensure repayment (whether in the form of a mortgage over the vessel or otherwise) will usually become immediately enforceable.

THE EFFECT OF RESCISSION BY THE BUILDER

The SAJ Form provides that, upon the buyer's receipt of the builder's notice of rescission (i.e., termination), the contract "shall forthwith become null and void". This is, however, plainly an error of drafting, as the contract expressly remains alive for the purposes both of regulating the subsequent sale of the vessel and allocating the proceeds of sale between the parties, a process described by Lord Fraser of Tullybelton in *Hyundai*[21] as the "final accounting". Depending upon the amount of the buyer's instalments paid over at the time of the rescission and the value of the vessel realised on her sale, such provisions may confer benefits upon both the builder and the buyer.[22]

Rescission nevertheless brings to an end the builder's obligation to construct and the buyer's obligation to purchase the vessel. It has the following further effects:

Prepaid instalments

Most shipbuilding contracts, including those under the SAJ Form, expressly provide that, in the event of the builder's rescission, he is entitled to retain the instalments of the

16 [1980] 2 Lloyd's Rep. 1.

17 As indicated, the contract may, of course, include a specific term entitling the builder to suspend the works for non-payment or other default by the buyer, *supra*.

18 See pages 65–68, *supra*.

19 Clause 39(b)(ii).

20 See page 43, *supra*.

21 *Supra* at n. 16.

22 The buyer may benefit where newbuilding prices have risen because he is entitled to at least part of the surplus sale proceeds of the vessel after the builder's losses have been made good (see page 219, *infra*).

contract price already paid by the buyer[23]; this is subject, however, to the builder's obligation to give credit to the buyer for such payments in the "final accounting".

Instalments due but unpaid

The legal position is more complex where the builder seeks to recover from the buyer the amount of any instalments of the contract price due but unpaid at the time of rescission. This will typically occur where the buyer encounters financial difficulties during the course of the construction process and the builder is unable or unwilling to alter the agreed payment schedule for the vessel. If the builder then rescinds the contract by reason of the buyer's non-payment, can he still claim the amount of the unpaid instalment from either the builder or the latter's guarantor?

In *Hyundai* the shipbuilders rescinded the contract pursuant to an express term for non-payment of the second instalment of the contract price. They then sued the purchaser's guarantors for the amount of that instalment. The guarantors argued that the shipbuilders' exercise of their right of rescission had relieved the purchaser from liability to pay the instalment by substituting therefor an obligation to pay damages, performance of which they had not guaranteed.

Although the House of Lords decided unanimously in these circumstances that the shipbuilders were entitled to recover from the guarantors, only three of five of their Lordships were prepared to hold that the shipbuilders' subsequent rescission of the contract had not affected their claim for the second instalment; Lords Russell and Keith in particular plainly felt that, while the claim against the guarantors had crystallised before the contract was rescinded (and was accordingly unaffected), the shipbuilders' rescission of the contract would have prevented recovery of the amount of the instalment from the purchaser directly.

The problem facing the House of Lords in *Hyundai* was that there is longstanding authority, represented by the judgment of Stable J. in *Dies* v. *British and International Mining and Finance Corporation Ltd* (1939),[24] supporting the proposition that the purchaser's repudiation of a contract for the sale of goods does not prevent him from recovering his pre-payments of the price, at least to the extent that these exceed the vendor's recoverable damages. If (it was said in *Hyundai*) pre-paid instalments, less an allowance for the proven damages, are as a general principle recoverable by a defaulting purchaser, why should the builder be automatically entitled to recover the amount of any instalments accrued due but unpaid? In other words, is he not adequately compensated by the right to claim contractual damages for the buyer's breach?

In *Hyundai* Viscount Dilhorne and Lord Fraser distinguished *Dies* on the grounds that the contract in the latter was for the sale of goods, which unlike a shipbuilding contract, "did not require the vendor to perform any work or incur any expense on the subjects of sale".[25] This reasoning is, however, far from convincing. Quite apart from the long line

23 A similar provision is contained in Clause 39(f) of NEWBUILDCON Form.

24 [1939] 1 K.B. 724.

25 *Per* Lord Fraser at page 13. The remaining judge, Lord Edmund-Davies, held that the amount of the first instalment (2.5% of the contract price) was insufficient to attract the rule established in *Dies*; it is, however, difficult to see why the quantum of the pre-payment should affect the application of the general principle.

of earlier authorities which had previously held that shipbuilding agreements are indeed contracts for the sale of goods,[26] the distinction between such contracts and those where one party "performs work or incurs expenditure" is difficult to justify. Under a contract of sale, the seller of goods may equally incur advance expenditure in buying in the goods needed to perform his obligations; there is no obvious reason why his position should be regarded as distinct from that of a party who has incurred advance expenditure in preparing to render services.

The decision in *Hyundai* has, however, since been followed and affirmed by the House of Lords in *Stocznia Gdanska S.A.* v. *Latvian Shipping Co. Latreefer Inc. and others* (1998),[27] a case involving a series of contracts for the construction of six vessels in Poland, each of which contained (at Article 5.05 thereof) buyer's default provisions similar to those of the SAJ Form.

In *Stocznia Gdanska* the buyer had paid the first instalment of the price under each contract but then ran into financial difficulties and sought from the builder both a reduction in the price and a postponement of the vessels' delivery dates. During the course of continuing negotiations between the parties, the builder laid the keels of the first two vessels but the buyer failed to pay instalments due thereon, whereupon the builder exercised its contractual right of rescission.

By way of defence to the builder's application for summary judgment in respect of each keel-laying instalment, the buyer argued:

(a) that as a matter of common law the builder's decision to rescind, in consequence of which neither vessel would be ever delivered to the buyer, gave rise to a total failure of consideration under each contract which discharged the latter from the obligation to pay the keel-laying instalment;[28] and
(b) that, upon its true construction, Article 5.05[29] only permitted the builder to retain instalments of the price, and by analogy to sue for those due but unpaid prior to rescission, where the builder could prove that these were required to compensate him for actual losses sustained in consequence of the rescission.[30]

The House of Lords dismissed both of these arguments holding that the buyer had no arguable defence to the claim in debt for the instalments.

As to the first submission, their Lordships held, following *Hyundai*, that the contract was: (*per* Lord Goff) not "simply a contract for the sale of a ship [but] . . . rather a contract under which the design of the vessel formed part of the yard's contractual duties, as well as the duty to transfer the finished object to the buyers . . . ".[31] In circumstances in which the builder had commenced construction of the vessels before the contracts were rescinded, there had been no total failure of consideration and it was not therefore open to the buyer to contend that the unpaid instalments were not due.

26 See page 1, *supra*.

27 [1998] 1 Lloyd's Rep. 609, H.L.

28 The buyer conceded, however, that he remained liable to pay to the builder such sums as might fall due upon the "final accounting" to be undertaken following the vessel's sale.

29 Which was similar to Articles XI.3 and 4 of the SAJ Form.

30 The buyer contended further that, in consequence of the sale of the hulls to a third party, the builder had in fact suffered no loss.

31 At pages 619–620.

The buyer's contentions as regards the interpretation of Article 5.05 were equally unsuccessful. Although recognising that the contract required the builder ultimately to account to the buyer for any excess of (i) the proceeds of sale and the aggregate of the instalments paid at the date of rescission over (ii) the outstanding balance of the contract price and the builder's sale costs, the House of Lords held, reversing a contrary decision of the Court of Appeal, that this principle did not excuse the buyer from its immediate obligation to settle instalments of the price which had already accrued due to the builder as at the date of rescission. Nothing in Article 5.05 indicated that the builder's rights to recover such instalments in accordance with usual common law principles had been excluded by agreement because such rights could in their Lordships' view only be waived by the use of very clear words.

It should also be noted that, during the course of earlier hearings before the High Court and the Court of Appeal, the buyer had additionally contended[32] that the builder was not entitled to claim the keel-laying instalments because it had acted unreasonably in proceeding with keel-laying after the buyer had indicated that it would not perform the contracts.

This rather unattractive argument failed, the High Court holding that the builder would have been unable to claim the instalments in question only if it had acted "wholly unreasonably" in proceeding to lay the keels. The court found, however, on the facts that, against the background of continuing equivocation on the part of the buyer as to whether it would perform the contract "the obvious course" was for the builder to continue to progress the construction in the normal manner to keel-laying. The argument was abandoned by the buyer before the House of Lords and appears to be unlikely to be successful other than in extreme cases, i.e. where the builder has no "legitimate interest"[33] in proceeding with construction of the vessel and has done so specifically and exclusively for the purposes of claiming the related instalment.

Unlike the agreements considered in *Hyundai* and *Stocznia Gdanska*, the SAJ Form standard wording specifically provides that the contract shall become "null and void" upon the builder's rescission. However, as previously indicated, this language cannot be meant to have literal effect,[34] and it seems unlikely in practice that the buyer would succeed in contending that upon rescission he is excused by reason of this language from previously accrued obligations to pay instalments of the contract price.

Unless, therefore, the buyer is able to show that nothing has been done by the builder in performance of the contract before this has been rescinded, i.e., there is a total failure of consideration, it seems unlikely that the buyer can in normal circumstances resist the builder's claim for unpaid instalments of the contract price on the grounds that the builder has chosen to treat non-payment as the basis for terminating the contract.

32 On the basis of the well-known case of *White and Carter (Councils) Ltd* v. *McGregor* [1962] A.C. 413.

33 See, by analogy, *Attica Sea Carriers Corporation* v. *Ferrostaal Poseidon Bulk Redeerei GmbH* [1976] 1 Lloyd's Rep. 250. Note, however, that in *Isabella Shipowner S.A.* v. *Shagang Shipping Co. Ltd* [2012] EWHC 1077 (Comm), the High Court emphasised that the burden upon the contract breaker of showing that the innocent party should be confined to a claim in damages (rather than continuing to insist upon contractual performance) is high. In the words of Cooke J. (at paragraph 44 of his judgment): "the effect of the authorities is that an innocent party will have no legitimate interest in maintaining the contract if damages are an adequate remedy and his insistence upon maintaining the contract can be described as 'wholly unreasonable', 'extremely unreasonable' or, perhaps . . . perverse".

34 See page 213, *supra*.

Future instalments

In the absence of express contrary wording, the effect of the builder's rescission is to preclude him from recovering any future instalments of the contract price.[35] In giving judgment in *Hyundai*, Lord Fraser stated that:

" . . . nobody has suggested that future instalments (that is, instalments which have not fallen due for payment by the date of cancellation of the contract) are payable. It is, I think, clear that they cease to be payable as instalments, and are replaced by the buyer's obligation to pay any deficiency brought out in the final accounting."[36]

It should be noted in this context that the standard guarantee used in relation to the SAJ Form (which ensures the "due and faithful performance by the buyer of all its liabilities and responsibilities under the Contract") plainly extends to any amounts owed by the buyer to the builder when such accounts have been drawn.[37]

Buyer's supplies

The further effect of the builder's lawful rescission of a contract on the SAJ Form wording is to transfer to him title to the buyer's supplies; this is needed to ensure that the sale of the vessel is not hindered by doubts as to the builder's legal title to parts, machinery and equipment provided by the buyer which may have already have been incorporated within the vessel.

Although buyer's supplies are defined at Article XVII of the SAJ Form as "all of the items to be furnished by the Buyer as specified in the Specifications", it seems doubtful that the transfer provisions of Article XI.3(b) are intended to apply to materials which have not yet been delivered to the shipyard at the time of rescission. This point is expressly addressed in Clause 39(f) of the NEWBUILDCON Form which provides that in the event that the contract is terminated, the buyer is entitled, among other things, to " sell the Vessel" (either in its complete or incomplete form) including those buyer's supplies which are installed or have been utilised on board the Vessel".[38]

SALE OF THE VESSEL

After rescinding the contract, the builder is generally permitted the option either to abandon the project and dispose of the vessel in an uncompleted condition, or to continue

35 Article XXII.4(ii) of the CMAC Form, in common with earlier Chinese standard form contracts, seeks to overcome this result by including an express provision that in the event of the buyer defaulting in payment of any pre-delivery instalment: " . . . The BUILDER shall . . . have the right to declare all unpaid 2nd, 3rd, and 4th instalments to be forthwith due and payable, and upon such declaration, the BUILDER shall have right to immediately demand the payment of the aggregate amount of the all unpaid 2nd, 3rd and 4th instalments from the Guarantor in accordance with the terms and conditions of the guarantee issued by the guarantor". Such provision will not, of course, normally be enforceable against the buyer's guarantor unless it is replicated in the guarantee itself.

36 [1980] 2 Lloyd's Rep. 1 at page 13.

37 See page 280, *infra*.

38 See generally pages 259–260, *infra*.

with construction and sell her once completed[39]; his choice will largely be determined by the stage of the project he has reached and the state of the newbuilding market at the time of rescission.

Under the SAJ Form, the builder is not, however, compelled to effect a sale—in *Stocznia Gdanska*,[40] where similar contract wording was in issue, Lord Goff, disagreeing with the views of the Court of Appeal, expressly recognised that "there may be circumstances in which there is no buyer available, or in which the seller's duty to mitigate requires a different course to be taken".[41]

Depending upon the circumstances, it may, for example, be open to the builder simply to incorporate reusable parts of the cancelled vessel into another newbuilding and to give credit to the buyer for the costs savings thereby achieved.

The *Stocznia Gdanska* decision also indicates, however, that, at least where the keel has been laid, the completion of the vessel to a different specification for another purchaser does not prevent her from being "sold" to such third party within the meaning of the SAJ Form wording. In that case, the builder had rescinded contracts for the construction of a series of reefer newbuildings for which it had laid the keels of the first two vessels. When the buyer failed to pay the keel-laying instalments, the builder rescinded the contracts and negotiated the terms with a third party purchaser to complete the vessels as reefer ships on the basis of changes to the specification which (it was assumed for the purposes of the legal proceedings) had not changed the contract price by more than plus or minus 5%. In the context of an argument relating to damages, the builder contended that in these circumstances it had not sold the vessels but had merely incorporated certain of their materials and machinery into the building of new ships.

This argument was, however, rejected by the House of Lords which held that the vessels had in fact been sold rather than their constituent elements incorporated into new ships. In the words of Lord Lloyd of Berwick:

"The fact that the specifications were not identical is irrelevant. In practical terms the hulls were completed and sold within the meaning of clause 5.05(2). If vessels 1 and 2 had already been launched before rescission, there would have been no doubt as to the application of clause 5.05(2). It would be absurd to require the yard to complete the vessels as a speculation before selling to a third party. The fact that these particular contracts were rescinded at an earlier rather than a later stage cannot affect the construction of the clause."[42]

It is nevertheless submitted that this question must always remain one of fact and that the builder's decision to re-use pre-assembled blocks or other parts will not necessarily lead to a "sale" of the vessel within the meaning of the relevant default clause. This is particularly so where the keel has had not been laid and/or where the new buyer seeks

39 Provisions of this type were described by Steel J. in *Stellar Shipping Co. LLP* v. *Cosco (Dalian) Shipyard Co. Ltd* [2011] EWHC 1278 (at paragraph 23 of his judgment) as "almost standard terms in shipbuilding contracts". This decision, relying in part on the judgment of the Court of Appeal in *Societe des Industries Metallurgiques* v. *Bronx Engineering Co. Ltd* [1975] 1 Lloyd's Rep. 465, confirms that, in circumstances in which the builder's termination of the contract is disputed, the buyer will not be entitled to injunctive relief to prevent the builder's sale of the vessel unless damages for wrongful termination would not represent an adequate remedy because, for example, the vessel is genuinely "unique".

40 [1998] 1 Lloyd's Rep. 609, H.L.

41 At page 618. This issue will nevertheless turn on the precise wording of the contract and it should be noted in this context that Clause 39(f) of the NEWBUILDCON Form states that the builder: "shall have right and power either to complete or not to complete the Vessel as it deems fit but in any event shall sell the Vessel *(either in its incomplete or incomplete form) . . . at the best price reasonably obtainable*" (emphasis added).

42 At page 626.

substantial changes to the specifications originally agreed in respect of the cancelled project.

The SAJ Form provides that the sale of the vessel may take place publicly[43] or privately "on such terms and conditions as the builder thinks fit without being answerable for any loss or damage". This is, however, clearly to be read as subject to an implied duty of good faith, which the builder will breach if he knowingly sells the vessel at an undervalue. Some standard shipbuilding contracts, including the NEWBUILDCON Form, contain an express stipulation that the builder should sell the vessel at the "best price reasonably obtainable" at a public or a private sale "on reasonable terms and conditions".[44] However, even where the contract does not contains such express obligation, and notwithstanding the absence of judicial authority directly on this point, it is submitted that the builder's obligations in this situation are akin to those of a mortgagee exercising a power of sale who must "take reasonable precautions to obtain the true market value of the mortgaged property at the date on which he decides to sell it".[45]

Article XI.4 of the SAJ Form preserves a distinction between the sale of the vessel in its "completed" and "uncompleted" state.[46] In relation to the former, the builder is entitled to be placed in a position in which he would have stood if the contract price had been paid in full, i.e., the net sale proceeds are applied to meet all of the outstanding instalments of the contract price, together with interest at an agreed rate from the dates on which the instalments fell due until the date of application. This arrangement obviously gives rise to some uncertainty where the contract provides for a builder's credit; where, however, the contract stipulates that any event of default will, at the builder's option, accelerate the buyer's obligation to pay post-delivery instalments, it seems likely that interest will be calculated from the date of the default on the assumption that such a notice would have been given.

Where the vessel is sold in an incomplete state, it is obviously inappropriate that the contract price should be payable in full from the sale proceeds. In such circumstances, the net sale proceeds will be applied to reimburse the builder's costs of construction to the extent that these have not already been recouped from instalments paid by the buyer. This formula may, of course, confer a windfall benefit upon the builder in circumstances in which his costs of construction were greater than originally anticipated when the contract price was originally negotiated and agreed.

To the extent that there is any surplus available following application of the sale proceeds, this is usually shared between the builder and the buyer. However, in order to discourage the possibility that an impecunious buyer in a rising market might deliberately provoke a rescission of the contract, it is customary to provide that the buyer's interest in the surplus should be restricted to the amount of his investment in the project at the time of rescission. This will typically be achieved by limiting the buyer's share to the aggregate of the instalments he has paid and the supplies he has purchased at that time.

43 That is, by open tender or auction. The level of bidding at a public auction will not, however, necessarily indicate the true market value; see *Tse Kwong Lam* v. *Wong Chit Sen and Others* [1983] 3 All E.R. 54.

44 See Clause 39(f) of the NEWBUILDCON Form.

45 *Per* Salmon L.J. in *Cuckmere Brick Co. Ltd* v. *Mutual Finance Ltd* [1971] Ch. 949 at page 966. The purported exclusion of the builder's liability for loss or damage contained in Article XI.4 is probably ineffective; see *Bishop* v. *Bonham* [1988] 1 W.L.R. 742.

46 A similar distinction between " complete" and "incomplete" sale can be found in Clause 39(f)(i) and (ii) of the NEWBUILDCON Form and Articles XXII.5(2) and(3) of the CMAC Form.

Where the final accounting leads to a deficiency, i.e., the net sale proceeds are less than the contract price or the builder's costs of construction, the buyer will normally be obliged to pay the amount of the shortfall to the builder on demand.

In *Neptune Navigation Corporation* v. *Ishikawajima-Harima Heavy Industries Co. Ltd* (1987)[47] this obligation was, unusually, coupled with a right in the buyer to match any offer made for vessel in the sale following the builder's rescission. It was held by the Court of Appeal that, in order to exercise such right, the buyer was required to be "ready, willing and able" to pay the market price (as established by reference to the offers received by the builder) plus the difference between (i) the contract price and (ii) the aggregate of the market price and the instalments paid at the date of the builder's rescission. The buyer was thus in effect obliged to meet his obligations in respect of the shortfall as a condition of the exercise of the pre-emption right.

COMMON LAW REMEDIES

Where the buyer seriously breaches the contract, e.g., by refusing to pay an instalment where this is plainly and unquestionably due, the builder may, as an alternative to exercising a contractual right of rescission, be entitled to treat his conduct as a repudiation of the agreement.

Although s. 10(1) of the 1979 Act provides that, unless a "different intention appears", terms relating to the time of payment are not usually "of the essence" (i.e., conditions of the contract whose breach will entitle the other party to terminate at common law), this proposition was doubted in a shipbuilding context by the Court of Appeal in *Stocznia Gdanska S.A.* v. *Latvian Shipping Co. (No. 2)* (2002).[48] Where the shipbuilding contracts expressly provided for the keel-laying instalments to be paid upon five banking days' notice of such event and for the builder to be entitled to rescind where payment had not been made within a 21-day "grace period" thereafter, the Court of Appeal held that payment by such later date was a condition of the contract. According to Rix L.J., delivering the principal judgment:

> " . . . while I accept that there is a breach on the fifth day, which I would also accept is at that time non-repudiatory, for the contract expressly allows a further 21 days before the yard can rescind, there is either a further breach, called under the clause a 'default', when payment remains unpaid after another 21 days or else the parties have expressly agreed to regard such continued non-payment as turning the original breach into a repudiatory one."[49]

Where the buyer commits such a repudiatory breach, the builder may elect either (i) to affirm the contract,[50] i.e., to maintain this in existence, in which event he will normally sue the buyer in debt or damages for the breach in question or (ii) to "accept" the breach,

47 [1987] 1 Lloyd's Rep. 24.

48 [2002] EWCA Civ 889.

49 At paragraph 81 of the judgment.

50 The Court of Appeal decision in *Stocznia Gdanska (No. 2)* contains an extensive and very technical discussion as to whether, by issuing notices (subsequently held to be invalid) which demanded payment of the keel-laying instalments for hulls 3–6, the builder had affirmed the contracts for these vessels, thereby preventing it from treating the buyer in repudiatory breach. The Court (*per* Rix L.J.) held that, in circumstances in which the buyer persistently refused to confirm its willingness to perform the contracts, it committed an "anticipatory" and continuing breach of contract which the builder was entitled to accept, thereby terminating the contracts, notwithstanding its prior demand for payment of the keel-laying instalments.

bringing to an end the parties' respective obligations to construct and purchase the vessel and substituting therefore a secondary obligation upon the buyer to pay damages for the builder's loss of bargain.

In *Stocznia Gdanska (No. 2)*,[51] the Court of Appeal, confirming an earlier decision of Thomas J. in the High Court[52] held that the builder's express rights of rescission for non-payment of an instalment did not constitute a "complete code" under the shipbuilding contracts which was intended to replace the operation of common law principles. In the judge's view, an effective exclusion of the right to claim damages at common law required very clear words and such an intention could not be derived from a clause entitling, but not obliging, the builder to exercise a right of rescission for non-payment of an instalment by the buyer. The builder was therefore entitled to pursue a claim in damages for the buyer's actual repudiatory breach in failing to pay the keel-laying instalments for the first two vessels and his "anticipatory" repudiatory breach in indicating that he would not accept and pay for further performance of the contracts for the third to sixth vessels.

Acceptance of the buyer's conduct as a repudiation does not, however, bring to an end the builder's right to sue in debt for any instalments of the price unpaid as at that time.

In *Hyundai Shipbuilding and Heavy Industries Co. Ltd* v. *Pournaras* (1978)[53] the failure by purchasers of four newbuildings to pay part of the first and the second instalments of the price was treated as a repudiatory breach by the shipbuilders, who thereupon sued the purchasers' personal and corporate guarantors. Anticipating in a slightly different context the contentions later to be advanced in the *Papadopoulos* case,[54] the guarantors argued that they were obliged only to ensure performance of the purchasers' obligations, rather than that the instalments would be payable in any event; they also contended that such obligations had ceased upon acceptance of their repudiation, being then subsumed within the shipbuilders' claim in damages consequent upon the loss of the contract.

Both arguments were rejected by the Court of Appeal, Roskill L.J. holding:

> " . . . the fact that these contracts came to an end on Oct. 21, 1976, did not free the buyers from their respective obligations to pay the various instalments, liability for which had already accrued and accordingly . . . the guarantors' several liabilities for those instalments under the respective guarantees remained wholly unaffected."[55]

The court also rejected an argument, based on *Dies*, that the guarantors were entitled to set off against their liability such sums as they anticipated might be payable to the purchasers upon completion of the "final accounting".

51 *Ibid*.
52 [2001] 1 Lloyd's Rep. 537.
53 [1978] 2 Lloyd's Rep. 502.
54 *Supra*, at n. 16.
55 At page 507.

Article XII—Insurance

1. Extent of Insurance Coverage:

From the time of keel-laying of the VESSEL until the same is completed, delivered to and accepted by the BUYER, the BUILDER shall, at its own cost and expense, keep the VESSEL and all machinery, materials, equipment, appurtenances and outfit, delivered to the Shipyard for the VESSEL or built into, or installed in or upon the VESSEL, including the BUYER'S Supplies, fully insured with Japanese insurance companies under coverage corresponding to the Japanese Builder's Risks Insurance Clause.

The amount of such insurance coverage shall, up to the date of delivery of the VESSEL, be in an amount at least equal to, but not limited to, the aggregate of the payment made by the BUYER to the BUILDER including the value of the BUYER'S Supplies.

The policy referred to hereinabove shall be taken out in the name of the BUILDER and all losses under such policy shall be payable to the BUILDER.

If the BUYER so requests, the BUILDER shall at the BUYER'S cost procure insurance on the VESSEL and all parts, materials, machinery and equipment intended therefor against risks of earthquake, strikes, war peril or other risks not heretofore provided and shall make all arrangements to that end. The cost of such insurance shall be reimbursed to the BUILDER by the BUYER upon delivery of the VESSEL.

2. Application of Recovered Amount:

(a) Partial Loss:

In the event the VESSEL shall be damaged by any insured cause whatsoever prior to acceptance thereof by the BUYER and in the further event that such damage shall not constitute an actual or a constructive total loss of the VESSEL, the BUILDER shall apply the amount recovered under the insurance policy referred to in Paragraph 1 of this Article to the repair of such damage satisfactory to the Classification Society, and the BUYER shall accept the VESSEL under this Contract if completed in accordance with this Contract and Specifications.

(b) Total Loss:

However, in the event that the VESSEL is determined to be an actual or constructive total loss, the BUILDER shall by the mutual agreement between the parties hereto, either:

(i) proceed in accordance with the terms of this Contract, in which case the amount recovered under said insurance policy shall be applied to the reconstruction of the VESSEL'S damage, provided the parties hereto shall have first agreed in writing as to such reasonable postponement of the Delivery Date and adjustment of other terms of this Contract including the Contract Price as may be necessary for the completion of such reconstruction or

(ii) refund immediately to the BUYER the amount of all Installments paid to the BUILDER under this Contract without any interest, whereupon this Contract shall be deemed to be rescinded and all rights, duties, liabilities and obligations of each of the parties to the other shall terminate forthwith.

If the parties hereto fail to reach such agreement within two (2) months after the VESSEL is determined to be an actual or constructive total loss, the provisions of sub-paragraph (b)(ii) as above shall apply.

3. Termination of BUILDER'S Obligation to Insure:

The BUILDER'S obligation to insure the VESSEL hereunder shall cease and terminate forthwith upon delivery thereof and acceptance by the BUYER.

Throughout the course of her construction, outfitting and trials the vessel will face significant risks of physical loss and damage. As noted previously, these risks customarily fall upon the builder,[1] although both parties to the contract will normally wish to be satisfied that he is adequately insured against such exposures. The buyer will in particular wish to know that, in the event of a casualty, the builder will be able either to repair the damage without financial support from the buyer or to refund the buyer's advance instalments of the contract price if repair of the vessel should be uneconomic.[2]

The majority of modern shipbuilding contracts accordingly impose upon the builder an obligation to insure the vessel in respect of so-called "builders' risks" from the time of her keel-laying until delivery; the sum insured must normally be not less than the total of the contract price instalments from time to time paid by the buyer. The insurance will usually be taken out in the builder's name alone, although this is not always so, particularly if the project is likely to involve the provision of buyer's supplies of a substantial value.

Apart from defining the nature and scope of the obligation to insure, the contract will also detail the parties' rights and obligations in the event of a loss, whether partial or total, affecting the vessel prior to her delivery and acceptance.

THE DUTY TO INSURE

Article VII.5 of the SAJ Form provides that "until . . . delivery is effected, title to and risk of loss of the VESSEL and her equipment shall be in the BUILDER, excepting risks of war, earthquakes and tidal waves".[3] The builder is not, however, directly liable for loss of the buyer's supplies, although he must exercise "reasonable care" in their storage and handling following delivery to the shipyard (Article XVII.2).

To ensure that he is protected against the risks of physical loss or damage, the builder is obliged under Article XII to insure the vessel and all machinery (including the buyer's supplies) delivered to the shipyard or incorporated into the vessel under coverage corresponding to the Japanese Builder's Risks Insurance Clauses; coverage is, however, required to be effected only from the time of keel-laying and, given the modern practice of undertaking substantial block construction and sub-assembly prior to laying the vessel's keel, this term is in practice often amended to provide for inception of the insurance coverage upon steel-cutting. Apart from the value of the buyer's supplies, the policy must

1 See pages 143–144, *supra*. As previously noted, the builder's assumption of risk confers upon him an "insurable interest" in the vessel within the meaning of s. 5 of the Marine Insurance Act 1906; without this, the policy will be unenforceable at law.

2 The buyer will normally be secured in part by a refund guarantee, although, depending upon its terms, this may respond only if the contract is rescinded.

3 Although, at least in an export context, the exceptions of war etc are in practice normally deleted and assumed by the builder.

cover the aggregate of the instalments of the contract price paid from time to time by the buyer. The builder need not, however, take into account interest on the pre-paid instalments as this is not payable where the instalments are refunded consequent upon a total loss (Article XII.2).

In the context of export orders, Article XII.1 of the SAJ Form is also normally amended to provide that the insurance coverage should be placed on the terms of the Institute of London Underwriters (ILU) 1988 Builders' Risks Clauses or other London insurance clauses (see below), rather than the Japanese wording. It may also be supplemented by a term requiring that the builder should, within a specific period following inception of the insurance, provide documentary proof to the buyer that coverage has been effected; this may be in the form of either a copy of the policy itself or a broker's cover note.

The NEWBUILDCON[4] and CMAC[5] Forms similarly provide for the assumption by the builder in the pre-delivery period of the risks of loss and damage to the vessel although neither seek to make an exception in respect of war, earthquake or tidal wave risks.

Under the NEWBUILDCON Form, the builder's insurance, which is required to be in place from the date of steel-cutting, must be effected on the "Institute Clauses for Builders' Risks (1/6/88)" terms, including Institute War and Institute Strike Clauses".[6] The insurance must furthermore be taken out "in the joint names (as assureds) of the Builder and the Buyer" and "be provided by insurers reasonably acceptable to the Buyer". Unless the buyer requests additional coverage (in which case he is obliged to pay for the same), the amount insured is to be determined from time to time as the aggregate of all amounts paid by the buyer to the builder (but not interest thereon) together with the value of the buyer's supplies at the shipyard.

Curiously, the CMAC Form does not provide for a specific form of insurance coverage which the builder is required to arrange, other than that this must be with "a qualified Chinese insurance company", in itself an extremely vague provision. A further distinctive feature of the form lies in the assumption by the buyer of an obligation to "assist the Builder in arranging" the builders' risks insurance "and providing relevant document required by the insurance company"; the scope of the buyer's obligation to assist is not defined, although it seems clear that this is essentially a duty to co-operate, rather than to initiate.

THE JAPANESE BUILDER'S RISKS INSURANCE CLAUSE

The SAJ Form requires that the builder's insurance should be placed with Japanese insurance companies "under coverage corresponding to the Japanese Builder's Risks Insurance Clause". It should be noted, however, that, at least in respect of export newbuildings, Japanese shipbuilders in practice frequently use the London insurance clauses (see below).

The so-called Japanese "Special Clauses for Builders' Risks (1/10/92)", as amended in April 2010, insure the builder in respect of "maritime and shore perils" leading to partial or total loss of the vessel, re-launching expenses in the event of a failure to launch and

4 At Clause 31.
5 At Article XVI.
6 The latter clauses apply only from the date of launching, see n. 22 *infra*.

collision, salvage and general average liabilities incurred in the course of the vessel's trials.

They expressly exclude coverage in respect of loss arising from earthquakes or volcanic eruptions. The builder is equally uninsured against protection and indemnity risks, the absence of coverage for pollution liabilities representing in particular a significant limitation upon the scope of the insurance.

THE LONDON INSURANCE CLAUSES

The ILU[7] Institute Clauses for Builders' Risks (1/6/88)[8] (the "1988 Clauses"), which are intended to operate in conjunction with the associated clauses for war and strikes risks, represent the most widely used international form of insurance coverage for vessels under construction. Even where the buyer and the builder have agreed that the latter's insurance may be placed in his own national insurance market rather than in London, it is frequently stipulated that the terms of the policy shall be "equivalent to" or "not less extensive than" the 1988 Clauses.

However, in 2007, a new industry association, the International Underwriting Association of London,[9] published the "London MarCAR 2007 (Marine Construction All Risks 01/09/07)" Clauses (the "2007 Clauses"),[10] which have also gained a significant measure of industry support.

The scope of coverage

The scope of coverage under the 1988 Clauses differs significantly from that provided by the 2007 Clauses, which are designed to cover a broader range of marine construction activities, including conversion and repair.

The 1988 Clauses, which are expressed to be "subject to English law and practice", insure the builder over an agreed timescale (the "provisional period") linked to the vessel's construction programme, but subject to automatic termination upon delivery to the buyer.[11] The underwriters undertake, however, that the vessel will be "held covered" at a premium to be agreed in the event of delay in delivery beyond the provisional period but in no circumstances for more than 30 days from the completion of the trials. The builder must accordingly renegotiate the terms of cover in the event of a significant delay in the delivery and acceptance of the vessel following the completion of her trials.

During the policy period, coverage is provided on a valued basis, linked to the contract price, in respect of:

7 The Institute of London Underwriters.

8 See Appendix C.

9 The product of a merger between the ILU and the London International Insurance and Reinsurance Market Association.

10 See Appendix D. These Clauses are reproduced on the basis of permission sought from, and kindly granted by, the International Underwriting Association and the Lloyd's Market Association.

11 The ILU Clauses assume that title to the vessel, her machinery and equipment will pass to the buyer upon delivery. The wording requires amendment if title is to be transferred continuously during the construction period, see pages 140–142, *supra*.

(a) the vessel's "hull and machinery etc." under construction at the shipyard or the builder's other premises "within the port or place of construction at which [the shipyard] is situated", including in transit between such locations;
(b) "machinery etc." which is (i) under construction by the builder's subcontractors or in transit or (ii) delivered to the shipyard.

Cover cannot attach to any item of hull and machinery falling within (a) or (b)(i) unless this has been "allocated" to the vessel. "Allocation" is not defined but probably means the setting aside of the item, either by marking or physical segregation, preparatory to its incorporation within the insured hull.[12]

To the extent that the cover has attached, the underwriters agree to indemnify the builder against:

"all risks of loss of or damage to the subject-matter insured caused and discovered during the period of this insurance including the cost of repairing replacing or renewing any defective part condemned solely in consequence of the discovery therein during the period of this insurance of a latent defect. In no case [however] shall this insurance cover the cost of renewing faulty welds."[13]

Insurance is thus extended on an "all risks" basis in respect of loss or damage to the vessel and, crucially, also to cover the replacement cost of condemned parts where the defect is "latent".[14]

Cover is also provided under the 1988 Clauses for loss caused by "faulty" design,[15] collision and protection and indemnity liabilities (principally pollution clean-up, death and personal injury claims, contacts with fixed or moveable objects and wreck removal) arising out of an "accident or occurrence" during the period of the insurance. Additionally, where the launching of the insured vessel is unsuccessful, the underwriters will pay all expenses subsequently incurred by the builder in completing the same.

Although expressed to cover "all risks of loss of or damage", the 1988 Clauses nevertheless contain a number of specific exclusions of liability, including war risks, earthquake and volcanic eruptions, "strikes" (including terrorist or other politically motivated activities), the detonation of explosives or "any weapon of war" by "any person acting maliciously or from a political motive" and any liability upon the builder by way of workmen's compensation as the result of accident or illness (which extends to any contractual obligation to indemnify the buyer in respect of liabilities to his own employees).

The perils of war and strikes may be reinstated into the builder's policy by agreement with underwriters on the terms of the Builders' Risks War Clauses and Strikes Clauses, respectively.[16] However, in the case of the War Clauses, coverage will only attach from the date of launching and then only as regards items built into, in or on the vessel at that time.[17]

12 This is similar (but not identical) to the meaning of "appropriation" in the context of continuous transfer of title provisions; see pages 140–142, *supra*.
13 Clause 5.1. The exclusion for faulty welding is often deleted by agreement.
14 See *infra*.
15 See *infra*.
16 See Appendix C, *infra*.
17 This reflects the provisions of the so-called Waterborne Agreement of 1937, pursuant to which Lloyd's underwriters agreed not to insure war risks on land; the restriction upon writing war risks was, however, to a certain extent lifted in January 1997.

The 2007 Clauses represent a significant development of coverage provided by the 1988 Clauses. In addition to providing on an "all risks" basis hull and machinery, collision and P & I risks coverage (see below), the Clauses also encompass certain war and strikes risks, terrorism, political activity and malicious acts.[18] Latent defects, as well as defects in materials, workmanship and "design, plan or specification", are, however, excluded although such exclusion does not:

"... extend to the cost of repairing physical loss or physical damage caused by such defect and discovered during the Period of the Insurance, to the extent that the cost of repairing such physical loss or physical damage exceeds the cost that would have been incurred to replace, repair or rectify the said defect had it been discovered immediately prior to the occurrence of the physical loss or physical damage caused thereby".[19]

Part V of the 2007 Clauses nevertheless includes provision for a number of "optional buy-back" extensions of coverage for which an additional premium is payable; these include coverage against the cost of rectifying latent defects etc. (other those in any "design, plan or specification") in circumstances in which damage has occurred to the vessel which is recoverable under the policy.

The subject matter insured under the 2007 Clauses comprises the vessel and related materials if the latter are within the shipyard and have been "allocated" to the vessel. However, the assured can, by payment of the appropriate additional premium, cover such materials prior to their arrival at the yard or allocation to the vessel.[20]

Pursuant to Clause 2 ("Perils") the insurers under the 2007 Clauses are liable only for physical loss or damage "caused and discovered during the Period of the Insurance". This applies even where the physical impairment to the insured newbuilding results from defects in design, workmanship or material and/or latent defect.[21]

Unless otherwise agreed, and except for the war risk element of the insurance,[22] which (in common with the 1988 Clauses) only takes effect upon launching, coverage incepts upon the commencement of construction and continues until the vessel is delivered, or until the insurance is cancelled or terminated automatically.[23] The 2007 Clauses therefore abandon the concept employed in the 1988 Clauses of a provisional period of coverage combined with a "held covered" clause in the event of delayed delivery.

A novel feature of the 2007 Clauses is provided by Clause 48, which requires the Assured (who may be either the builder or the buyer):

"to exercise due diligence in the conduct of all operations relating to the Subject Matter Insured and in the utilisation of all safety practices and equipment considered prudent for such operations, such duty including but not limited to:

... the exercise of due diligence in the selection and employment of Contractors, Sub-contractors and others in connection with the Subject Matter Insured; and

... the exercise of due diligence in relation to such precautions as may be reasonably required to prevent loss, damage, liability or expense in connection with the Subject Matter Insured."

18 The 2007 Clauses are intended to apply also to construction risks relating to existing vessels or other seaborne structures whilst undergoing conversion or repair; see pages 311–316, *infra*.

19 See Clause 3.4.

20 See Clause 50.3.

21 *Infra*.

22 Section C, Clauses 9 to 15. War risks cover for materials allocated to the vessel will only attach once these are physically placed on the vessel.

23 This is defined in Clause 56.16 as the "Period of Insurance".

Where the Assured commits a breach of either of these "due diligence" obligations, the insurers are not discharged from liability but are exempted from "any loss, damage, liability or expense attributable to such breach".[24]

Latent defects

Except that it does not encompass faulty welding, "latent defect" is left undefined in the 1988 and 2007 Clauses. The term has, however, been categorised in another maritime context as referring to defects "which could not be discovered on such examination as a reasonably careful skilled man would make".[25] In order to recover against his insurers on the basis of latent defect, the builder will therefore be required to demonstrate that the defect in question could not have been detected through the application by his representatives at the shipyard of reasonable quality control techniques. The defect must be discovered within the policy period. Furthermore, coverage in respect of damage to the vessel caused by a latent defect is conditional upon discovery of the damage within such period, i.e., the policy will not pay in respect of damage caused by a latent defect which only becomes apparent after expiry of the Provisional Period (in the case of the 1988 Clauses) or the Period of Insurance (under the 2007 Clauses).

In the absence of provision to the contrary, it seems that "latent defect" does not normally extend to defects in design.[26] In *Jackson* v. *Mumford* (1902),[27] a policy effected in respect of a steamer under construction for the Admiralty provided coverage in respect of (*inter alia*) "loss of or damage to hull and machinery . . . through any latent defect in the machinery . . . ". During the course of her trials, a main engine con-rod broke, shattering the cylinder cover and killing eight men.

Having found that the cause of the failure lay in the inadequate design of the con-rod, Kennedy J. declined to categorise this as a "latent defect". In his view:

> " . . . while the proper effect to be given to the word 'latent' . . . may vary with circumstances . . . the phrase 'defect in machinery' in a business document means a defect of material, in respect either of its original composition or . . . its original or its after acquired condition . . . [it] does not in my view cover the erroneous judgment of the designer as to the effect of the strain which his machinery will have to resist, the machinery itself being faultless, the workmanship faultless, and the construction precisely that which the designer intended it to be."[28]

However, in *Prudent Tankers Ltd S.A.* v. *The Dominion Insurance Co. Ltd (The "Caribbean Sea")* (1980),[29] Goff J. expressed misgivings as to the correctness of this dictum, describing *Jackson* as "a very special case". In the context of a policy on a secondhand vessel, his Lordship held that the fact that the origin of a defect lay in inadequate design did not prevent it from being "latent" within the meaning of the standard "Inchmaree" clause.[30]

24 Clause 48.2.

25 *Per* Porter J. in *Charles Brown & Co. Ltd and Others* v. *Nitrate Producers Steamship Co. Ltd* (1937) 58 Ll.L.Rep. 188 at page 191, approved by Goff J. in *The "Caribbean Sea"*, *infra*.

26 This is expressly provided under Part V of the 2007 Clauses.

27 (1902) 8 Com. Cas. 61.

28 At page 69.

29 [1980] 1 Lloyd's Rep. 338.

30 The Inchmaree wording covers "loss of or damage to the vessel directly caused by . . . any latent defect in the machinery or hull".

This issue is, however, expressly addressed in the 1988 Clauses, Clause 8 of which provides coverage in respect of loss or damage to the subject matter insured (i.e., the vessel, her machinery and equipment) by reason of "faulty" design where this is both caused and discovered during the period of the insurance. The clause nevertheless excludes any liability upon the underwriters for the cost of repairing or replacing the defective part itself or "any cost or expense incurred by reason of betterment or alteration in design". In *Stone Vickers Ltd* v. *Appledore Ferguson Shipbuilders Ltd* (1991),[31] which concerned defects discovered in a ship's propeller, these words were held "clearly to exclude from the cover the cost of all remedial work on the defective part and the extra costs and expenses caused to the assured by having to carry out the remedial work".[32] Although the decision itself was set aside by the Court of Appeal,[33] this point was confirmed, Parker L.J. describing the judge's finding as "inevitable".

As indicated, insurance for the costs of remedying latent defects, as well as defects in materials, workmanship and "design, plan or specification", is available under the 2007 Clauses as an additional "buy back" option but excluding coverage in respect of defective design.

Buyer's supplies

Unless the underwriters are specifically prepared to agree otherwise, the 1988 Clauses extend only to the builder and do not insure the buyer directly in respect of loss of his supplies. Depending upon their value, the buyer may wish to insure himself separately against such risks.

The buyer may, however, be entitled to recover damages from the builder if he can demonstrate that the loss of his supplies has resulted from a breach of the latter's duties as bailee.[34] Under the 1988 Clauses, it seems that the builder is not afforded liability coverage in respect of this risk. Clause 19.3.5 expressly excludes any claim for "loss of or damage to property, owned by the builders . . . *or for which they are responsible*, which is on board the vessel" (emphasis added). Buyer supplied items are not covered under the 2007 Clauses unless specifically agreed, in which event these must be listed in a schedule to the policy, the buyer and the builder being jointly assured in respect of the same.[35]

Assignment

The contract will often provide that the builder should execute in favour of the buyer an assignment of his insurances over the vessel as security for the repayment of his pre-delivery instalments in the event of a total loss. In such circumstances merely to attach to the policy a loss payable clause stating that total loss claims should be paid to the buyer will not suffice. Thus, in *Iraqi Ministry of Defence* v. *Arcepey Shipping Co. S.A. (The "Angel Bell")* (1979)[36] Donaldson J. expressed the view that:

31 [1991] 2 Lloyd's Rep. 288.
32 *Per* Anthony Colman Q.C., sitting as a deputy judge, at pages 303–304.
33 [1992] 2 Lloyd's Rep. 578.
34 As to the builder's liability as bailee of the buyer's supplies, see page 258, *infra*.
35 See the definition of "Assured" at Clause 56.4 and the provisions of Clause 41.
36 [1979] 2 Lloyd's Rep. 491.

"a loss payable clause gives no rights to the loss payee unless it also constitutes or evidences an assignment of the assured's rights under the policy or evidences the fact that the designated person is an original assured."[37]

This principle is taken further in the assignment provisions of both the 1988 Clauses and the 2007 Clauses which state that the coverage (and any claim monies payable thereunder) can be assigned by the builder only if a dated notice of assignment, signed by the builder, is endorsed on the policy document.[38] If the builder's assignee wishes to make a direct claim under the policy, he will be obliged to produce the document so endorsed before the claim will be admitted.

PARTIAL LOSSES

Most shipbuilding contracts stipulate that, in the event that the vessel is partially damaged prior to delivery, the builder is both entitled and obliged to apply the proceeds of the insurance claim towards her repair. It is often further provided either that any delay in completion of the vessel caused by the casualty will automatically extend the Delivery Date or that the builder's obligation to repair should be conditional upon the parties' agreement on a mutually acceptable extension thereof.

Article XII.2(a) of the SAJ Form provides that where a partial loss is sustained "by any insured cause whatsoever" the builder shall apply the insurance recoveries to the repair of the damage in a manner satisfactory to the classification society. Where this is done, the buyer is obliged to accept the vessel if she is completed in accordance with the contract; he cannot legitimately refuse to take delivery simply because the vessel is repaired rather than new.

The builder's obligations under Article XII.2(a) are expressed to arise only in respect of insured losses. The article does not appear to apply, for example, if the vessel is damaged before her launching by the operation of a war peril, unless the buyer has previously exercised his rights under Article XII.1 to require that the builder should effect additional insurance in respect of such risks. Furthermore, circumstances giving rise to the partial loss will usually constitute a *force majeure* event within the meaning of Article VIII, thereby permitting the builder the right to seek an extension of the Delivery Date.

The CMAC and the NEWBUILDCON Forms[39] similarly impose an obligation upon the builder to make good any damage caused by an insured cause which does not constitute a total loss. Under both forms, any such repair/replacement must be made in a manner satisfactory not only to the classification society, but also to the other regulatory authorities listed in the specification.

However, in contrast with both the SAJ and CMAC Forms, the NEWBUILDCON Form provides that the builder shall also apply the insurance proceeds towards the repair or replacement of any buyer's supplies which may have been damaged or lost.

37 At page 497.

38 Respectively, Clause 16 and Clause 53 (which allows the assignment to be endorsed not only on the policy but also on "other document evidencing the insurance"). Both clauses require that subsequent assignments (e.g., by the buyer to his bank) also be evidenced by endorsement on the policy (or "other document evidencing the insurance" in the case of the 2007 Clauses).

39 At Article XXVIII and Clause 38, respectively.

Under Clause 38(b) of the form, the builder is obliged to make good the damage regardless whether or not he has received the related insurance proceeds.

TOTAL LOSS

If the vessel becomes an actual or constructive total loss before delivery to the buyer, the viability of the entire construction project will usually be called into question. Both buyer and builder will wish to ensure that the contract affords them in such event the widest possible freedom of movement.

The key to the operation of Article XII.2 of the SAJ Form (and, similarly, of Article XXVIII.2(2) of the CMAC Form) is not the casualty itself but a "determination" that the vessel has thereby sustained an actual or constructive total loss. It is not expressly stated who must reach this decision but it seems plain by implication that the judgment cannot unilaterally be made by either of the parties to the contract and that an effective determination occurs only when the underwriters subscribing to the builder's risks policy agree to accept the claim as a total loss.

Under both the Japanese Special Clauses and the 1988 Clauses, the cost of recovery and/or repair consequent upon a casualty must exceed the insured value before a constructive total loss occurs.[40]

Under the SAJ Form the parties must thereafter agree within a period of two months either to reconstruct the vessel on the basis of mutually acceptable alterations to the contract terms or to rescind[41] the agreement; in such latter event the buyer is entitled to an immediate refund (but without interest thereon[42]) of the instalments of the contract price he has pre-paid. This second alternative is automatically invoked if the parties have not reached agreement on either of the two options within the stipulated time limit. Under the CMAC Form this time period is limited to 30 days,[43] whilst the NEWBUILDCON Form provides only for agreement to be reached within "a reasonable time".[44]

In such circumstances the builder's refund obligation is absolute. Although the liability arises only as and when the vessel is determined by the underwriters to be a total loss, the builder is then required immediately to effect the refund, regardless of whether the insurance claim proceeds have in fact been paid to him. This represents a significant credit and interest cost exposure for the builder, and the SAJ Form is therefore on occasion varied to provide that the buyer is entitled to a refund of his pre-paid instalments only from the receipts of the insurance claim. As previously indicated, it is often agreed in such circumstances that total loss claims under the builder's policy should (as from the date of

40 See Article 8 of the Special Clauses and Clause 12.2 of the 1988 Clauses. According to Clause 12.1 of the 1988 Clauses, for the purposes of ascertaining whether the vessel is a constructive total loss, "the insured value shall be taken as the repaired value". However, in the event of a significant loss affecting a newbuilding under construction, it is unlikely that a repaired value will easily be ascertainable, since no market value exists for partly-built vessels. This has led to the introduction in the 2007 Clauses of an alternative and complex benchmark for ascertaining the occurrence of a constructive total loss; see Clauses 28 and 31 thereof.

41 "Rescission" in this context is something of a misnomer. The Article plainly envisages that the contract will be regarded as terminated by mutual agreement.

42 Under the NEWBUILDCON Form, the buyer is also entitled to interest on his pre-paid instalments at the agreed contract rate; see Clause 38(b)(ii)(2).

43 Article XXVIII.2(2).

44 Clause 38(b)(ii)(2).

its inception) be assigned to the buyer as security for the pre-delivery instalments of the contract price.

Finally, it should be noted that under the SAJ Form the builder's refund obligations are not expressed to extend to the value of the buyer's supplies (if any) damaged or destroyed in the casualty giving rise to the total loss.[45] On the contrary, Article XII.2 specifically provides that, upon refund of the pre-paid instalments, both parties' liabilities and obligations "shall terminate forthwith". This may operate significantly to the prejudice of the buyer in circumstances in which the total loss has resulted from the builder's negligence; but for Article XII.2, the buyer might in such a case be entitled to recover the value of his supplies by demonstrating that the builder had breached his contractual obligations to exercise "reasonable care" in their storage and handling. In contrast, the NEWBUILDCON Form provides that the effect of the deemed termination of the contract is limited to "all future rights and obligations of each of the parties to the other",[46] thereby preserving the parties' rights and obligations accrued prior to termination.

DELAYED DELIVERY/CANCELLATION INSURANCES

Before leaving the topic of insurance, mention should be made of the use of delayed delivery coverages in large-scale shipbuilding projects. These are insurances placed by the buyer as a means of protecting his investment in the shipbuilding project which pay him an agreed sum in the event of excessive delay in delivery of the vessel and/or rescission of the contract by either party, in each case as a direct consequence of the impact of defined perils. Insurances of this type, which are often required by the buyers' financiers where the project involves significant political risks,[47] are usually written for the benefit of the buyer alone[48] and do not form part of his contractual arrangements with the builder.[49]

45 This is notwithstanding that the builder's policy of insurance must, in order to conform with the requirements of Article XII.1, include provision for the value of the buyer's supplies. The position is different under both the CMAC and NEWBUILDCON Forms, each of which expand the builder's refund obligations to encompass the buyer's supplies or the value thereof (see Article XXVIII.2(2)(b) and Clause 38(b)(ii)(2)(ii)).

46 Clause 38(b).

47 That is, the risk of non-performance by reason of political, rather than commercial, factors. Policies of this type were previously often seen in the context of shipbuilding projects in Eastern Europe.

48 However, even if these qualify as "*force majeure* events", the builder may also elect to insure himself separately against certain risks of delay to the project caused by events beyond his control.

49 Indeed, such policies may be written subject to an express warranty that their existence should not be disclosed to the builder.

Article XIII—Dispute and arbitration

1. Proceedings:

In the event of any dispute between the parties hereto as to any matter arising out of or relating to this Contract or any stipulations herein or with respect hereto which can not be settled by the parties themselves, such dispute shall be submitted to and settled by arbitration held in Tokyo, Japan, by the Japan Shipping Exchange, Inc. (hereinafter called the "Exchange") in accordance with the provisions of the Rules of Maritime Arbitration of the Exchange, except as hereinafter otherwise specifically provided.

Either party desiring to submit such dispute to the arbitration of the Exchange shall file with the Exchange the written Application for Arbitration, the Statement of Claim and the notice of appointment of an arbitrator accompanied by written acceptance of such arbitrator appointed by such party.

Within twenty (20) days after receipt of such documents as aforementioned from the Exchange, the other party shall file in turn with the Exchange the notice of appointment of an arbitrator accompanied by written acceptance of such second arbitrator appointed by the other party. These two (2) arbitrators shall be deemed, in performance of office of arbitration, as the arbitrators appointed by the Maritime Arbitration Commission (hereinafter called the "Commission") of the Exchange.

The third arbitrator to preside over the proceedings shall be appointed by the Commission from among such persons on the Panel of Members of the Commission (or in case of particular need, from among persons not so empanelled) as have no concern whatever with the parties or in the subject of such dispute.

The three (3) arbitrators thus appointed shall constitute the board of arbitration (hereinafter called the "Arbitration Board") for the settlement of such dispute.

In the event, however, that the said other party should fail to appoint a second arbitrator as aforesaid within twenty (20) days following receipt of the documents concerned from the Exchange, it is agreed that the said other party shall thereby be deemed to have accepted and appointed as its own arbitrator the one appointed by the party demanding arbitration, and the arbitration shall proceed forthwith before this sole arbitrator who alone, in such event shall constitute the Arbitration Board.

The award made by the sole arbitrator or by the majority of the three (3) arbitrators, as the case may be, shall be final and binding upon the parties hereto. If the majority of the three (3) arbitrators is not obtained, then the decision of the third arbitrator shall be final and binding upon the parties hereto.

Notwithstanding the preceding provisions of this Paragraph, it is recognised that in the event of any dispute or difference of opinion arising in regard to the construction of the VESSEL, her machinery or equipment, or concerning the quality of materials or workmanship thereof or thereon, such dispute may be referred to the Classification Society upon mutual agreement of the parties hereto as far as the Classification Society agrees to determine such dispute. The decision of the Classification Society shall be final and binding upon the parties hereto.

2. Notice of Award:

The award shall immediately be given to the BUYER and the BUILDER in writing or by cable confirmed in writing.

3. Expenses:

The Arbitration Board shall determine which party shall bear the expenses of the arbitration or the portion of such expenses which each party shall bear.

4. Entry in Court:

Judgment upon the award may be entered in any court having jurisdiction thereof.

5. Alteration of Delivery Date:

In the event of reference to arbitration of any dispute arising out of matters occurring prior to delivery of the VESSEL, the award may include any postponement of the Delivery Date which the Arbitration Board may deem appropriate.

As in any large construction project, there is enormous potential for disputes to arise between the parties to a shipbuilding contract. These may be either technical or commercial in nature (or a combination of the two) but in every case the scope for disruption of the project as a whole may be substantial if a solution cannot quickly be found; furthermore, the financial consequences for the parties of either winning or losing the dispute may be very significant. It is accordingly vital that, in addition to choosing the law by which the contract is to be governed, the buyer and the builder should agree upon an effective and fair mechanism by which disputes arising between them are to be determined.

The traditional mechanism for resolving shipbuilding disputes is that of arbitration, rather than court proceedings. In addition to the benefits of privacy, the use of arbitration procedures affords the buyer and the builder a measure of control over both the procedures to be followed and the identity (and thus the experience and technical knowledge) of the individuals who will judge their disputes.

It should also be noted in a European context that the choice of arbitration as a dispute-resolving mechanism avoids the application of much of the so-called Brussels I Regulation[1] and the 2007 Lugano Convention.[2] These measures, which are implemented in the United Kingdom by the Civil Jurisdiction and Judgments Act 1982 and statutory instruments issued thereunder, contain complex jurisdictional rules concerning the commencement of legal proceedings against a party domiciled or resident within the European Union.[3]

STANDARD FORM ARBITRATION PROVISIONS

Each of the SAJ, NEWBUILDCON and CMAC Forms contain specific provisions for the arbitration of disputes arising between the buyer and the builder.

1 Council Regulation (EC) 44/2001; this has largely superseded the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters and the subsequent 1988 Lugano Convention.

2 Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters signed in Lugano on 30 October 2007 and published in the Official Journal of the European Union on 21 December 2007 ([2007] O.J. L339/1). The terms of the revised Lugano Convention are substantially the same as those of the Brussels I Regulation.

3 See further, Collins, *European Community Law in the U.K.* (5th edn.).

The SAJ Form

The arbitration provisions of the SAJ Form are in practice rarely used other than in the context of domestic Japanese newbuildings. Article XIII.1 provides for the arbitration of all disputes in Tokyo according to the Rules of Maritime Arbitration of the Japan Shipping Exchange, Inc. (Nippon Kaiun Shukaisho). Arbitrations conducted under the auspices of the exchange are administered by the Tokyo Maritime Arbitration Commission (TOMAC),[4] which publishes detailed and regularly updated rules of procedure.[5]

Article XIII.1 provides, by way of variation to the rules, that the parties shall each appoint one arbitrator, the third arbitrator to be appointed by TOMAC. Under the usual TOMAC procedure, the arbitration board will, following the exchange of written submissions, fix the date for a hearing at which the parties may each adduce factual and expert oral evidence. Subsequent to the hearing, the Tribunal is required within thirty days to publish a reasoned award unless the parties have agreed otherwise. The proceedings and the award are conducted in English in the case of international proceedings, i.e., those involving non-Japanese parties.[6]

The NEWBUILDCON Form

The NEWBUILDCON Form specifically permits the parties to choose the arbitration forum for the resolution of their disputes, and (somewhat vaguely) provides that the procedural rules applying in such location shall apply to any such proceedings.[7] However, in the absence of an express alternative choice, Clause 42(c) of Part II of the form stipulates that the dispute should be referred to arbitration in London before three arbitrators in accordance with both the Arbitration Act 1996 and the standard terms of The London Maritime Arbitrators' Association (LMAA) in force at the time of commencement of the proceedings.[8]

The CMAC Form

Perhaps unsurprisingly, the CMAC Form provides for disputes between the parties to be submitted to The China Maritime Arbitration Commission itself and to be conducted in accordance with CMAC's own arbitration rules.[9] These require that the arbitration tribunal should be composed of arbitrators listed on a relevant CMAC panel and comprised of either one or three arbitrators.[10]

TECHNICAL AND NON-TECHNICAL ARBITRATIONS

If, however, either the buyer or the builder is unwilling to arbitrate disputes under the mechanism contained in the standard form they have adopted, the parties will often agree

4 Previously known as the Maritime Arbitration Commission, which name is still used in the SAJ Form.

5 The translated text of the Rules, which were most recently amended in February 2010, is at http://www.jseinc.org/en/tomac/arbitration/ordinary_rules.html.

6 See Article 30.

7 Clause 42(d).

8 The current version of the LMAA terms can be found at http://www.lmaa.org.uk/terms2012.aspx.

9 See http://www.cmac-sh.org/en/rules.asp.

10 Article 26 of the CMAC Form.

upon the terms of their own arbitration clause. In so doing, they will often seek to draw a distinction between technical and non-technical disputes and will agree upon different arbitration mechanisms for each.

It may, of course, be extremely difficult in practice to categorise a particular dispute as either technical or non-technical; if, for example, the buyer alleges that he is not obliged to accept the vessel when she has been tendered to him, the issues arising may be both legal (e.g., as to the correct interpretation of the contract) and technical. The parties are nevertheless at no stage precluded from agreeing between themselves that a particular dispute which has arisen shall be regarded as technical in nature; it is only if they disagree on the categorisation of the dispute that it must be determined by the compulsory procedure.

Technical disputes

Disputes of a purely technical nature (i.e., as to the methods and standards by which the vessel is to be constructed) tend to arise only after the keel has been laid and often originate in a simple difference of approach or working methods between the buyer's superintendents and the builder's workforce at the shipyard. Particularly where work on the vessel must be postponed until this difference is resolved, the priority from the builder's perspective will normally be to obtain a binding decision at the earliest possible opportunity. So far as practicable, he will wish the arbitration proceedings to take place on site and to exclude any appeal procedures which might delay the final resolution of the dispute.

In relation to technical matters the contract will therefore often stipulate that, provided both parties consent, any dispute arising between the buyer and the builder should be determined by the classification society[11] or another mutually acceptable expert third party; this will often be a firm of marine surveyors or consultants trusted by both parties. Alternatively, the parties may agree to decide upon the identity of the expert only as and when disputes arise. Such proceedings are almost invariably informal in nature and the decision is rendered within days, if not hours, of the disputes emerging.

The contract will often further specifically state that the third party appointed in such cases should act as an expert rather than an arbitrator and that his decision will be "final and binding". As a general principle of English law, where the parties to a contract have agreed to be bound by the decision of third party employed to issue an expert opinion, his decision, even if plainly mistaken, is truly binding upon them and will be incapable of appeal unless fraud or impartiality is demonstrated or he has "departed from his instructions in a material respect".[12]

The fact that the contract provides for the appointment of an expert to decide technical issues arising thereunder will not, however, normally preclude the court or arbitration tribunal from determining legal issues which arise in connection with, or as a preliminary

11 This is entirely distinct from the mandatory terms of Article I.3 of the SAJ Form, and equivalent provisions of the NEWBUILDCON and CMAC Forms, which provide that the classification society is to be the sole judge of the vessel's compliance with class rules and requirements; see page 33, *supra*.

12 *Jones* v. *Sherwood Computer Services plc* [1992] 1 W.L.R. 277, C.A.; *British Shipbuilders* v. *VSEL Consortium plc* [1997] 1 Lloyd's Rep. 106 and *Shell U.K. Ltd* v. *Enterprise Oil plc* [1999] 2 Lloyd's Rep. 456. Where the clause permits the expert, expressly or impliedly, to choose a method or procedure for reaching his determination, the parties are normally bound by his choice; see *Conoco (U.K.) Ltd* v. *Phillips Petroleum Co. (U.K.) Ltd*, 19 August 1996, *per* Morison J.

to, the expert determination.[13] Furthermore, if the expert proceeds to his decision on the basis of an error of law, including a mistaken interpretation of the terms of the shipbuilding contract, this may be open to subsequent review by the Court unless the parties have expressly agreed otherwise; this is so even if the parties have agreed that the decision is to be "final and binding".[14]

The SAJ Form provides[15] that disputes of a purely technical nature may by *mutual agreement of the parties* be determined by the classification society, but not by any other third party. In contrast, the NEWBUILDCON Form makes extensive provision[16] for the determination of disputes by an expert agreed between the parties; it includes in particular a specific timetable for the submission of written representations, and comments thereon, by each of the parties and makes provision for a possible hearing at the discretion of the expert. Although this is not contractually binding, the form further provides that the expert shall use all reasonable endeavours to publish his decision within twenty eight days of his appointment.[17]

Non-technical disputes

Most shipbuilding contracts provide that all disputes which the parties do not agree to submit to a technical expert or arbitrator and all non-technical disputes should be determined under a compulsory procedure by a tribunal composed of between one and three arbitrators. The contract will typically state that either the buyer or the builder may unilaterally commence the proceedings by appointing an arbitrator or requiring the other's concurrence in a joint appointment; further provisions will permit either party to make a default appointment in the absence of co-operation from the other party.

Once appointed, the scope of the arbitrators' jurisdiction will be largely dependent upon the terms of the arbitration clause itself. Where, as in the SAJ Form, the arbitrators are empowered to decide all disputes "arising out of" the contract, the arbitrators will enjoy a very wide ranging jurisdiction to determine almost all issues between the parties relating to the vessel's construction. In *H.E. Daniel Ltd* v. *Carmel Exporters & Importers Ltd* (1953),[18] Pilcher J. expressed the view that "the words 'any dispute arising out of the contract' cover every dispute except a dispute as to whether there was a contract at all". Furthermore, in *Fiona Trust & Holding Corporation and others* v. *Privalov and others* (2007),[19] the House of Lords held that, in determining the scope of an arbitration clause,

13 *Postel Properties and Daichi lire (London)* v. *Greenwell* [1992] 47 E.G. 106; *National Grid Co plc* v. *M25 Group Ltd* [1999] 1 E.G.L.R. 65; *Mercury Communication Ltd* v. *Director General of Telecommunications and another* [1996] 1 All E.R. 575.

14 *Norwich Union Life Insurance Society* v. *P&O Property Holdings Ltd and other* [1993] 1 E.G.L.R. 164 and *Barclays Bank plc* v. *Nylon Capital LLP* [2011] EWCA Civ 826 where Thomas L.J. said (at paragraph 63 of his judgment): "There is, in my view, a powerful argument for saying that, depending, of course, on the terms of the particular contract in question, a valuation by an expert, even whose valuation is agreed to be 'final and binding', can be challenged in court if it can be shown to have been arrived at on the basis of a mistake of law". Note also that *Barclays Bank* establishes that, while English arbitrators are normally entitled to determine the scope of their own jurisdiction, this principle does not apply to experts, the extent of whose authority to determine a particular dispute is generally reviewable by the court.

15 At Article XIII.1.

16 Clause 42(b) of Part II.

17 The Clause apparently does not envisage the appointment of a female expert.

18 [1953] 2 Lloyd's Rep. 103.

19 [2007] UKHL 40 at paragraph 13; affirmed in *Barclays Bank plc* v. *Nylon Capital LLP* [2011] *supra* at n. 14.

the tribunal or court should avoid drawing fine distinctions between phrases such as "*arising under*", "*arising out of*", "*in relation to*" or "*in connection with*" the agreement in question; their Lordships took the view that, where an arbitration clause appears in general terms to cover the issue in dispute, it should be permitted to do so except to the extent that it is clear that specific issues have been agreed to be excluded from the tribunal's jurisdiction.

Certain judicial dicta[20] nevertheless suggest that a mere failure by the parties to reach agreement cannot constitute a dispute. This is of considerable relevance in the context of shipbuilding contracts, which often incorporate terms requiring the buyer and the builder to seek to agree upon matters relevant to the vessel's construction but make no provision for the consequences of their failure to agree.[21]

Such a problem arose in *Vosper Thornycroft Ltd* v. *Ministry of Defence* (1976),[22] where the arbitration clause of the shipbuilding contract extended to "any dispute or difference between the parties". The agreement further stipulated that:

> "in the event of exceptional dislocation and delay arising during the construction of the vessel due to modifications . . . or any other cause beyond the Contractor's control, the effect thereof shall be assessed by mutual agreement between the Ministry and the Contractor failing which the Ministry may pay for the Vessel on an 'actual cost' basis . . . plus a fair and reasonable sum for profit."

The vessel's construction was substantially delayed by reason of modifications to the specification and an amount of £2,000,000 was paid by agreement between the parties. The Ministry contended, however, that its obligation to pay an additional sum of £4,000,000 claimed by Vosper Thornycroft was conditional upon a further agreement being reached and that, in the event that this was not achieved, nothing further was due; the Ministry sought to argue that a failure to agree upon the builder's additional claims did not constitute a dispute falling within the terms of the arbitration clause.

The High Court nevertheless held that it was essential for the business efficacy of the contract that a term be implied that, in default of agreement between the parties as to the effect of the exceptional dislocation and delay, the arbitration clause should be used to determine the difference between them.[23]

ARBITRATION PROCEEDINGS IN LONDON

Although other centres possess substantial relevant expertise,[24] London remains the pre-eminent arbitral forum for the resolution of international shipbuilding contract disputes. Most shipbuilding contracts of an international nature are governed by English law and provide that disputes shall be determined in London by either a sole arbitrator or a panel of three arbitrators in accordance with the rules of an established arbitration institution[25]

20 See, e.g., *May & Butcher* v. *R.* [1934] 2 K.B. 17 *per* Viscount Dunedin at page 22.

21 See, e.g., Articles III.1(c), V.1 and V.2 of the SAJ Form.

22 [1976] 1 Lloyd's Rep. 58.

23 See also *William Press & Son Ltd* v. *Foster Wheeler Power Products Ltd* (6 February 1981, unreported), QBD (Comm Ct) and the Scottish case of *Scott Lithgow Ltd* v. *Secretary of State for Defence* (27 December 1991, unreported), Ct of Session, each of which appear to accept the correctness of *Vosper Thornycroft*.

24 Principally Stockholm, Geneva, New York and Singapore.

25 For example, The London Maritime Arbitrators' Association (whose website is at www.lmaa.org.uk/default.html) as provided for under Clause 42(c) of Part II of the NEWBUILDCON Form; and the London Court of International Arbitration (http://www.lcia.org/).

and the Arbitration Act 1996 (the "Act"). In conjunction with established common law rules, the Act provides a framework for arbitration in the United Kingdom based largely upon the principle of freedom of contract, i.e., the right of the parties to define their own arbitration regime, subject only to the "public policy" requirements of ensuring the proper administration of justice.

So far as shipbuilding is concerned, the principal features of London arbitration are as follows:

The constitution of the arbitration tribunal

This will be almost entirely dependent upon the terms of the arbitration clause itself, which will normally provide for:

(a) a sole arbitrator to be appointed by agreement between the buyer and the builder; or
(b) a panel of three arbitrators, one to be appointed by each of the parties and the third by the two so chosen; or
(c) a panel of two arbitrators and an umpire, the latter being entitled to act only if the arbitrators are unable to agree on the outcome of the matter in dispute.

The Act includes provisions empowering the High Court to make arbitral appointments by default where the parties have been unable to agree upon the identity of a sole arbitrator or, in circumstances in which the clause provides for two or three arbitrators, if one party fails to make an appointment.[26] Where, exceptionally, the buyer and the builder have simply agreed upon "arbitration in London", this is deemed by the Act to constitute a reference of all disputes to a sole arbitrator.[27]

The proceedings

An account of the practice of arbitration in London is beyond the scope of this book. In outline, however, the proceedings will usually progress through the five basic stages: (i) exchange of written pleadings; (ii) discovery of relevant documentation; (iii) exchange of witness statements; (iv) the hearing of oral evidence and submissions; and (v) issuance of the award. This standard procedure may, however, be varied either by agreement between the parties or by the direction of the arbitration tribunal itself.

Appeals

Unless the buyer and the builder have agreed otherwise, the award of the tribunal will normally be capable of appeal to the High Court on questions of law, although not of fact.[28] Other than where the parties each consent to the appeal being heard, it is, however, necessary in all cases to obtain the permission or "leave" of the High Court before the appeal can be brought. Furthermore, strict criteria have to be satisfied before leave is granted. In particular, the applicant must demonstrate that the issue of law he considers

26 Sections 16–18 of the Act.
27 Section 15(3).
28 Section 69(1).

wrongly decided will, if decided in any other way, substantially affect the rights of the parties. If the issue is of only marginal relevance to the tribunal's overall decision, he will not usually be granted leave to appeal. The court must furthermore be satisfied (a) that, on the basis of the findings of fact in the award, the arbitration tribunal's decision is "obviously wrong" or that the question is one of "general public importance and the decision of the tribunal is at least open to serious doubt and (b) that "despite the agreement of the parties to resolve the matter by arbitration, it is just and proper in all the circumstances for the court to determine the question".[29]

Agreements to waive the right to appeal

As indicated, the parties may agree to waive the right to seek leave to appeal against an arbitration award. Such an agreement must be in writing,[30] but there are no other formal requirements. The agreement to waive can expressly form part of the arbitration clause itself or be founded upon the parties' incorporation of arbitration rules containing such a waiver[31]; such an agreement can furthermore be concluded before, during or after the commencement of any proceedings. Both the SAJ[32] and CMAC Forms[33] provide that any arbitration award shall be "final and binding" upon the parties. It should be noted, however, that, contrary to general industry understanding, this language is not sufficient in itself to exclude the parties' entitlement to seek leave to appeal, or to appeal. In *Essex County Council* v. *Premier Recycling Ltd* (2006),[34] Ramsey J. held that the words "*final and binding*" in this context meant "final and binding subject to the provisions of the Arbitration Act 1996", including the right to seek leave to appeal. This was followed in *Shell Egypt West Manzala GmBH* v. *Dana Gas Egypt Ltd* (2009),[35] where the Commercial Court considered whether the words "final, conclusive and binding" operated to exclude the parties' rights of appeal and held that the addition of the word "conclusive" did not alter the legal position i.e. the language again did not operate as an effective exclusion agreement.

In light of these decisions, it is necessary, if rights to seek leave to appeal are intended to be excluded, for the shipbuilding contract to say so expressly.

Back-to-back contracts

Although the practice has declined substantially in importance in recent years, it is sometimes the case that the purchaser of an export newbuilding will enter into the

29 Section 69(3). For further details as to the procedure adopted by the High Court in determining applications for leave to appeal, see Mustill and Boyd, *Commercial Arbitration* (2nd edn.), Chapter 36, and 2001 Companion.

30 Section 5.

31 Waivers of the right to appeal contained in standard form rules of arbitration incorporated into the parties' contract are normally sufficient to qualify as valid "exclusion agreements" under s. 69(1) of the 1996 Act; see *Sumukan Ltd* v. *The Commonwealth Secretariat* [2007] EWCA Civ 243

32 Article XIII.1.

33 Article 67 of the CMAC Form provides that "The award is final and binding upon both disputing parties. Neither party may bring a suit before a law court or make a request to any other organization for revising the award", which language is probably sufficient evidence of a mutual intention to exclude the right to seek leave to appeal. The NEWBUILDCON Form makes no specific provision in this respect.

34 [2006] EWHC 3594.

35 [2009] EWHC 2097 (Comm).

shipbuilding contract with an intermediary, such as a state selling organisation or trading house, rather than the shipbuilder directly. The intermediary then contracts on back-to-back terms with the shipbuilder.[36]

In such circumstances claims for breach of contract can usually be brought only against the intermediary. While he may choose to pursue up or down the chain similar claims against the buyer or the builder, there is (in the absence of contrary agreement in both contracts) no right in any party to insist that the two sets of proceedings be consolidated into one action. Furthermore, although the two sets of proceedings will usually continue in parallel, the two tribunals have no power, in the absence of agreement, to order that any of the buyer, the builder or the intermediary should be bound by any aspect of the proceedings to which he is not a party.

Other standard provisions

Two other standard arbitration provisions typically found in shipbuilding contracts (and incorporated within the SAJ Form) should also be mentioned.

First, it is usual to provide that the tribunal should have jurisdiction to decide which party is to bear the legal costs of the proceedings. As a matter of English law, this is not strictly necessary because such a power is implied in the absence of agreement to the contrary.[37] The inclusion of express wording in the contract may nevertheless be of value if the arbitration award, including the order for costs, is to be enforced outside the United Kingdom.

Secondly, the contract may stipulate that, when making its award, the tribunal shall be empowered to extend the Delivery Date of the vessel. This mechanism allows the builder to seek further time for the performance of his contractual obligations where the proceedings themselves have caused him delay in the completion of the vessel.

Under Article XIII.5 of the SAJ Form, the discretion allowed to the arbitration board is not, however, specifically limited to time lost by reason of arbitration proceedings. In the event of any reference to arbitration in the period prior to delivery, the contract provides that "... the award may include any postponement of the Delivery Date which the Arbitration Board may deem appropriate". The Form provides no guidance as to the criteria to be applied by the arbitration board in exercising this discretion and it would appear that the power can theoretically be exercised regardless of the nature of the dispute which has given rise to the making of the award. Furthermore, it is not a bar to the exercise of the discretion that the builder has himself commenced the arbitration proceedings which have given rise to the delay in completion of the vessel.

Although this type of provision is commonly employed in shipbuilding contracts governed by English law[38] and subject to London arbitration, its legal effect is somewhat uncertain. Under English procedural rules, the principal forms of relief customarily granted in arbitration proceedings (damages, orders for specific performance and declarations) do not extend to a power to vary the terms of the contract. Unless the buyer

36 This structure was previously much used in relation to export shipbuilding projects in Eastern Europe, although it is now usual for the buyer to contract with the shipyard directly. The use of intermediaries is, however, still important in some jurisdictions, in particular China.

37 Section 61(1) of the Act.

38 Note that, in its unamended form, the SAJ Form is governed by law of the place of construction (Article XX.1), rather than by English law.

and the builder have expressly agreed that any disruption caused by arbitration to the construction schedule should constitute Permissible Delay,[39] in which event the arbitrators will plainly be entitled to make a declaratory award as to the extent of the delay involved, it is questionable whether the tribunal is legally empowered to alter the Delivery Date of the vessel as envisaged by Article XIII.5.

JUDICIAL PROCEEDINGS

Although arbitration is undoubtedly the preferred mechanism for resolving shipbuilding contract disputes, it is not uncommon for the parties to agree to submit disputes to the jurisdiction of certain municipal courts. Where the contract is governed by English law, and arbitration is not an acceptable mechanism for either or both of them, the parties may agree to submit their disputes to the Commercial Court or (in the case of substantial technical matters) to the Technology and Construction Court, each based in London.[40] In such circumstances each party will usually also state in the contract the name and address of an agent in England authorised to accept service of legal proceedings on its behalf.

It should be noted in this context that the English civil procedure system has in recent years substantially shifted the emphasis of High Court proceedings in favour of encouraging the settlement of disputes without the need for a final judicial determination. Under the Civil Procedure Rules introduced in 1999, a so-called "Pre-Action Protocol for Construction and Engineering Disputes"[41] requires that, before legal proceedings are commenced, the parties to such disputes must normally engage in a period of written and oral dialogue intended to identify precisely, and if possible resolve, the differences between them.[42] If proceedings are commenced, it is furthermore open to the High Court to order that the parties should seek to resolve the differences between them by engaging in alternative dispute resolution (ADR) procedures prior to any judicial determination.[43]

If, unusually, the parties expressly or impliedly choose English law to govern their contract, but fail to provide for a choice of jurisdiction for disputes, the English courts will usually be prepared to exercise its discretion to assume jurisdiction, at least in respect of a defendant located outside the European Union. Where, however, the proposed defendant is domiciled within the European Union, the position is very different. In the absence of a written agreement conferring jurisdiction upon them, English courts will normally be obliged by the Civil Jurisdiction and Judgments Act 1982[44] to stay (i.e. discontinue) the

39 See, e.g., the arbitration clause considered in *Neptune Navigation Corporation* v. *Ishikawajima-Harima Heavy Industries Co. Ltd* [1987] 1 Lloyd's Rep. 24.

40 The Commercial Court and the Technology and Construction Court each form part of the Queen's Bench Division of the English High Court.

41 The Protocol is to be found at http://www.justice.gov.uk/guidance/courts-and-tribunals/courts/procedure-rules/civil/contents/protocols/prot_ced.htm.

42 The requirement for such dialogue does not, however, preclude either party from, among other specified matters, seeking interim injunctive relief from the Court; see Section 1.2 of the Protocol.

43 See further, *infra*.

44 Implementing the Brussels I Regulation; see n. 1, *supra*.

proceedings in favour of the courts of the defendant's European domicile even where the contract is subject to English law.[45]

ALTERNATIVE DISPUTE RESOLUTION

Alternative Dispute Resolution (ADR) is the label given to various procedures designed to assist contracting parties to settle their differences without the need for arbitration or litigation. These include Mediation, in which an independent mediator assists the parties in seeking to reach a compromise between their respective positions, and Neutral Evaluation, where a qualified third party hears a summary of each side's case and gives a non-binding assessment of the merits of the dispute; this can then be used by the parties as the basis for further negotiation and possible settlement of their differences.

Where ADR is to be employed, the chosen procedure is usually defined, either expressly or by reference to the rules of a recognised ADR institution,[46] as part of the dispute resolution clause of the contract; the parties are usually obliged to exhaust the agreed ADR procedure before they can invoke the arbitration or litigation mechanisms set out in the remainder of the clause.[47] ADR is of particular value in circumstances in which there is an ongoing commercial relationship between the parties which might be seriously affected by the early commencement of an adversarial dispute resolution process.

Reflecting its relative antiquity, the SAJ Form imposes no obligation upon the parties to mediate or engage in any alternative form of dispute resolution. A more modern approach is adopted in the NEWBUILDCON Form, which contains extensive provisions for mediation and permits the parties to refer any dispute or difference arising out of the contract to mediation even if they have previously agreed to submit the same to arbitration.[48]

A party wishing to do so is required to serve on the other a written notice (the "Mediation Notice") calling on the other party to agree to mediation; there is no obligation upon the latter to do so, although a refusal to agree may (if the matter is not otherwise settled) be brought to the attention of the Tribunal who may take this into account in relation to determining liability for the costs of the arbitration proceedings. If arbitration has already been commenced, and the parties agree to mediate, the Form provides[49] that arbitration proceedings should continue during the conduct of the

45 Note, however, that Article 5 of the Brussels I Regulation provides that a person domiciled in the European Union may (as an alternative to proceedings in the country of his domicile) be sued in the country of the place of performance of his contractual obligations. This would, for example, permit an English shipbuilder to bring suit in England against an Italian buyer in respect of instalments of the contract price payable in London (being the place of performance of the buyer's obligation) and notwithstanding the absence in the contract of a jurisdiction clause.

46 For example, the Centre for Effective Dispute Resolution (http://www.cedr.com/) which is based in London.

47 See, e.g., the CMAC Form, which (at Article XXVI) requires the parties to seek to settle dispute by "friendly consultation or conciliation" before they submit the same to arbitration. If a settlement is reached through such process, the Form provides that a sole arbitrator may be appointed either by the parties or the CMAC's Chairman, to render an arbitration award reflecting the settlement terms; there will, however, be only a limited category of cases in which this is likely to be required by the parties.

48 Clause 42(e) of Part II

49 Clause 42(e)(v) of Part II.

mediation although the Tribunal may take the mediation into account when setting the arbitration timetable.

The NEWBUILDCON Form also provides that the mediation process will operate without prejudice to the parties' positions in any arbitration proceedings, and that no information or documents disclosed during the mediation should be shown to the tribunal except to the extent that these are disclosable under the procedure governing the arbitration proceedings.

Finally, it should be noted that, where litigation is the chosen procedure for the resolution of disputes under a shipbuilding contract, the English High Court enjoys extensive powers to order the parties to engage in one or more ADR procedures before the matter proceeds to a hearing and judgment. In such circumstances, the legal process will normally be stayed (i.e., suspended) pending the outcome of the ADR process, and any party failing to co-operate in the process may be sanctioned by the High Court in terms of its liability for, or its entitlement to recover, the costs of the continuing judicial proceedings.[50]

50 See generally, Mackie, Miles & Marsh, *Commercial Dispute Resolution—an ADR Practical Guide* (3rd edn.)

Article XIV—Right of assignment

Neither of the parties hereto shall assign this Contract to a third party unless prior consent of the other party is given in writing.

In case of assignment by the BUYER, such assignment shall further be subject to approval of the Japanese Government, and the BUYER shall remain liable under this Contract.

This Contract shall enure to the benefit of and shall be binding upon the lawful successors or the legitimate assigns of either of the parties hereto.

Each of the buyer and the builder may need the option to transfer to a third party the rights or obligations created by the contract. The builder may, for example, be unable to obtain finance for the construction of the vessel unless the instalments of the contract price are assigned to his bank. A right of transfer may in particular be needed by the buyer to secure financing in respect of payment of his pre-delivery instalments or, alternatively, if he views the contract as a speculation against a rising newbuilding market, to permit him to on-sell the vessel before she is delivered.[1] It is equally possible that the buyer may decide to sell the vessel shortly after her delivery, in which event his "on-purchaser" will almost certainly wish to enjoy the benefit of the builder's post-delivery warranty against defects.[2]

Although it is, of course, open to the parties at any time to agree to vary or even discharge the contract to permit a transfer of its rights or obligations, either or both of them will usually wish to define at the outset the limits within which he can unilaterally effect such a transfer, whether before or after delivery of the vessel.

There are nevertheless risks for both the buyer and the builder in allowing third parties to acquire an interest in the benefits and burdens of the contract. The builder will, in particular, be concerned that any change in the identity of his contractual partner should not increase his costs of performance of the contract[3] or the nature and extent of his credit risks. For his part, the buyer will wish to ensure that the technical and financial standing of the builder's assignee is equal to that of the builder himself.

Most shipbuilding contracts therefore significantly curtail the extent to which the rights and duties of either party may be assigned or transferred without the prior agreement or approval of the other party. Before looking at this issue in a specific shipbuilding context,

1 See, by way of example of such a transaction, *Abram Steamship Co. Ltd* v. *Westville Steamship Co. Ltd* [1923] A.C. 773.

2 See pages 180–182, *supra*.

3 See *per* Lord Browne-Wilkinson in *Linden Gardens Trust Ltd* v. *Lenesta Sludge Disposals Ltd and Others* [1993] 3 All E.R. 417 at page 429: "The reason for including the contractual prohibition [against assignment] viewed from the contractor's point of view must be that the contractor wishes to ensure that he deals, and deals only, with the particular employer with whom he has chosen to enter into a contract. Building contracts are pregnant with disputes: some employers are much more reasonable than others in dealing with such disputes."

it is, however, necessary to consider the general principles of English common law relating to the assignment of contractual rights and obligations as well as the effect of the Contract (Rights of Third Parties) Act 1999.

GENERAL PRINCIPLES RELATING TO ASSIGNMENT

The extent to which the parties to an agreement are entitled to assign the benefits and burdens arising thereunder is determined by its governing law.[4] The relevant rules of English law can be summarised as follows[5]:

1. Benefits

In the absence of an express or implied prohibition, it is open to either party to an agreement to assign to a third party the benefits accruing thereunder. Depending upon its substance and form, such an assignment may be either legal or equitable in nature.

In the case of a legal assignment, the assignee will assume all the rights of the assignor under the agreement and may enforce its terms against the other party without joining the assignor to any legal proceedings in connection with such enforcement.[6] Where, by contrast, an assignment takes effect only in equity, the assignee's rights are more limited; in particular, he will normally be required to join the assignor to any proceedings he commences to enforce the agreement.

A legal assignment, which must be in writing and signed by the assignor, needs to be "perfected" by notice in writing given to the other party to the contract.[7] It must also be "absolute" in its terms, i.e., not expressed to be given by way of charge only.[8]

2. Burdens

It is not normally open to either party to assign to a third party the burdens imposed by a contract, i.e., neither can require the other to accept by the way of substitution a third party's performance of the obligations assumed thereunder. For this reason a term

4 See Dicey, Morris & Collins, *Conflict of Laws* (14th edn.), pages 1181–1867. The law governing the contract of assignment will, however, determine its intrinsic validity and the nature and extent of the obligations as between the assignor and the assignee; see Article 12(1) of the Rome Convention 1980 as enacted in English law by Schedule 1 of the Contracts (Applicable Law) Act 1990 and Article 14(1) of EC Regulation 593/2008 (the "Rome I Regulation") (see pages 273–275, *infra*).

5 The right to assign a contract should be carefully distinguished from the right to subcontract performance of particular obligations arising thereunder. Where the builder employs a subcontractor, this will not (in the absence of express provision) alter the nature and scope of his obligations to the buyer, i.e., the builder remains personally liable in respect of his subcontractor's performance; see pages 35–37, *supra*.

6 Where an assignment of the benefit of a contract has been effected, it is not normally an obstacle to the recovery by the assignee of substantial damages for breach of contract that the assignor would not itself have suffered any loss by reason of the breach; see *Darlington Borough Council* v. *Wiltshier Northern Ltd* [1995] 1 W.L.R. 68, H.L. The assignee will, however, otherwise take the benefit of the contract subject to any equitable rights (e.g. to rescind for misrepresentation) which have already accrued in favour of the other party to the contract.

7 Section 136 of the Law of Property Act 1925. The other party to contract is typically known as the "debtor", although his contractual obligations may comprise more than the mere payment of money.

8 An assignment given by way of security for a loan may, however, be absolute notwithstanding that it is intended to be discharged, and the property in question re-transferred to the assignor, upon repayment of the loan; *Tancred* v. *Delagoa Bay, etc., Ry* (1889) 23 Q.B.D. 239.

permitting either party to "assign this contract" will normally be interpreted as permitting an assignment only of its benefits and not of its burdens.[9]

Where, however, party A to the contract is willing specifically to agree to the substitution of party B by an identified third party, C, this usually takes effect by way of a "novation" of the contract, under which the rights and obligations originally existing between A and B are replaced by an identical relationship between A and C (see further below).

3. Prohibitions upon assignment

The legal position is rendered more complex where the contract expressly or impliedly prohibits its assignment by one or other party without the consent of the other party. Such a prohibition does not affect the issue of assignment of the burdens of the contract,[10] but gives rise to difficult questions in the context of a purported assignment of its benefits.

It is in this context clearly established in English law[11] that such an assignment, whether legal or equitable, undertaken in breach of an express or implied prohibition, will not convey to the assignee any interest in the contract itself or any cause of action arising thereunder.[12] This principle applies whether the assignment is intended to be absolute in nature or only to take effect by way of security.

Until *Linden Gardens Trust Ltd* v. *Lenesta Sludge Disposals Ltd. and Others* (1993),[13] it was thought that the existence of this rule rendered it problematic for either the buyer of defective manufactured goods or his "on-purchaser" to enforce the seller's post-delivery guarantee where: (i) the original contract of sale contained a prohibition on assignment without the seller's consent; (ii) such consent was not forthcoming; and (iii) the goods had been "on sold" by the buyer to a third party following delivery by the seller. The on-purchaser could not in such circumstances enforce the seller's guarantee at all, whilst the buyer, provided that he had sold the goods before the defects became known,[14] arguably suffered no loss by reason of the seller's failure to honour his guarantee.

At one time, the existence of this so-called "legal black hole" represented a significant concern in the context of the on-sale or bareboat chartering of newbuildings which were still subject to the customary twelve-month post-delivery guarantee furnished by the builder.[15] If, because of the shipbuilding contract prohibition upon assignment, the "on purchaser" or bareboat charterer could not directly enforce the builder's guarantee, and

9 See *per* Lord Browne-Wilkinson in *Linden Gardens*, *supra*, at page 427.

10 Which, as indicated above, cannot in any event be transferred other than by agreement reached with the other party to the contract.

11 *Helstan Securities Ltd* v. *Hertfordshire C.C.* [1978] 3 All E.R. 262 and *Linden Gardens*, *supra*. Such an assignment may nevertheless still create enforceable obligations between the assignor and the assignee; *Shaw & Co.* v. *Moss Empires and Bastow* (1908) 25 T.L.R. 190, Lord Browne-Wilkinson's judgment in *Linden Gardens* at page 431 and *Don King Productions Inc.* v. *Warren and others* [1999] 3 W.L.R. 276.

12 It is possible for a contract to prohibit the assignment of rights to future performance whilst allowing either or both parties to assign to third parties their accrued rights to monies (whether arising in debt or damages) due thereunder; see, as an example in a shipbuilding context, *Adam Bros.* v. *Blythswood Shipbuilding Co.* (1922) 13 Ll.L.Rep. 411. However, in *Linden Gardens*, *supra*, Lord Browne-Wilkinson expressed the view (at page 429) that, unless the very clearest language was used " . . . parties who have specifically contracted to prohibit the assignment of the contract cannot have intended to draw a distinction between the right to performance of the contract and the right to the fruits of the contract."

13 *Supra* at n. 3.

14 And thus without suffering any diminution in the resale price.

15 See generally pages 170–192, *supra*.

the seller or registered owner had suffered no loss, was the builder effectively excused from any responsibility for post-delivery defects?

In *Linden Gardens* the owners of certain properties had entered into contracts for the removal of asbestos from the same and for their redevelopment. The contracts contained provisions prohibiting their assignment without the contractors' consent. Thereafter, prior to any breach by the contractors of their obligations and without their consent, the owners purported to assign the contracts to "on-purchasers" of the properties. The latter sought in due course to sue the contractors for the cost of remedying certain alleged shortcomings in their performance of the works.

Against this background, the House of Lords, whilst confirming that the assignees could acquire no interest in the contracts assigned to them in breach of the contractual prohibition, held that the assignors, the original owners of the properties, could recover substantial damages on the assignees' behalf for the contractors' breaches of contract. In the words of Lord Browne-Wilkinson, delivering the principal judgment, it was proper:

"to treat the parties as having entered into the contract on the footing that [the original owners] would be entitled to enforce contractual rights for the benefit of those who suffered from defective performance but who, under the terms of the contract, could not acquire any right to hold [the contractors] liable for breach."[16]

His Lordship nevertheless also stated that this principle did not in his view apply where the contractor has " . . . pursuant . . . to the terms of the original building contract . . . undertaken liability to the ultimate purchasers to remedy defects appearing after they acquired the property . . . ".[17] This aspect of the decision was thereafter affirmed by the House of Lords in *Alfred McAlpine Construction Ltd* v. *Panatown Ltd* (2000),[18] which emphasised that the right to recover on behalf of an interested third party damages for breach of a construction contract may be excluded where such third party has a separate and direct right of recourse against the contract breaker.[19]

Since *Linden Gardens*, the Court of Appeal has further considered these questions in another important non-marine decision, *Offer-Hoar* v. *Larkstore Ltd* (2006).[20] Although this case did not concern a contractual prohibition on assignment, the Court examined the proposition that the assignees of a contract for consultancy services could not enforce claims for damages against the consultants where the assignor, who had originally appointed them, had suffered no loss by reason of their negligence. This defence was, however, dismissed in terms which make clear that English courts and arbitration tribunals must not permit legal "black holes" to defeat the enforcement of contractual obligations by an assignee, including (presumably) obligations arising under construction contract warranty clauses.[21]

16 At page 437.

17 *Ibid.*

18 [2000] 4 All E.R. 97.

19 For example, pursuant to an extra-contractual warranty given by the contractor directly to the third party.

20 [2006] EWCA Civ 1079.

21 See also *Pegasus* v. *Ernst & Young* [2012] EWHC 738 (Ch) *per* Mann J. at paragraph 30 of his judgment: "Where a wrong has been committed in relation to property, and loss is capable of arising as a result, the fact of an assignment, whether gratuitous [*GUS Property Management Ltd* v. *Littlewoods Mail Order Stores Ltd* 1982 S.C., H.L., 157, 1982 S.L.T. 533]), for part value (*GUS)* or for full value (*Linden Gardens* and *Offer-Hoar*) does not mean that it thenceforth has to be acknowledged that the assignor no longer can be said to have suffered loss. . . . the law says that the loss flowing can and should still be treated as a loss of the assignor which the assignee can recover. Black holes are to be (as all black holes should be) avoided where possible."

In light of these decisions, it seems that, as an exception to the general principle that a party can only claim damages in respect of his own loss,[22] English law recognises the existence of a remedy in favour of an assignee of a construction contract who has suffered loss as the result of the contractor's breach and who (by reason of a prohibition on assignment contained in the construction contract) would otherwise have no right of recourse against the contractor. Any claim must, however, normally be brought by the assignor of the contract, who will hold the damages recovered on trust for the assignee.

4. "Consent not to be unreasonably withheld"

Finally in this context, it should be noted that it is common for the parties to a contract to agree that the granting by one or either party of consent to its assignment should not be "unreasonably withheld".[23]

Where one party alleges that a required consent has, in breach of contract, been unreasonably withheld, the burden rests upon him to prove that the other's decision to withhold the consent was one which no reasonable person could have reached in the circumstances.[24] The party whose consent is needed is entitled to have regard to its own interests and not required to balance these with the interests of the party requesting the consent.[25] Where, however, the requesting party would suffer disproportionate detriment as a result of a refusal of consent, this may nevertheless be unreasonable.[26] Furthermore, the party refusing consent to an assignment which he has agreed will not be unreasonably withheld must make his decision on the basis of the proposed assignee's expected ability to perform the contract and not by reference to other factors. Where, as in *British Gas Trading Ltd* v. *Eastern Electricity plc and others* (1996),[27] the decision to refuse consent is taken for reasons unconnected with the assignee's ability to perform,[28] such decision is likely to constitute a breach of contract which will give rise to a claim in damages.[29]

In *British American Continental Bank Ltd* v. *William Doxford & Sons Ltd* (1922),[30] a shipbuilding case, a contract for two newbuildings provided that it should be "passed" by the original purchaser to "approved owners". Astbury J. accepted the purchaser's submission that this language imposed upon the shipbuilder a duty to act reasonably in

22 *Woodar Investment Development Ltd* v. *Wimpey Construction U.K. Ltd* [1980] 1 W.L.R. 277.

23 See, e.g., Article XXIV.2(2) of the CMAC Form and Article 45(b)(ii) of the NEWBUILDCON Form.

24 *Estates Governors of Alleyn's College* v. *Williams*, *The Times*, 21 January 1994.

25 *Porton Capital Technology Funds and others* v. *3M UK Holdings Ltd and another* [2011] EWHC 2895 (Comm). Note, however, that this decision is subject to a pending appeal.

26 *Ibid*.

27 18 December 1996, C.A.

28 In that case in order to take advantage of an express right of cancellation of the contract which arose if the consent was withheld.

29 Note that in *Abu Dhabi National Tanker Co.* v. *Product Star Shipping Co. Ltd* [1993] 1 Lloyd's Rep. 397 Leggatt L.J. (at page 404) held that "where A and B contract with each other to confer a discretion on A, that does not render B subject to A's uninhibited whim . . . the authorities show that not only must the discretion be exercised honestly and in good faith but, having regard to the provision of the contract by which it is conferred, it must not be exercised, arbitrarily, capriciously or unreasonably". See also *Ludgate Insurance Co. Ltd* v. *Citibank N.A.* [1998] Lloyd's Rep. I.R. 221, C.A. and *Socimer International Bank Ltd* v. *Standard Bank London Ltd* [2008] 1 Lloyd's Rep. 558 *per* Rix L.J. at page 576 that: "a decision maker's discretion will be limited, as a matter of necessary implication, by concepts of honesty, good faith, and genuineness, and the need for the absence of arbitrariness, capriciousness, perversity and irrationality".

30 (1922) 10 Ll.L.Rep. 301, 364.

considering whether to approve proposed assignees. He held, however, that this obligation had not been breached in circumstances in which the purchaser had been requested to guarantee a specific assignee's performance of the contract and had refused to do so.[31]

If the contract specifically requires a consent to assignment, this must always be requested in advance and a purported assignment without such a consent will be ineffective if no request has been made.[32] This is so even if the consent in question could not legitimately have been withheld if it had been properly requested.[33]

THE CONTRACT (RIGHTS OF THIRD PARTIES) ACT 1999

The principles referred to above are obviously relevant only where one of the parties to the contract has assigned, or purported to assign, rights arising thereunder. However, even in circumstances in which there has been no actual or purported assignment, it is possible in certain circumstances for contractual rights to be enforced by a third party provided that he was originally intended to benefit from the same. This fundamental change in English law resulted from the entry into effect of the Contract (Rights of Third Parties) Act 1999, which very substantially modified the application of the doctrine of so-called "privity of contract".

The Act provides in essence that a third party may directly enforce a term of a contract where either (i) the contract expressly provides that he may or (ii) the contracting parties intended that he should be entitled to do so.[34] The third party must "be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into".[35]

In such circumstances the third party is entitled under the Act to the same remedies as would have been available to him in an action for breach of contract if he had been an original party to the contract.[36] The original contracting parties are, however, free to impose conditions on the enforcement by a third party of any contractual term and the contractual defences available to either of the original parties are expressly preserved vis-à-vis the third party.

31 Note, however, that the "transfer" envisaged by the contract encompassed (unusually) both its benefits and burdens. It seems unlikely that a similar result would have been reached if the transfer had been limited only to the benefits of the agreement.

32 See *per* Millett L.J. in *Hendry* v. *Chartsearch Ltd* [1998] CLC 1382 " . . . retrospective consent, if given, may operate as a waiver, but cannot amount to the consent required by the contract. The proper course is for the assignor to ask for consent to a new assignment and to wait until it is given or unreasonably refused before proceeding to make it". Note also *CEP Holdings Ltd and CEP Claddings Ltd* v. *Steni A.S.* [2009] EWHC 2447 *per* Mrs Justice Gloster (at paragraph 37 of her judgment) that: "Where an assignment of contractual rights is prohibited without the prior written consent of the other contracting party, such consent not to be unreasonably refused, then there can be no valid assignment until written consent has been granted or the court has declared that the consent has been unreasonably refused", from which it would appear that, where consent to an assignment is being withheld unreasonably, the purported assignor must obtain a declaration of the court or arbitration tribunal to such effect before the assignment will take legal effect.

33 *Ibid*.

34 The Act nevertheless deals only with the enforcement of contractual rights and does not alter the rule which prohibits contracting parties from imposing burdens on a third party without the latter's prior consent.

35 Section 1(3).

36 Section 1(5); it would appear that (unlike the position of an assignee) a third party pursuing a claim under the Act is not limited to the amount of the damages which could have been claimed by the original promisee under the agreement.

The implications of these rules for sales of manufactured goods are obviously very significant. Where a third party "on purchaser" or lessee of goods falls within a contractually defined class or description of those intended to benefit from the manufacturer's warranty, the third party may (in the absence of express agreement to the contrary) enforce the warranty directly against the manufacturer whether or not an assignment of the original contract has been validly effected in his favour. Thus, for example, a sale of goods on terms that the warranty will apply "in favour of the purchaser or any party acquiring a proprietary or possessory interest in the goods during the warranty period" will allow any such party to enforce the same directly even if he had no involvement in the contract when originally concluded or in the goods when initially delivered to the purchaser.[37] Unless the parties have otherwise agreed,[38] the manufacturer will be entitled to the same defences and limitations of liability as would have been available in respect of a warranty claim by the purchaser, but it will be immaterial in this context that the purchaser has, by reason of the onsale, been unaffected by the defect in question.

SHIPBUILDING CONTRACT ASSIGNMENTS

In a shipbuilding context the most commonly used form of assignment is that effected by the buyer in favour of the bank providing pre-delivery finance for the purchase of the vessel. The primary purpose of a "security assignment"[39] of this type is to ensure that, in the event of the buyer's default under the loan agreement prior to delivery of the vessel, the bank will be entitled to take over the contract and, in return for paying the further instalments of the price as these fall due, to accept delivery of the vessel for its own account.[40] As previously indicated, assignments are nevertheless also used as the principal means of on-selling the vessel prior to her delivery to the buyer or, following her delivery, of vesting in the on-purchaser the benefit of the builder's warranty.

However, most shipbuilding contracts specifically limit or altogether exclude either or both parties' freedom to assign the benefits and burdens arising thereunder.

Against this background, and in light of the decisions referred to above, the basic principles relating to the assignment of a shipbuilding contract are as follows:

(a) where (unusually) the contract is silent on this issue, either the buyer or the builder may assign its benefits[41] but not its burdens;
(b) where the contract contains an express prohibition on assignment, the party against whom the prohibition operates cannot convey an interest in the contract

37 By the same token, the original purchaser of goods may be entitled to enforce warranties given to the manufacturer by the latter's subcontractors; see pages 178–182, *supra*.

38 Section 3(5).

39 The use of this term is somewhat misleading as it suggests that the assignment is not "absolute" and is therefore unenforceable at law. Such assignments, although given for the purposes of providing security, are nevertheless invariably drafted in absolute terms and s. 136 of the Law of Property Act will therefore usually apply, see n. 7, *supra*, and *Hughes* v. *Pumphouse Hotel* [1902] 2 K.B. 190.

40 Security assignments are considered further at pages 307–308, *infra*.

41 The buyer's rights are essentially to require construction and delivery of the vessel subject to the terms of the contract, including, in particular, the builder's post-delivery warranty. The builder's rights are normally limited to receipt of the purchase price, coupled with an entitlement to require the buyer to take delivery of the completed vessel.

to any third party. In such a case, however, it seems, in light of the decision in *Linden Gardens*, that the buyer may enforce for the benefit of the on-purchaser (or bareboat charterer) claims against the builder for breach of the quality obligations of the contract and/or the builder's warranty; this does not, however, apply where a direct contractual warranty has been extended by the builder to the on-purchaser (or bareboat charterer);

(c) where the shipbuilding contract has been entered into for the benefit of an identified or identifiable "on-purchaser" or bareboat charterer,[42] the builder's quality and warranty obligations will in any event (and assuming no agreement to the contrary) normally be enforceable by such third party directly under the Contract (Rights of Third Parties) Act 1999 as an exception to the general rule of English law denying rights of suit to "strangers" to a contract.

Finally, where the buyer is a single-purpose company incorporated (or acquired) for the purposes of entering into the contract, it is occasionally agreed that the company itself should be sold rather than that it should assign its contractual rights. The sale of all (or a controlling interest in) the share capital of the buyer will not as a matter of English law normally affect rights and obligations arising under the contract or any related guarantees. It may furthermore overcome problems which sometimes arise in transferring, pursuant to an assignment of the shipbuilding contract, an export licence or other governmental approval issued specifically (and exclusively) in favour of the buyer.

The third party acquiring the buyer will, however, be concerned to ensure that the latter is not subject to unknown liabilities which will affect its value or expose the third party to obligations which he cannot, for either legal or commercial reasons, subsequently disclaim. Unless the vendor is prepared to provide warranties and indemnities in respect of these matters (and, where appropriate, to secure the third party by the provision of bank or other guarantees), any purchase of the buyer's share capital will represent a relatively risky and problematic method of acquiring an interest in the shipbuilding project.

THE STANDARD FORMS

The SAJ Form prohibits assignment of "this Contract" by either party without the prior consent of the other; and provides that assignment by the buyer shall further be subject to Japanese Government approval.[43] Even where the relevant consents are forthcoming, it is expressly provided that the buyer "shall remain liable under [the] contract". This language is, however, in practice often amended.

In contrast, each of the NEWBUILDCON and CMAC Forms expressly permit both the buyer and the builder to assign the benefit of the contract to their respective financiers. However, while the NEWBUILDCON Form provides that such an assignment is generally permissible "*for the purposes of securing (. . .) financing*", the CMAC Form rather curiously stipulates that this must be "*in order to prevent the committed financing from*

42 The use of a bareboat charter structure is a common feature of newbuilding projects in which a bank or other financial institution provides lease financing (which is often "tax-driven") to a shipowner.

43 The requirement to seek Japanese Government approval is in practice unlikely to be found in any modern shipbuilding contract.

suffering any loss", which appears a somewhat arbitrary and uncertain test to satisfy, particularly at the outset of the shipbuilding project.[44]

As regards assignments to other third parties, the NEWBUILDCON Form provides that the buyer may assign, transfer or novate "this Contract" subject to the Builder's consent which is not to be unreasonably withheld.[45] The CMAC Form is in similar terms.[46]

NOVATION

As previously indicated, assignment of the contract will not normally divest the assignor of responsibility for the performance of the obligations arising thereunder. Accordingly, where either the buyer or the builder wishes to be released absolutely from his obligations under the contract and for a third party to be introduced in his place, it is normal for all parties to enter into a novation agreement. This is a tripartite arrangement under which the original contract is discharged by agreement and replaced by a new contract between either the buyer or the builder and the third party. It is obviously vital in this context that any third party guarantees issued in relation to the original contract should be replaced or reconfirmed, as the novation will almost invariably discharge such guarantees automatically.[47]

44 See the NEWBUILDCON Form Article 45(a) and (b)(i) and the CMAC Form Article XXIV.1 and 2(1).
45 Article 45(b)(ii).
46 Article XXIV.2(2).
47 See pages 300–303, *infra*.

Article XV—Taxes and duties

1. Taxes and Duties in Japan:

The BUILDER shall bear and pay all taxes and duties imposed in Japan in connection with execution and/or performance of this Contract, excluding any taxes and duties imposed in Japan upon the BUYER'S Supplies.

2. Taxes and Duties outside Japan:

The BUYER shall bear and pay all taxes and duties imposed outside Japan in connection with execution and/or performance of this Contract, except for taxes and duties imposed upon those items to be procured by the BUILDER for construction of the VESSEL.

The construction and sale of the vessel may, depending upon their domicile and the location of the shipyard, involve either the buyer or the builder in significant tax liabilities. These may typically arise in the form either of sales or value added taxes related to the contract price of the vessel or of customs or other duties levied on items imported in connection with the contract works. Most shipbuilding contracts incorporate express provisions allocating responsibility for such liabilities.

The SAJ Form follows the traditional geographical formula under which the builder meets all tax liabilities imposed in his own domicile or elsewhere to the extent that these relate to the performance of the contract works. For his part, the buyer is obliged to meet all tax liabilities (i) incurred outside the builder's domicile other than taxes relating to the builder's scope of supply and (ii) wherever incurred in connection with the buyer's supplies. Similar provisions are contained in the NEWBUILDCON Form, which also contains an express mutual indemnity between the builder and the buyer in respect of tax liabilities.

In contrast, and somewhat oddly in light of its origins, Article VII of the CMAC Form is significantly more favourable to the buyer than the SAJ and NEWBUILDCON forms. The builder is not only responsible for taxes incurred in China, but also liable to indemnify the buyer against (i) any duties imposed in China on imported buyers' supplied items and (ii) any duties or taxes imposed in China on the export of the vessel "as whole or upon any its parts or equipments".[1]

The shipbuilding contract will also frequently provide that, as between the buyer and the builder, the former shall be responsible for any income or other personal taxes levied upon his superintendents whilst they are resident at the shipyard. Such provisions are usually clear and uncontroversial.

1 See Article VII.2.

Article XVI—Patents, trademarks, copyrights, etc.

1. Patent, Trademarks and Copyrights:

Machinery and equipment of the VESSEL may bear the patent number, trademarks or trade names of the manufacturers.

The BUILDER shall defend and save harmless the BUYER from patent liability or claims of patent infringement of any nature or kind, including costs and expenses for, or on account of any patented or patentable invention made or used in the performance of this Contract and also including costs and expenses of litigation, if any.

Nothing contained herein shall be constructed as transferring any patent or trademark rights or copyright in equipment covered by this Contract, and all such rights are hereby expressly reserved to the true and lawful owners thereof.

The BUILDER'S warranty hereunder does not extend to the BUYER'S Supplies.

2. General Plans, Specifications and Working Drawings:

The BUILDER retains all rights with respect to the Specifications, and plans and working drawings, technical descriptions, calculations, test results and other data, information and documents concerning the design and construction of the VESSEL and the BUYER undertakes therefore not to disclose the same or divulge any information contained therein to any third parties, without the prior written consent of the BUILDER, excepting where it is necessary for usual operation, repair and maintenance of the VESSEL.

In even the most straightforward of shipbuilding projects, the construction and outfitting of the vessel is likely to involve the use of designs, construction methods and materials over which third parties enjoy patent and other intellectual property rights.[1] It is customary for the builder to assume the obligation of procuring from such third parties any licences required for the use of the materials and processes needed to complete and thereafter to operate the vessel.

Most shipbuilding contracts therefore contain an express warranty by the builder[2] that no infringement of third party intellectual property rights will take place during the course of construction and that the vessel will upon delivery and thereafter accordingly be free from all such claims. The builder's warranty will, however, not normally extend to the buyer's supplies.

In addition to such warranty, the contract will often also provide for an express indemnity in favour of the buyer in respect of any claims relating to patent or other

1 See, e.g., the design licensing arrangements described in *Anangel Atlas Compania Naviera S.A. and Others* v. *Ishikawajima-Harima Heavy Industries Co. Ltd* [1990] 1 Lloyd's Rep. 168.

2 The intellectual property provisions of Clause 40 of the NEWBUILDCON Form differ from other shipbuilding contract forms in that each party undertakes to the other that "any manufacture and/or supply according to specifications, drawings, models or other instructions supplied by it" will not infringe any third party "copyright, Trade Mark, patent or similar rights". Each party provides an indemnity to the other against any breach of such undertaking.

intellectual property right infringements which affect the vessel after delivery. The indemnity will frequently extend to a commitment on the part of the builder to provide security to release the vessel if she is arrested following delivery in pursuance of such a claim.

The SAJ Form incorporates within Article XVI.1 an express indemnity against the consequences of patent infringements. Curiously, however, this does not extend to infringement of any other intellectual property rights[3] and the buyer is accordingly unprotected against the claims for breach of trademark, copyright or (in an English law context) a so-called "registered" or "unregistered" design right.[4] Depending upon the circumstances, such claims may nevertheless fall within the terms of the declaration of warranty of freedom from encumbrances and other liabilities issued by the builder pursuant to Article VII.3 upon delivery and acceptance of the vessel.

In any event, however, there is no obligation upon the builder under the SAJ Form to provide security in respect of any actual or threatened arrest of the vessel in pursuance of a claim for infringement of intellectual property rights.

Finally, the reference in the fourth paragraph of Article XVI.1 to a "BUILDER's warranty" appears to be inappropriate. There is no warranty in the Article itself and the wording of the fourth paragraph excluding liability for the buyer's supplies must be taken to refer to the builder's indemnity in the second paragraph.

PROPERTY IN PLANS, DRAWINGS, ETC.

The contract will frequently also incorporate a clause stipulating that the builder is to retain title to all plans, drawings and other data relating to the design and construction of the vessel. This is often coupled with an express obligation upon the buyer not to divulge such information other than where required for the purposes of the vessel's operation or subsequent on-sale.

Under the SAJ Form, however, the right to disclose information is limited to matters "necessary for usual operation, repair and maintenance", i.e., there is no specific right in the buyer to divulge details of the vessel's plans and drawings to any on-purchaser. This issue is addressed in the NEWBUILDCON Form, which permits disclosure of plans and drawings to "subsequent owners".[5]

3 Similar wording can be found in Article XXIX of the CMAC Form where the express indemnity is also limited to the consequence of patent infringement. In contrast, the equivalent indemnity contained in the NEWBUILDCON Form applies to any infringement of intellectual property rights generally.

4 Such rights may derive from the provisions of the Registered Designs Act 1949, as amended by the Registered Designs Regulations 2001, and/or Part III of the Copyright and Designs Patent Act 1988. There is also a substantial measure of European Union law protection against the infringement of design rights; in particular deriving from Directive 98/71/EC of the European Parliament (O.J. No. L289, 28.10.1998, p. 28) and Regulation (EC) No. 6/2002 (O.J. No. L003, 05.01.2002, p. 1).

5 Clause 40(a).

Article XVII—Buyer's supplies

1. Responsibility of BUYER:

(a) The BUYER shall, at its own risk, cost and expense, supply and deliver to the BUILDER all of the items to be furnished by the BUYER as specified in the Specifications (herein called the "BUYER'S Supplies") at warehouse or other storage of the Shipyard in the proper condition ready for installation in or on the VESSEL, in accordance with the time schedule designated by the BUILDER.

(b) In order to facilitate installation by the BUILDER of the BUYER'S Supplies in or on the VESSEL, the BUYER shall furnish the BUILDER with necessary specifications, plans, drawings, instruction books, manuals, test reports and certificates required by the rules and regulations. The BUYER, if so requested by the BUILDER, shall, without any charge to the BUILDER, cause the representatives of the manufacturers of the BUYER'S Supplies to assist the BUILDER in installation thereof in or on the VESSEL and/or to carry out installation thereof by themselves or to make necessary adjustment thereof at the Shipyard.

(c) Any and all of the BUYER'S Supplies shall be subject to the BUILDER'S reasonable right of rejection, as and if they are found to be unsuitable or in improper condition for installation. However, if so requested by the BUYER, the BUILDER may repair or adjust the BUYER'S Supplies without prejudice to the BUILDER'S other rights hereunder and without being responsible for any consequences therefrom. In such case, the BUYER shall reimburse the BUILDER for all costs and expenses incurred by the BUILDER in such repair or adjustment and the Delivery Date shall be automatically postponed for a period of time necessary for such repair or replacement.

(d) Should the BUYER fail to deliver any of the BUYER'S Supplies within the time designated, the Delivery Date shall be automatically extended for a period of such delay in delivery. In such event, the BUYER shall be responsible and pay to the BUILDER for all losses and damages incurred by the BUILDER by reason of such delay in delivery of the BUYER'S Supplies and such payment shall be made upon delivery of the VESSEL.

If delay in delivery of any of the BUYER'S Supplies exceeds thirty (30) days, then, the BUILDER shall be entitled to proceed with construction of the VESSEL without installation thereof in or on the VESSEL, without prejudice to the BUILDER'S other rights as hereinabove provided, and the BUYER shall accept and take delivery of the VESSEL so constructed.

2. Responsibility of BUILDER:

The BUILDER shall be responsible for storing and handling with reasonable care the BUYER'S Supplies after delivery thereof at the Shipyard, and shall, at his own cost and expense, install them in or on the VESSEL, unless otherwise provided herein or agreed by the parties hereto, provided, always, that the BUILDER shall not be responsible for quality, efficiency and/or performance of any of the BUYER'S Supplies.

Although it is expressly or impliedly provided in most shipbuilding contracts that the vessel shall be delivered in a fully completed condition ready immediately to commence commercial operations, it is in practice unusual for the builder to supply all of the

machinery and equipment required for this purpose. Apart from minor items such as furniture, crockery, charts, etc., the buyer will often choose, for reasons of cost or ease of inspection, to supply elements of the vessel's machinery and equipment and will rely upon the builder only for their safekeeping at the shipyard and installation on board the vessel.

The nature and extent of the buyer's supplies will vary widely from one project to the next but may typically include specialised cargo handling gear, navigational and telecommunications systems or, in the case of cruise vessels, catering and other hotel equipment. Where, however, the vessel is either relatively unsophisticated or to be constructed to the builder's standard design, the buyer's supplies are likely to represent only a very small proportion of the overall project cost.

The extent to which the buyer, rather than the builder, is to provide such items will nevertheless obviously affect the contract price. Where buyer's supplies are to be furnished, it is therefore common for the parties to agree upon a list of the same before the contract is concluded[1] and for this to be incorporated in an appendix to the specification. If, however, agreement has not been reached on this issue at the date of the contract, the parties will often decide to treat the contract price as provisional only, to be adjusted as and when the extent of the buyer's supplies is agreed.

Under Article XVII.l(a) of the SAJ Form, the buyer's primary obligation is to deliver his supplies in "proper condition" ready for installation in accordance with the builder's time schedule. The buyer is also required to provide manuals and other information to facilitate installation of the supplies by the builder. He can further be obliged by the builder to procure the attendance and assistance at the shipyard of representatives of the manufacturers of the machinery and equipment in question.

For his part, the builder must exercise reasonable care in storing and handling the buyer's supplies.[2] He does not, however, accept any responsibility whatsoever for their performance, either before or after delivery of the vessel; it will be recalled that "any parts for the VESSEL which have been supplied by or on behalf of the BUYER" are expressly excluded from the terms of the builder's post-delivery warranty.[3]

In the event that, prior to delivery of the vessel, any items falling within the definition of buyer's supplies prove to be defective, these may be rejected by the builder in the reasonable exercise of his discretion, in which event they must be replaced by the buyer. Alternatively, such items may, at the builder's option, be repaired for the buyer's account on the basis that any delay arising shall automatically extend the Delivery Date. The builder undertakes all such remedial works "without being responsible for any consequences therefrom".[4]

If any of the buyer's supplies are delivered late, the effect upon completion of the project may be substantial. The SAJ Form accordingly provides that the Delivery Date is automatically extended for the period of "such delay in delivery" and the buyer becomes liable for any additional costs incurred by the builder as a consequence thereof; there is

1 Alternatively, the schedule is provided to the builder during the period of pre-production planning.

2 This merely reflects English common law, which imposes upon a bailee of goods a duty to take reasonable care of the same: *Houghland* v. *R.R. Low (Luxury Coaches) Ltd* [1962] 1 Q.B. 694. By contrast, under the NEWBUILDCON Form, the builder is expressly responsible for the safe storage, handling and insurance of the buyer's supplies from the time these are delivered to the shipyard; see Clause 21(b).

3 Article IX.l see page 172, *supra*. The equivalent provision in the CMAC Form is Article XIX.1.

4 This exclusion may, however, be subject to the operation of the Unfair Contract Terms Act 1977; see pages 188–191, *supra*.

no scope for the buyer to claim that performance of his obligations has been prevented or impeded by *force majeure* events.

Under the SAJ Form the builder's right to an extension of the Delivery Date accrues whether or not the construction of the vessel has in fact been affected by the delay in delivery of the buyer's supplies. The builder is, however, entitled only to claim an extension for the number of days of delay in delivery rather than the period by which his construction programme has been disrupted. From the builder's perspective, this represents a potential exposure which will sometimes be dealt with by specific amendment to the standard form.

Where the delay in delivery exceeds thirty days,[5] the builder is entitled to proceed with the vessel without incorporating the missing supplies and may deliver the vessel in such condition, in which event the vessel will be contractually compliant.[6] This liberty applies even if the supplies are delivered to the shipyard after expiry of the 30-day period, but before the Delivery Date. It should also be noted that in the event of delay in delivery of the buyer's supplies, the buyer is contractually responsible, without financial limit, for "all losses and damages incurred by the BUILDER by reason of such delay in delivery"; in practice, however, this clause is often deleted.

The provisions of the CMAC Form relating to buyer's supplies are similar to those of the SAJ Form, but differ from those of the NEWBUILDCON Form. The latter provides for a more balanced approach to this issue under which, in circumstances in which the buyer delivers his supplies later than the agreed date(s) or these are defective, the builder is entitled (subject to giving the appropriate notices required for a Permissible Delay claim) to an extension of time, but only to the extent that the delay or defect has caused actual delay to the delivery of the vessel.[7] Similarly, where the delay in delivery of the buyer's supplies exceeds thirty days, and is causing continuing delay to delivery of the vessel, the builder is entitled to deliver her without them.

The supplies themselves are to be provided by the buyer in accordance with the building and testing schedules provided for under Clause 20(a) of the NEWBUILDCON Form. It should be noted that in the event of the supplies being defective, there is no express right in the builder to carry out repairs for the buyer's account. The form also makes clear that, although subject to an obligation to "install them in or on the Vessel in accordance with the specification", the builder assumes no responsibility for "the quality, efficiency and/or performance" of any of the buyer's supplies. Difficult issues of liability may nevertheless arise in circumstances in which complex equipment is included within the scope of the buyer's supplies, and it is contended that failures in performance have resulted both from inherent deficiencies in the same and from errors and omissions in their installation by the builder.

Complex questions may also arise where the contract is terminated before delivery of the vessel. In such circumstances, the builder will usually wish to ensure that its ability to resell the vessel to a third party is not impeded by the buyer's ownership of important

5 The 30-day limit applies to each item of buyer's supply, rather than in aggregate.

6 See *BW Gas AS* v. *JAS Shipping Ltd* [2010] EWCA Civ 68, a case concerning a bareboat charter in respect of a newbuilding, where the Court of Appeal held that the vessel, although delivered without certain buyer's supplies, which the buyer had failed to provide, had nevertheless been completed in accordance with its SAJ Form shipbuilding contract and associated specifications.

7 Clause 34(a)(ii)(1).

elements of buyer's supplies, particularly where these have been physically incorporated within the hull or superstructure.

Under the SAJ Form,[8] title to the buyer's supplies passes to the builder automatically upon the latter's rescission of the contract, but not (it would appear) where the contract is rescinded by the buyer, in which event the builder is in principle subject to a duty to return to them to the buyer.[9]

The CMAC and the NEWBUILDCON Forms both provide that, in the event of the buyer's termination of the contract, the builder must return the buyer's supplies unless they cannot be returned, in which case the builder is obliged to reimburse the buyer's costs of purchase of the same[10]; neither form provides any guidance as to the circumstances in which the supplies are to be considered non-returnable, although this is presumably meant to encompass the situation in which these have been physically incorporated within the vessel such that it is not practical, physically and/or economically, to remove them.

Where the contract is instead terminated by the builder in consequence of the buyer's default, title to the buyer's supplies either passes to the builder without direct compensation, in the case of the CMAC form,[11] or the builder is authorised to retain or sell the same on the buyer's behalf together with the vessel, in the case of the NEWBUILDCON Form[12]; under the latter form, the buyer is nevertheless entitled, at the builder's option, to remove his supplies from the vessel prior to any third-party sale or to receive "credit for the full value thereof" in the post-termination accounting of the sale proceeds.

8 Article XI.3(b).

9 It is submitted that the builder can fulfil this duty by making the supplies available to the buyer for collection at the shipyard, being their original point of delivery to him.

10 Article XXVII.5 of the CMAC Form and Clause 39(e) of the NEWBUILDCON Form.

11 Article XXII.4(2)(i) of the CMAC Form.

12 Clause 39(f) of the NEWBUILDCON Form.

Article XVIII—Notice

1. Address:

Any and all notices and communications in connection with this Contract shall be addressed as follows:

To the BUYER:

.....

.....

Cable Address: .....

Telex No.: .....

To the BUILDER:

.....

.....

Cable Address: .....

Telex No.: .....

2. Language:

Any and all notices and communications in connection with this Contract shall be written in the English Language.

A number of formal notices (in particular, concerning payment of the contract price instalments and the delivery of the vessel) will need to be given by each of the parties during the life of any shipbuilding contract. Given that the buyer and the builder will often be located thousands of miles apart, it is common to include within the contract provisions concerning the precise methods by which such notices are to be given.

This assists both parties to the contract. The sender knows that, provided that the provisions of the contract are followed, he need not inquire whether a notice he has given has actually been received and understood. For his part, the recipient can be assured that notices sent to him will be contractually binding only if directed to the individuals or departments he has designated as ready to receive and act upon them.

Apart from stipulating a number of alternative methods by which notices may be given (typically airmail, courier service and telefax), the parties will often agree upon a

timeframe within which notices given by such methods shall be deemed served upon the recipient. A notice or communication given by telefax will usually be regarded as received immediately, while that contained in a document sent via courier may, for example, be deemed served only three days after dispatch.[1]

Difficult legal questions arise as to the conclusiveness or otherwise of notice provisions of this type, in particular whether it is open to the sender to contend that a notice was in fact received even if the agreed channels of communication were not used. This will depend upon the proper construction of the clause itself, although it is submitted that the usual interpretation of such provisions is that they raise only a presumption of notice. Thus, even if the correct channels have not been used, it is still open to the sender to prove that the notice was in fact duly received.

Article XVIII of the SAJ Form (which sets out merely a postal and cable address, together with a telex number, for each party) is less sophisticated than many similar clauses in current use. It should be noted first, that the Article applies to both "notices and communications" and, secondly, that its provisions are directly linked to those of Article IV.1 concerning the timescale for the buyer's approval of the builder's drawings and plans. The Article contains no provisions regarding the date of deemed receipt of any notices and communications.

The NEWBUILDCON Form[2] largely addresses these deficiencies and significantly updates the procedures contained in the SAJ Form to reflect modern communication methods. Notices may be sent "by post, facsimile, electronically or delivered by hand" to the addresses to be completed as Boxes 2 and 3 of Part 1 of the form, which include physical and e-mail addresses and telefax numbers. The form contains provisions determining the date of deemed receipt of notices.

The CMAC Form[3] also envisages e-mail communication of notices between the parties. It also provides that notices shall be written in Chinese or in English "subject to the situation" and that each language shall be "of equal effect, while in case there is any disagreement between the English version and Chinese version, the Chinese one shall prevail". It seems unlikely that these provisions will in practice appeal to many non-Chinese-speaking newbuilding purchasers.

1 Where the contract provides merely that notices shall be given "in writing", this does not (it is submitted) preclude the use of telefax or e-mail communications. Schedule I of the Interpretation Act 1978 (which admittedly relates to the interpretation of statutes rather than private agreements) provides that " 'writing' includes typing, printing . . . photography and other modes of representing or reproducing words in a visible form . . . ", which plainly includes both fax and e-mail communications.

2 At Article 43.

3 At Article XXX.

Article XIX—Effective date of contract

This Contract shall become effective as from the date of execution hereof by the BUYER and the BUILDER.

However, in the event that a Construction Permit[1] for the VESSEL shall not have been granted by the Japanese Government within (.....) days from the date of this Contract, then, in such case, this Contract shall automatically become null and void, unless otherwise mutually agreed in writing between the parties hereto, and then both parties hereto shall be immediately and completely discharged from all of their obligations to each other under this Contract as though this Contract had never been entered into at all.

Each of the buyer and the builder may, for a variety of reasons, be unable or unwilling to commit himself unconditionally to the contract at the time of its signature. The terms of the agreement may, for example, have to be approved formally by each party's board of directors. The parties may also need to secure bank financing to meet either the costs of construction or the contract price. Perhaps most importantly, the law governing the contract or applying at the shipyard may stipulate that a governmental approval or licence is required for the construction or export of the vessel.

Such requirements may, however, be difficult or impossible to secure unless and until the project is defined and documented. It is accordingly very common for shipbuilding contracts to incorporate so-called "Effective Date" provisions under which either the agreement itself or the performance of obligations arising thereunder are expressly made conditional upon the occurrence of certain defined events. This structure permits each of the parties to make the necessary arrangements to permit performance of the contract without incurring a liability to the other party if its efforts should be unsuccessful, but in the knowledge that, if both parties succeed, the agreement provisionally concluded between them will become (or remain) fully binding and effective.

CONDITIONS PRECEDENT AND SUBSEQUENT

A term upon which the enforceability of a contract depends is usually known in English law as a "condition" of that contract.[2] Such terms may be either conditions "precedent"

1 The SAJ Form originally provided for the issuance by the Japanese Government of an export licence. The requirement under Japanese law to procure an export licence no longer exists, although a construction permit, issued by Ministry of Land, Infrastructure and Transport (formerly the Ministry of Transport) is still needed; provided that construction of the vessel does not obstruct the "sound development of the international shipping industry of Japan" and the builder has the relevant capability and resources, the Ministry is nevertheless legally obliged to issue a permit. Most of the other major shipbuilding jurisdictions equally no longer require the issuance of an export licence for commercial newbuildings.

2 In this context the meaning of the term "condition" is quite distinct from that referred to earlier (see pages 108–109, *supra*) as categorising certain types of promise which, if breached, entitle the innocent party to treat the agreement as repudiated. The two types of term were referred to respectively as "contingent" and "promissory" conditions in *Total Gas Marketing Ltd* v. *Arco British Ltd* [1998] 2 Lloyd's Rep. 209, H.L.

or conditions "subsequent". A condition precedent is a term which will prevent either the contract itself or obligations thereunder from becoming effective until it has been satisfied, while a condition subsequent terminates an already binding contract upon the occurrence of a defined event.[3] The principles of law applying to each type of condition are, however, very similar[4]; neither condition negates the application to a contract of sale of the provisions of the 1979 or 1994 Acts.[5]

CONDITIONS AND CONTRACTUAL OBLIGATIONS

It is also important in this context to distinguish between the conditions of a contract and its obligations. If a contract provides, for example, for the sale by one party to the other of certain goods which both know will require an export licence, it will be a question of construction of the contract as a whole whether obtaining the licence is merely a condition of the vendor's obligation to sell (and, conversely, that of the purchaser to buy) or a separate obligation which the vendor has undertaken to perform.[6] It is normally only in the latter situation that the seller will be liable in damages if the licence is not procured and the contract accordingly cannot be performed.[7]

However, even if the term in question comprises an obligation rather than a condition of the contract, this may be qualified rather than absolute in nature, often amounting to no more than a duty to use reasonable endeavours. Thus, in *Re Anglo-Russian Merchant Traders and John Batt & Co. (London) Ltd* (1917),[8] where the export to Russia of certain metals required a UK Government permit, the sellers were held not liable in damages for their failure to supply, although they had not even applied for the permit. Their contractual obligation was only to use reasonable efforts to obtain the same and the court found as a fact that an application, even if made, would have been refused.[9]

CONDITIONS PRECEDENT AND SUBSEQUENT IN SHIPBUILDING CONTRACTS

It is unusual in the context of shipbuilding projects for the parties to assume express obligations, even of a qualified nature, to bring about the circumstances required to permit the vessel's construction. As indicated above, the usual practice is rather, by means of an

3 As in *Gyllenhammar*, *infra*, the "event" may nevertheless be merely the failure to obtain a licence or other permission within a defined period, i.e., strictly speaking a "non-event".

4 See *per* Scott J. in *Thompson* v. *ASDA-MFI plc* [1988] 1 Ch. 241 at pages 251 and 261.

5 Section 2(3) of the 1979 Act provides that "A contract of sale may be conditional or absolute".

6 It may be the purchaser's obligation to obtain the licence, although this would be extremely unusual in a shipbuilding contract.

7 For an example in a shipping context of a term which, although carrying certain hallmarks of a condition precedent, was in fact an obligation, see *Damon Compania Naviera S.A.* v. *Hapag-Lloyd International S.A. (The "Blankenstein")* [1985] 1 Lloyd's Rep. 93, C.A., in which the purchasers' failure to post the agreed deposit for the purchase of three vessels constituted a breach of contract rather than the failure of a condition.

8 [1917] 2 K.B. 679. See also *Brauer & Co. (Great Britain) Ltd* v. *James Clark (Brush Materials) Ltd* [1952] 2 All E.R. 497 and *Overseas Buyers* v. *Granadex* [1980] 2 Lloyd's Rep. 608.

9 A similar finding was made in *Gyllenhammar*, *infra*, in relation to the shipbuilders' failure to apply for registration of the credit terms of the optional contract (see n. 18, *infra*).

Effective Date clause, to provide for agreed conditions which must be satisfied if the parties are to become (or remain) contractually bound.

This may be achieved by the use of either type of condition, precedent or subsequent. Although the former are more usual in international projects, subsequent conditions will often be employed where, for example, the parties wish to commence work on the project immediately but know that the granting of an export licence is likely to be delayed for administrative reasons. Even in this situation, however, it will be unusual for the buyer to pay the first instalments of the contract price until the condition has been satisfied or repayment of the instalment has been secured by a refund guarantee or other third party undertaking.

Thus, for example, the SAJ Form provides that the contract should be binding from the date of signature but rendered "null and void, unless otherwise mutually agreed in writing" in the event that the required construction permit for the vessel is not granted within an agreed time; the first instalment of the contract price is nevertheless not due until this requirement has been satisfied. In contrast, the CMAC Form uses conditions precedent to achieve a similar result, Article XXXII providing that the contract will become effective upon the fulfilment of certain specific conditions, including the issuance of a Chinese Government export licence[10] and payment by the buyer of the first instalment of the contract price.[11] The NEWBUILDCON Form also provides for conditions precedent to be satisfied before the contract becomes effective, although these are not defined in the standard form and need to be specifically agreed by the parties.[12]

Where a contract provides that it may be rescinded by either party if a condition precedent to performance is not satisfied within a stipulated date, the exercise of such right will normally be valid notwithstanding that the condition is satisfied after the stipulated date but before the notice of rescission is given.[13]

RELIANCE UPON EFFECTIVE DATE PROVISIONS

The key issue in this context is the extent to which either the buyer or the builder is entitled to rely upon the provisions of an Effective Date clause where he has been responsible for the circumstances causing the contract to fail. This is of particular importance in a volatile market where, as prices rise or fall quickly, either party may be tempted to try to renegotiate or avoid altogether commitments provisionally made to the other. While the parties will obviously be prepared to accept the risk that the failure of the contract may occur without fault on either side, this is very different from the situation in which one party seeks to rely upon his own deliberate act or omission to avoid performance of the obligations he has previously agreed to assume.

This issue, although of some complexity in English law, merits detailed examination in light of its practical importance to both parties to the contract.

10 This must be issued by the Chinese Ministry of Commerce.

11 Article XXXII is, however, poorly drafted for several reasons. In particular (i) it provides that the buyer's payment of the first instalment of the contract price should represent a condition of effectiveness of the contract notwithstanding that Article V allows him at least 3 Banking Days from effectiveness to make the payment; and (ii) it does not stipulate a time scale for the approval of the contract by each party's board of directors.

12 Clause 44(a).

13 *Millers Wharf Partnership* v. *Corinthian Column* (1990) 61 P. & C.R. 461.

The main principle applicable to this situation is that, if a term of a contract renders performance of its obligations conditional upon a defined event, it is presumed that the parties intend that neither may rely upon that term if he himself has prevented (or, in the case of a condition subsequent, caused) the occurrence of that event.

In an early Scottish case, *Mackay* v. *Dick* (1881),[14] a contract for the sale of an excavating machine stipulated that its acceptance by the purchaser was to be conditional upon the vendor demonstrating its ability to remove a certain quantity of clay in a fixed time on a "properly opened-up face" at the purchaser's railway cutting. In breach of contract, the purchaser refused to provide facilities to permit the required test to take place. He was held not to be entitled to rely upon the condition attaching his acceptance of the machine and therefore liable for the agreed price.

At one stage in the development of English law this principle (i.e., that neither party might rely upon his own act or omission as the basis for seeking to avoid his contractual obligations) was considered to be fixed and immutable, being founded upon the maxim that "no man can take advantage of his own wrong". Thus, according to Lord Atkinson in *New Zealand Shipping Co. Ltd* v. *Société des Ateliers et Chantiers de France* (1918)[15]:

> "If the . . . contract shall be void on the happening of an event which one or either of them can by his own act or omission bring about, then the party, who by his own act or omission brings that event about, cannot be permitted either to insist upon the stipulation himself or to compel the other party, who is blameless, to insist upon it, because to permit the blameable party to do either would be to permit him to take advantage of his own wrong. . . . "[16]

In *New Zealand Shipping* a French shipbuilder agreed to construct a newbuilding for completion by 30 January 1915. Clause 5 of the contract stated, however, that the delivery date was to be subject to extensions of time if construction was delayed by any "unpreventable cause beyond [his] control". It was also agreed that if, as the result of France becoming engaged in a European war, the shipbuilder should fail to deliver the vessel within 18 months of the date agreed for completion, the contract would become "null and void" and the purchaser's pre-delivery instalments be repaid with interest.

On 30 July 1916 (i.e., 18 months after the original date for completion) the question arose whether the shipbuilder was entitled to treat the contract as null and void. The House of Lords held in these circumstances that, as the failure to complete the vessel had not resulted from any breach of the contract by the shipbuilder, he was not precluded from relying upon the condition subsequent as a basis for its termination. As can be seen from Lord Atkinson's dictum cited above, the House of Lords was nevertheless clearly of the view that the condition could not have been invoked if the shipbuilder's failure to complete had not been "due entirely to causes beyond his control covered by Clause 5 in the contract".[17]

The *New Zealand Shipping* decision has, however, since been considered at length in three important decisions, *Cheall* v. *Association of Professional Executive Clerical and*

14 (1881) 6 App. Cas. 251; see also *Nissho Iwai Petroleum Inc.* v. *Cargill International S.A.* [1993] 1 Lloyd's Rep. 80 and *Compagnie Noga d'Importation et d'Exportation SA* v. *Abacha & anr* [2001] 3 All E.R. 513.

15 [1919] A.C. 1.

16 At page 9.

17 *Per* Lord Finlay L.C. at page 6.

Computer Staff (1983),[18] *Thompson* v. *ASDA-MFI plc* (1988)[19] and *Gyllenhammar & Partners International Ltd* v. *Sour Brodogradevna Split* (1990),[20] as a result of which it is now clear that the principle in question is one of construction, rather than law, and that it can accordingly be excluded by agreement between the parties. There is, however, a presumption against agreements of this type; according to Lord Diplock in *Cheall*[21]:

" . . . the rule of construction [is] that, except in the unlikely case that the contract contains clear express words to the contrary, it is to be presumed that it was not the intention of the parties that either party should be entitled to rely upon his own breaches of his primary obligations as bringing the contract to an end . . . ".[22]

In *Gyllenhammar*,[23] Yugoslav shipbuilders had entered into a contract to build a bulk carrier on terms incorporating a builder's credit and requiring them to provide a refund guarantee for the purchasers' pre-delivery instalments. Article 23 of the agreement, which was headed "Entering into Force", provided that the contract should be subject (*inter alia*) to "(a) The BUILDER declaring . . . to the BUYER . . . that the [refund guarantee] . . . has been obtained and airmailed to the [BUYER'S] Bank . . . [and] (b) The BUILDER declaring by telex . . . that . . . all necessary permissions and approvals have been obtained"; if the contract had not entered into full force and effect within 30 days of the date of signature, it was to become null and void "unless otherwise mutually agreed". At the same time, the shipbuilders granted the purchasers an option, exercisable at any time prior to delivery of the vessel, to purchase a second newbuilding "on identical terms to those in the [original] contract".

By the time the option was exercised three years later, the newbuilding market had moved very significantly in favour of the purchasers. The shipbuilders signed the optional agreement but thereafter alleged that this had become null and void as a result of their failure to make either of the telex declarations within the thirty-day period prescribed by Article 23. This failure, they alleged, had resulted from their inability to secure the approval of their bankers, Jugobanka, to a request to provide financing for the vessel's construction; in consequence, the shipbuilders had been unable to secure further necessary approvals from the National Banks of Croatia and Yugoslavia.

In response, the purchasers argued that the shipbuilders could not rely upon Article 23 in circumstances in which they were in breach of their express obligation to procure the refund guarantee and of an implied obligation to use best endeavours to obtain any necessary approvals or permissions; in this latter respect, the purchasers contended that no permissions and approvals were in any event necessary for the performance of the contract.

Against this background, the Commercial Court (Hirst J.) held:

(a) that in light of the decision in *Cheall*, the application of the principle in *New Zealand Shipping* depended upon the implication of a term that Article 23 should not benefit the shipbuilders where they were in breach of their contractual obligations;

18 [1983] 2 A.C. 180.
19 *Supra* at n. 4.
20 [1989] 2 Lloyd's Rep. 403.
21 *Supra*, at page 189 of the report.
22 See also *Alghussein Establishment* v. *Eton College* [1988] 1 W.L.R. 587, *per* Lord Jauncey at page 595.
23 *Supra*, at n. 18.

(b) that, on its true construction, Article 23 did not permit the implication of such a term; on the contrary, the Article operated on a "fault-free" basis, in the sense that it permitted the shipbuilders to rely upon its terms whether or not they were in breach of their contractual obligations to procure the refund guarantee and to use reasonable endeavours to obtain any "necessary permissions and approvals";

(c) that, following the Court of Appeal decision in *British and Commonwealth plc* v. *Quadrex Holdings Inc.* (1989),[24] "necessary permissions and approvals" within Article 23 connoted consents required by Yugoslav law and did not encompass Jugobanka's refusal to provide construction finance;

(d) that the national banks' approvals were, however, "necessary" within the meaning of Article 23 in that these were (on the judge's findings of fact) required by Yugoslav law; it was irrelevant in this context that a failure to obtain such approvals would not have rendered performance of the contract illegal but might (possibly) have attracted a fine.[25]

Although the decision in *Gyllenhammar* turned largely upon the wording of Article 23, the result led to a number of surprising consequences, not least of which being that it effectively rendered the shipbuilders' obligation to perform the option they had granted in 1985 subject to "permissions and approvals" they had no duty to attempt to obtain. Although the existence of an obligation resting upon the shipbuilders to use reasonable endeavours to obtain the permissions etc. was of only limited significance in relation to the original contract,[26] it was crucial to the option, which was almost valueless without it. The judge's acceptance of the submission that, in light of Yugoslavia's financial difficulties in 1985, the shipbuilders should be taken to have granted only a "conditional" option[27] is (at the very least) somewhat at odds with the industry's understanding of the nature of this type of commitment. It should be noted that in *Little* v. *Courage Ltd* (1995),[28] which concerned an option to extend a property lease, Millett L.J., giving judgment in the Court of Appeal, stated that:

"The whole point of an option is that the grantor undertakes to grant an interest to the grantee in the future if the grantee calls on him to do so, whether the grantor is then willing to grant it or not. The Court will struggle to avoid a construction which would render the option illusory by making it impossible for the grantee to exercise it unless the grantor were willing to grant the interest anyway."

Finally, it should be emphasised that it is only acts or omissions that constitute a breach of obligations owed by one party to the other which attract the operation of the principle in *New Zealand Shipping*.

In *Fast Ferries One S.A.* v. *Ferries Australia Pty Ltd* (2000)[29] the intending purchaser of two newbuildings had secured a conditional commitment from its financiers, Debis, to

24 [1989] 3 W.L.R. 723.

25 Although this was not strictly required in light of his decision as to the true construction of Article 23, the judge also held on the facts that the shipbuilders had used reasonable endeavours to secure the required approvals; this was notwithstanding that they had not even submitted the relevant application forms to the two National Banks.

26 In that, if any of the conditions precedent had not been satisfied, the buyer would have wasted a maximum of 30 days before placing his newbuilding order elsewhere.

27 See page 416 of the report.

28 (1995) 70 P. & C.R. 469.

29 [2000] 1 Lloyd's Rep. 534.

provide the finance needed for their purchase. Under considerable time pressure, the buyer and the builder signed a shipbuilding contract on terms that, if the buyer had met all of the conditions for the financing defined in the commitment letter, Debis' failure to provide funding on terms satisfactory to each of the buyer and the builder would constitute a condition subsequent terminating the shipbuilding contract. The buyer meanwhile paid a deposit to the builder.

The funding was in due course not provided but the builder refused to return the deposit, arguing that the buyer was in breach of an implied contractual term that he would take "all reasonable steps and exercise best endeavours" to reach agreement with Debis even if this involved the acceptance of conditions not originally provided for in the commitment letter. However, the High Court rejected this argument and held that, in the absence of any breach of obligation on the part of the buyer, the condition subsequent took effect terminating the shipbuilding contract and rendering the deposit repayable. In the view of Steel J.[30]:

" . . . it is important to bear in mind that the [shipbuilding] contract had been conditional on the provision of finance by Debis on terms which were satisfactory to [the buyer and the builder]. . . . While a term could readily be implied that neither party would prevent approval [of the financing] being given on the terms offered (e.g. by withdrawing the application), there is no basis . . . for implying any term to the effect that either party was under an obligation to accept different finance terms."

In *Covington Marine Corporation* v. *Xiamen Shipbuilding Industry Co.* (2005),[31] the parties had entered into shipbuilding contracts subject to a number of conditions subsequent including, as set out in Article 21(b)(i), "agreement . . . as to the supplier of the main engine . . . which the parties shall use their best endeavours to reach". If this or other specified conditions were not satisfied within 20 "banking days" from the date of signature,[32] the contracts were expressed to be automatically rescinded and the parties discharged from all any liability to each other.

Within such twenty banking day period, the builder entered into agreements to build similar vessels for another purchaser and effectively refused to proceed with the original contracts, relying *inter alia* on the parties' failure to agree upon the identity of the supplier of the main engines.

In these circumstances, the High Court, in appeal proceedings against an arbitration award in favour of the builder, held that the parties had indeed reached agreement as to the engine supplier. On this basis, the builder's defence failed, although the court helpfully also considered the position in the event that this conclusion was wrong i.e. that no agreement had been reached within the twenty banking day period owing to the builder's withdrawal from the negotiations.

In this latter context, the Court held that Article 21(b)(i) provided merely for an "agreement to agree" and that, if agreement had not in fact been reached, the builder would have been permitted to rely upon the "automatic rescission" provisions of each contract. Langley J. said:

"I do not think the 'principle' in *Mackay* v. *Dick* (1881) . . . assists the Buyers. This would not be a case of one party preventing performance by the other of a matter they have agreed should be done

30 At page 541.

31 [2006] 1 Lloyd's Rep. 745.

32 Within this 20 banking day period, the time scale for agreement on the identity of the engine supplier was expressly limited to 10 banking days.

because in sub-para (b)(i) . . . the Builders have not agreed more than to agree. Nor would the Builders be taking advantage of their own wrong or breach of a duty owed to the Buyers: *Cheall* v. *A.P.E.X.* [1983]. . . . It would not be a wrong or a breach of duty not to agree on the supplier of the main engine".[33]

The principle in *New Zealand Shipping* equally has no application at all where the circumstances alleged to preclude reliance upon an Effective Date clause are, for example, expressly excused by the terms of the contract[34] or evidence an obligation owed only to a third party.[35]

In summary, therefore, the rules applying to clauses of this type are as follows:

(a) whether the Effective Date clause relies for its effect upon the use of conditions precedent or subsequent, the extent to which it can be relied upon by a party whose own acts or omissions have brought into existence the circumstances causing the contract to fail will depend upon its true interpretation. While there exists a presumption in English law that a commercial agreement is not intended to permit either party to benefit from his own breach of its terms, this presumption can (as in *Gyllenhammar*) be rebutted if it is clear from the terms of the contract that this was indeed the parties' intention;
(b) in any event, however, either party may rely upon the terms of an Effective Date provision to avoid performance of his contractual obligations if the circumstances causing the contract to fail neither constitute nor evidence a breach of an obligation owed to the other party.

Where, therefore, either the buyer or the builder expects to incur a significant loss, either in terms of actual expenditure or of opportunity, in the event that the contract should fail to become (or cease to be) binding, very careful consideration should be given to the terms of the Effective Date clause. Notwithstanding the presumption of construction derived from *Cheall*, the use of inappropriate language in this context may in particular permit the other party to frustrate the purposes for which the contract was originally executed.

WAIVER OF CONDITIONS

A related issue, which is again of considerable practical importance in a volatile market, is whether either party may waive part or all of the requirements of an Effective Date clause so as to bring the contract either closer to, or into, effect. This is particularly likely to be in issue where the buyer, having initially sought to reserve his position by inserting a number of conditions precedent into the contract, faces the prospect in a rising market that he cannot satisfy all of the conditions within the agreed time and that the contract will consequently become null and void, thereby depriving him of a valuable bargain.

33 *Ibid*., at page 757.

34 As in the *New Zealand Shipping* case itself, where *force majeure* provisions excused the shipbuilder's failure to perform, see also *Thompson* v. *ASDA-MFI plc*, *supra*.

35 *Per* Lord Diplock in *Cheall* (at page 289): "to attract the principle . . . that a party to a contract is not permitted to take advantage of his own breach of duty, the duty must be one that is owed to the other party under that contract; breach of a duty whether contractual or non-contractual owed to a stranger to the contract does not suffice".

English law in this respect is quite clear. A party to a contract may only waive a condition precedent or subsequent if it is apparent that the same operates exclusively in his favour. Thus, according to Brightman J. in *Heron Garage Properties Ltd* v. *Moss* (1974),[36] the right of waiver applies only:

"where the stipulation is in terms for the exclusive benefit of the Plaintiff because it is a power or right vested by the contract in him alone . . . or where the stipulation is by inevitable implication for the benefit of him alone . . . ".[37]

Where, for example, the contract is signed subject to the buyer receiving within a defined time limit a satisfactory offer of financing or employment for the vessel, this is likely to be viewed as a term exclusively in his favour,[38] which he will be entitled to waive at any stage prior to the prescribed date. In *Covington Marine*,[39] the High Court held that a contractual condition, contained in an effectiveness clause, that the builder should within a specified time period provide the buyer with a refund guarantee operated solely for the latter's benefit and could be unilaterally waived.[40]

By contrast, however, terms providing that the contract should be conditional upon the granting of an export licence or an approval by a third party (e.g., the classification society) to the vessel's design normally confer a benefit on both the buyer and the builder and cannot be waived unilaterally.

In *Manheath Ltd* v. *H. J. Banks & Co. Ltd* (1995),[41] a Scottish case, the parties to a contract for the sale of land agreed that the same would remain conditional upon the purchaser notifying the seller that he had obtained planning permission to develop it and that, if notice was not given within five years, the contract would terminate. It was held that the purchaser could not unilaterally waive the condition because the granting of planning permission was, in the circumstances of that case, an issue of importance to both parties. The judge[42] also commented that the fact that the contract provided not merely that the purchaser should be entitled to withdraw if the condition was not met but also that the contract should terminate automatically was a very strong indication that it was intended to confer benefits on both parties to the agreement.[43]

Where, however, the condition precedent in question truly benefits one party exclusively, he may waive this not merely by words but also by conduct inconsistent with reliance upon it, including the exercise of rights under the contract itself.

36 [1974] 1 All E.R. 421.

37 At page 426.

38 This will not, however, invariably be so; the other party may, e.g., wish to be certain that his contracting partner has the necessary finance to meet his commitments.

39 *Supra*, at n. 31.

40 The Court also construed the effectiveness clause providing for a sequential performance of the relevant conditions precedent and held that, in circumstances in which the buyer had waived performance by the builder of its obligation to furnish the refund guarantee within a defined time scale, the builder could not rely upon the buyer's subsequent failure to provide a performance guarantee to the builder as automatically discharging the contract. According to Langley J. (at page 758): "In the case of those conditions which are for the benefit of one party, if the other party cannot or will not perform them when it is for them to do so, the other party may waive the time for compliance rather than have the contract automatically rescinded. But, absent mutual agreement, the sequence of performance of the conditions remains unaffected and the non-performing party cannot call upon the other party to perform their subsequent obligation or rely upon automatic precision until he has performed his own anterior obligation."

41 *The Times*, 2 June 1995.

42 Lord Gill.

43 See also *Gregory* v. *Wallace* [1998] I.R.L.R. 387.

In *Chiemgauer Membran und Zeltbau GmbH* v. *New Millennium Experience Co. Ltd* (1999),[44] a contract for the supply and fitting of a large roof covering provided that it should be a "condition precedent" to the liability of the employer, Millennium, that the contractor should furnish a performance bond and other third party securities for his performance. The contract also included, at Clause 31(5), provisions entitling the employer to terminate for convenience upon payment of compensation. The employer in due course exercised this right with the consequence that the performance bond and securities could no longer be issued in the forms prescribed in the contract.[45] The employer thereafter rejected the contractor's claim for compensation on the grounds that the condition precedent to its liability remained unsatisfied.

Perhaps not surprisingly, the Court of Appeal rejected this argument, holding the employer liable to compensate the contractor in accordance with the contract terms. According to Chadwick L.J.:

"The condition precedent was a condition wholly for the benefit of the Millennium Company. It was a condition which the Millennium Company was entitled to waive. By choosing to serve a notice under Clause 31(5), that is what the Millennium Company did in this case. By bringing the contract to an end by notice, the Millennium Company made it impossible for the condition precedent . . . to be fulfilled; and so must be taken to have chosen not to rely upon it."

Finally, specific and often difficult issues arise where the shipbuilding contract is negotiated and signed "subject to Board of Directors' approval", the same to be given within a defined period. Although such a provision arguably confers a benefit only upon the party to whom it relates, it is submitted that the better view is that, by requiring that the authority of that party's signatory to the contract be ratified by his board of directors, the term also confers a benefit upon the other party; this will particularly be so where the condition of effectiveness of the contract is the presentation to the latter of formal evidence (e.g., certified board minutes) of such ratification. If this is factually the position, the term cannot usually be waived unilaterally and the directors' approval must be obtained.

44 [2000] CILL 1595.

45 The form of the securities required that the employment contract should still be in effect at the time they were issued.

Article XX—Interpretation

1. Laws Applicable:

The parties hereto agree that the validity and interpretation of this Contract and of each Article and part thereof shall be governed by the laws of the country where the VESSEL is built.

2. Discrepancies:

All general language or requirements embodied in the Specifications are intended to amplify, explain and implement the requirements of this Contract. However, in the event that any language or requirements so embodied permit of an interpretation inconsistent with any provisions of this Contract, then, in each and every such event, the applicable provisions of this Contract shall prevail and govern. The Specifications and Plan are also intended to explain each other, and anything shown on the Plan and not stipulated in the Specifications or stipulated in the Specifications and not shown on the Plan shall be deemed and considered as if embodied in both. In the event of conflict between the Specifications and Plan, the Specifications shall prevail and govern.

3. Entire Agreement:

This Contract contains the entire agreement and understanding between the parties hereto and supersedes all prior negotiations, representations, undertakings and agreements on any subject matter of this Contract.

Article XX of the SAJ Form contains a number of provisions of general importance to the interpretation of the contract, each of which is to be found in the majority of shipbuilding contracts. These provisions are largely self-explanatory and their use rarely gives rise to controversy.

APPLICABLE LAW

The most significant issue in the formation of any international contract is the choice of governing law, i.e., the system of national law which will determine the extent of the parties' rights and duties thereunder. Subject to any restrictions imposed by the law of their domicile, the parties to a shipbuilding contract are free to select any system of law they wish to regulate their contractual relations.

Express choice of law

As a matter of English law, the Rome I Regulation on the Law Applicable to Contractual Obligations,[1] provides that:

1 Regulation (EC) No. 593/2008: see http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:177:0006:0006:en:PDF. The Rome I Regulation is implemented in English law by the Law Applicable to Contractual Obligations (England and Wales and Northern Ireland) Regulations 2009. Contracts concluded before 17 December 2009 are subject to a slightly different regime mandated by the Contracts (Applicable Law) Act 1990, enacting the 1980 Rome Convention on the Law Applicable to Contractual Obligations. See generally, Dicey & Morris, *Conflict of Laws* (14th edn.), Chapter 32.

"A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to a part only of the contract."[2]

In most shipbuilding projects, the parties will select as the governing law of the contract the law of the chosen place of arbitration. This is nevertheless not mandatory and the parties may occasionally agree upon a choice of national law (e.g., English law) and a distinct jurisdiction for the resolution of disputes (e.g., Singapore). Where, however, a different law has been agreed from the law of the place of dispute resolution (the so-called "forum"), it will normally still be for the procedural laws of the forum to determine the method and processes by which the dispute is to be resolved.

Article XX.1 of the SAJ Form expressly provides that the governing law of the contract shall be that of the place of construction; this obviously envisages the application of Japanese law in line with the choice of Tokyo as the arbitral forum.

By the same token, the CMAC Form provides for the shipbuilding contract to be governed by and interpreted in accordance with the laws of The People's Republic of China, although an alternative choice of law is also envisaged.[3] This reflects the choice afforded to the parties of the arbitral forum of The China Maritime Arbitration Commission (CMAC), or an alternative location or institute agreed between them.[4]

The NEWBUILDCON Form is less prescriptive, permitting the parties to select the law to apply to the contract by completing the appropriate box in Part I, but stipulating a default choice of English law.[5]

In practice, a very significant proportion of export contracts concluded by the world's major shipyards provide expressly both for English law and for the arbitration of all non-technical[6] disputes in London.

No express choice of law

Where, contrary to usual practice, the buyer and the builder have failed in the shipbuilding contract to specify their choice of law, the contract will (to the extent that this issue falls to be determined by an English court or arbitration tribunal)[7] also be governed by the Rome I Regulation.[8]

This essentially provides in such circumstances that the choice of law shall be that of the shipbuilder's "habitual residence". This is because Articles 4(1)(a) and (b) of the Regulation state that in the absence of an express choice by the parties, "a contract for the sale of goods shall be governed by the law of the country where the seller has his habitual residence" and that (b) "a contract for the provision of services shall be governed by the

2 Article 3(1) of the Regulation; this provision does not prejudice the application of so-called "mandatory rules" applying under the law of the country to which "all the other elements relevant to the situation at the time of the choice are connected" or under the law of the forum; see also Article 9(3) However, such rules do not in practice normally apply in the major shipbuilding jurisdictions.

3 Article XXI.

4 Article XXVI(3).

5 Clause 41.

6 See pages 237–238, *supra*.

7 Courts and arbitration tribunals in non-UK jurisdictions will obviously apply their own so-called "conflict of law" rules to determine the question of the applicable law governing the shipbuilding contract. Within the European Community, however, these rules are also likely to give effect to the Rome I Regulation.

8 Again, different choice of law rules apply to contracts concluded before 17 December 2009, to which the 1980 Rome Convention applies; see n. 1 above and Dicey & Morris, *ibid*.

law of the country where the service provider has his habitual residence." Given that it is clear that a shipbuilding contract is a mixed agreement for the provision of goods and services, there would seem little doubt in usual circumstances as to the applicable law.

Where, however, the shipbuilder's "habitual residence" is distinct from the country of the vessel's construction (e.g., where the shipbuilder is a multinational corporation, with shipyards in various jurisdictions) it is likely that the law of the place of construction will govern the contract. Article 4(3) of the Regulation permits the application of a law different from that mandated by Article 4(1) "where it is clear from all the circumstances of the case that the contract is manifestly more closely connected" with such other law; where the shipbuilder's head office is in one country but the shipyard is in another, it seems likely that the latter country, in which the contract will essentially be performed, will be "manifestly more closely connected" with the shipbuilding contract in question.

DISCREPANCIES

As previously indicated, most shipbuilding projects proceed on the basis of the parties' agreement upon three basic categories of documentation, namely the contract and any associated security documentation; the specification, including any relevant model and test results; and the principal plans and drawings (normally the general arrangement plan and the capacity plan). Although each of these classes of documents plays a distinct role in defining the commercial and technical parameters of the project, serious difficulties may arise if they should contradict each other.

In line with standard shipbuilding practice, Article XX of the SAJ Form specifies the order of precedence to be applied should a conflict arise between these various documents. The Contract prevails over the Specifications[9] and the latter over the Plan. Neither the Specifications nor the Plan is, however, a defined term, although both appear to form a part of the "Specifications" as referred to in Article I.1 of the Form. It must be assumed in these circumstances that the term "Specification" means the written part of the specifications and "Plan" means the vessel's General Arrangement Plan.

Similarly, Article VIII(3) of the CMAC Form provides that in the event of any inconsistency or conflict between the Contract, the Drawings and Specifications, the provisions of the Contract shall prevail over the Specifications, which in turn prevail over the Drawings. The NEWBUILDCON Form also addresses inconsistencies between key documents, providing for a "hierarchy" of Contract, Specification, Maker's List, and Plans and/or Drawings.[10]

ENTIRE AGREEMENT

The parties will often agree to incorporate within the shipbuilding contract a so-called "entire agreement" clause. This will typically state that the contract supersedes all prior

9 Note, however, the curious definition of "Specifications" contained in Article I.1, see page 25, *supra*.

10 These four key categories of documents are defined at the beginning of Part II of the Form. The Preamble to NEWBUILDCON Form also provides that in the event of a conflict in the wording or information added to Parts I and II of the Form, Part I will prevail.

agreements relating to the project (including, for example, any letters of intent or bridging contracts) and that, in agreeing to be bound by its terms, neither party relies upon any representation or inducement made by the other. Such a provision is intended to permit the parties to proceed on the assumption that their rights and duties have been comprehensively codified in the contract and the specifications, on which basis there should be no liability in damages, or other remedy, arising from anything said or agreed before the contract was concluded.[11] In *Springwell Navigation Corporation* v. *J.P. Morgan Chase Bank* (2010),[12] Aikens L.J. said that he could:

" . . . see commercial utility in such clauses being enforceable, so that parties know precisely the basis on which they are entering into their contractual relationship."

Whether a particular entire agreement clause achieves its intended objective nevertheless very much depends on the precise wording which the parties have used. The English courts have historically been reluctant to give effect to such clauses where the language in question is limited, or ambiguous, in its scope.[13]

"Non-reliance" provisions

In a shipbuilding context, the usual approach, as provided in the SAJ Form, is for the parties to agree that the contract "supersedes all prior negotiations, representations, undertakings and agreements", alternatively, that neither party may rely upon any pre-contract exchanges between them.

The legal effect of such "non-reliance" provisions has in recent years been the subject of considerable academic and judicial debate.[14] However, it seems clear from the Court of Appeal decision in *Peekay Intermark* v. *Australia and New Zealand Banking Group* (2006)[15] that such clauses can, by attracting the operation of the principle of contractual estoppel, effectively exclude remedies for misrepresentation. In *Peekay* the Court of Appeal held in essence that, where parties to a contract have agreed not to rely on prior representations or warranties, they will be estopped (i.e., legally prevented) from seeking remedies based on such representations and warranties where it would be inequitable to allow them to do so. According to Moore-Bick L.J., there is:

" . . . no reason in principle why it should not be possible for parties to an agreement to give up any right to assert that they were induced to enter into it by misrepresentation, provided that they make

11 See *Chitty on Contracts* (30th edn.), paragraph 12–104.

12 [2010] EWCA Civ 1221.

13 At paragraph 25 of his judgment in *Ravennavi SpA* v. *New Century Shipbuilding Co. Ltd* [2007] 2 Lloyd's Rep. 24, Moore-Bick L.J. appeared (albeit *obiter*) to take a more extreme view stating that, while the effect of the entire agreement clause must depend "primarily on its terms": " . . . there may be circumstances . . . in which the court can be satisfied that a clause of that kind, although apparently couched in language wide enough to encompass the particular matter on which one or other party seeks to rely, was not intended by the parties to operate in the way in which its terms would suggest, but any such conclusion must be borne out by the particular circumstances of the case."

14 See *Alman & Benson* v. *Associated Newspapers Group Ltd* (1980) (unreported); *Thomas Witter Ltd* v. *TBP Industries Ltd* [1996] 2 All E.R. 573; *Government of Zanzibar* v. *British Aerospace Ltd* [2000] 1 W.L.R. 2333; *Inntrepreneur* v. *East Crown Ltd* [2000] 2 Lloyd's Rep. 611; *Watford Electronics Ltd* v. *Sanderson CFL Ltd* [2001] B.L.R. 143; *E.A. Grimstead & Son Ltd* v. *McGarrigan* [1999] T.L.R. 384, Court of Appeal (Civil Division).

15 [2006] EWCA Civ 386.

their intentions clear, or why a clause of that kind, if properly drafted, should not give rise to a contractual estoppel . . . "[16]

This approach was endorsed in *Springwell*[17] where the Court of Appeal confirmed that an contractual acknowledgement of "non-reliance" on pre-contract statements and representations can in principle estop each party from claiming against the other legal remedies for misrepresentation. In its subsequent decision in *Bikam Ood & Another* v. *Adria Cable Sarl* (2012)[18] the High Court decided that, where the contract excluded the parties' rights "in respect of warranties and representations not expressly set out in the agreement", this was sufficient to prevent claims based on prior misrepresentation.[19]

It should be noted that an entire agreement clause seeking to exclude liability for pre-contract misrepresentation is, by reason of the Misrepresentation Act 1967, effective only in so far as it is "fair and reasonable" having regard to "the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made".[20] However, such statutory limitation does not apply to "international supply contracts",[21] and is as such unlikely to be relevant to most export shipbuilding contracts.[22]

In *Thomas Witter Ltd* v. *TBP Industries Ltd* (1996),[23] the High Court held that even if the "non-reliance" wording in the entire agreement clause in question had the effect of excluding liability for misrepresentation, it would not have satisfied the statutory requirement of reasonableness because the language used was wide enough to encompass all types of misrepresentation, even those which had been fraudulently made. This approach nevertheless appears to have been overruled in *E.A. Grimstead & Son Ltd* v. *McGarrigan* (1999),[24] where the Court of Appeal decided that the English courts should not refuse to give effect to acknowledgements of non-reliance in commercial contracts between experienced parties with equal bargaining powers, particularly where the parties have had recourse to professional advice when finalising their agreement.[25] This is obviously very common in substantial shipbuilding projects, particularly those for export vessels.

Against this background, it is submitted that the SAJ Form, which provides merely that the contract "supersedes all prior negotiations, representations, undertakings and agreements" and does not include express non-reliance language, is probably ineffective to waive the parties' rights arising from pre-contract misrepresentations. In contrast, the

16 At paragraph 57 of his judgment.

17 *Supra*, at n. 12.

18 [2012] EWHC 621 (Comm.).

19 See also *FoodCo* v. *Henry Boot Developments* [2010] EWHC 358, where it was held that the relevant clause prevented claims for innocent or negligent misrepresentation.

20 Section 3 (as amended by s. 8 of the Unfair Contract Terms Act 1977).

21 See page 188, *supra*.

22 See s. 26 of the Unfair Contract Terms Act 1977, as interpreted by the Court of Appeal in *Trident Turboprop (Dublin) Ltd* v. *First Flight Couriers Ltd* [2009] EWCA Civ 290.

23 *Supra*, at n. 14.

24 *Supra*, at n. 14.

25 Note also that in *Government of Zanzibar* v.. *British Aerospace Ltd* (2000), *supra*, at n. 14, the Court held that the wording of an entire agreement clause was not *per se* unreasonable within the meaning of UCTA merely because it did not distinguish between fraudulent and non-fraudulent misrepresentation; however, liability for fraudulent misrepresentation cannot be excluded: see *HIH Casualty and General Insurance Ltd and others* v. *Chase Manhattan Bank and others* [2003] UKHL 6.

NEWBUILDCON Form provides in broad terms[26] that "no promise, undertaking, representation, statement or warranty by either Party prior to the date of this Contract . . . shall affect this Contract" and (subject to the potential application of s. 3 of the Misrepresentation Act 1967) would appear to be legally effective, at least as regards negligent or innocent pre-contractual misrepresentations. Similar, although more concise, language is contained in the CMAC Form.[27]

Express exclusions of liability for misrepresentation

An alternative, but less common, approach is for the parties to agree expressly to exclude any liability to the other for pre-contractual misrepresentations. However, recent English authorities establish that, in order for an exclusion in such terms to be legally effective, the parties must use very clear wording.

In *Axa Sun Life Services plc* v. *Campbell Martin Ltd and others* (2011),[28] the Court of Appeal held that an entire agreement clause contained in Axa's standard form documentation did not exclude its liability for misrepresentation, even though the wording expressly disclaimed responsibility in respect of "representations". Construing the agreement as a whole, the Court decided that this wording was only effective in preventing claims for breach of collateral warranty[29] and had no effect on claims for misrepresentation. In so doing, the Court approved the dictum of Ramsey J. in the earlier decision of *BSkyB Ltd* v. *H.P. Enterprise Services UK Ltd* (2010)[30] that:

"While there is a reference to representation, there is nothing in the clause that indicates that it is intended to take away a right to rely on misrepresentation . . . I consider that clear words are needed to exclude a liability for negligent misrepresentation and that this clause does not include any such wording."

The legal effectiveness of a provision of this type is furthermore again potentially affected by UCTA. In *Springwell*[31] the Court of Appeal, approving the prior High Court decision in *Raiffeisen Zentralbank Osterrich AG* v. *Royal Bank of Scotland plc* (2010),[32] held that when faced with such a clause, the Court is required to consider two issues, namely, (i) does the clause exclude or restrict liability for misrepresentation, or any remedy available for misrepresentation and (ii) if so, does the clause satisfy the requirement of reasonableness for the purposes of UCTA?

26 At Clause 47.
27 Article XXXIII.
28 [2011] EWCA Civ 133
29 That is, it precluded the existence of any legally enforceable agreement between the parties ancillary to, but not expressly set out in, the contract.
30 [2010] EWHC 86 (TCC).
31 *Supra*, at n. 12.
32 [2010] EWHC 1392.

Article XXI—Sundry provisions

It is hereby mutually confirmed that the Contract Price includes the expenses amounting to ..... ¥ for design and supply of drawings as the technical services required to be rendered by the BUILDER under this Contract.

Article XXI of the SAJ Form provides that the contract price is deemed to incorporate a fixed sum agreed by the parties to represent the cost of design work and the supply of drawings. It is understood that the inclusion of this term reflects a difference in the tax treatment in Japan of receipts in respect of design and of other works. The wording is accordingly not used if the vessel is to be constructed elsewhere than Japan.

Guarantee

.....

.....

.....

.....

.....

Date: ..... , 19 (*sic*).....

GUARANTEE

In consideration of your executing a certain Shipbuilding Contract dated ....., 19 (*sic*) ..... (herein called the "Contract") with ..... (herein called the "BUYER") for construction and sale of one (1) single screw ..... having your Hull No. ..... (herein called the "VESSEL") providing among other things for payment of the Contract Price amounting to Japanese Yen (¥.....), the undersigned does hereby irrevocably and unconditionally guarantee to you, your successors and assigns due and faithful performance by the BUYER of all its liabilities and responsibilities under the Contract and any supplement, amendment, change or modification hereafter made thereto, including but not limited to, due and prompt payment of the Contract Price by the BUYER to you, your successors and assigns under the Contract and any supplement, amendment, change or modification thereto as aforesaid (hereby expressly waiving notice of any such supplement, amendment, change or modification as may be agreed to by the BUYER and confirming that this Guarantee shall be fully applicable to the Contract as so supplemented, amended, changed or modified).

Witness Guarantor

....

The SAJ Form incorporates a standard form of guarantee to be furnished by the buyer to the builder, although, curiously, this is not referred to in the body of the contract itself. By its terms, the guarantor warrants to the builder the due and faithful performance by the buyer of all of his liabilities and responsibilities under the contract as from time to time amended. The guarantee, which is unlimited in time, makes no provision for a choice of law or jurisdiction; it equally incorporates no formal mechanism by which demand is to be made upon the guarantor.

The legal principles relating to guarantees of this type are discussed further in Part 4.

Other typical shipbuilding contract terms

In addition to the provisions previously discussed, the contract may, depending upon the circumstances in which it was concluded, contain a number of other miscellaneous terms. These may be either negotiated by the parties on an *ad hoc* basis, or already form a part of the standard form they have elected to use. Such provisions typically concern (i) suspension of the work; (ii) environmental protection; (iii) confidentiality; and (iv) exclusions and limitations upon the builder's liability.

SUSPENSION OF THE WORK

Although no such provisions are contained in the SAJ Form, both the NEWBUILDCON and CMAC Forms incorporate terms entitling the builder to suspend performance of the construction works in circumstances of the buyer's default. It should be noted that no such common law right arises in the absence of express contractual provision.[1] Unless the contract specifically permits him to do so, the builder's suspension of the work may therefore constitute a breach of express or implied obligations resting upon him to proceed continuously with the construction of the vessel.[2]

In this context the NEWBUILDCON Form provides at Clause 39(c)[3] that:

"Without prejudice to [its contractual right of termination], the BUILDER shall have the right to suspend Work under this Contract if the Buyer fails to pay any instalment stated in Box 11 due for a period of fifteen (15) Banking Days until payment of such outstanding sums."

However, it is important to note in this respect that neither the buyer's non-payment, nor the builder's exercise of its right of suspension, has the effect of automatically extending the Delivery Date[4]. Instead, the builder's right of suspension under the NEWBUILDCON Form, which accrues where the buyer has defaulted for fifteen "Banking Days" in the payment of a contract price instalment, is characterised merely as generating a Permissible Delay event[5] in respect of which, if he seeks an extension of time, the builder must notify the buyer. However, the builder's notice is only required to be given within ten days of the date on which he "becomes aware of the occurrence

1 *Channel Tunnel Group* v. *Balfour Beatty* [1992] Q.B. 656 at 666, C.A.

2 However, in the absence of an express term to such effect, the English courts are generally reluctant to imply into a construction contract an obligation upon the contractor to proceed continuously or expeditiously with the work; see *GLC* v. *Cleveland Bridge and Engineering* (1984) 34 B.L.R. 50 at 66 and *Leander Construction Ltd* v. *Mulalley & Co. Ltd* [2011] EWHC 3449.

3 Similar provisions are contained in Article XXVII.3 of the CMAC Form.

4 The NEWBUILDCON Form materially differs in this respect from each of the SAJ and CMAC Forms, both of which automatically extend the contractual delivery date for the period of default by the buyer in the payment of the contract price instalments.

5 Clause 34(a)(v).

of the event of delay",[6] being presumably the date on which he suspends work; somewhat curiously, this would suggest that the builder is under no obligation immediately to advise the buyer that he has stopped work.[7]

It should also be noted that there are no provisions in the NEWBUILDCON Form allowing the builder to recover its costs incurred in consequence of either the suspension or recommencement of the work. Given that these costs may be very substantial, and that there would appear no basis upon which a right to such compensation can be implied into the contract, it is questionable whether the remedy of suspension is in practice likely to be used in the event of a short-term failure on the part of the buyer to pay a contract price instalment; if the failure continues, the builder may be better protected by terminating the contract, the NEWBUILDCON Form making clear in this context that the remedies of suspension and termination are not mutually exclusive.

ENVIRONMENTAL PROTECTION

In addition to setting out the regulatory requirements with which the vessel must comply,[8] the contract may also contain specific provisions addressing current or anticipated environmental protection requirements. Such provisions are typically focused on the prevention of marine environmental pollution and other health hazards, in particular in relation to the end-of-life recycling of the ship; this is primarily achieved by mandating the use of "environmentally friendly" shipbuilding materials and techniques and the maintenance of an inventory of such hazardous materials as are necessarily employed in her construction.

Environmental protection provisions are not included in the SAJ Form, but form part of both the NEWBUILDCON and CMAC Forms.

The NEWBUILDCON Form provides[9]:

"The Builder shall, in accordance with the IMO Guidelines on Ship Recycling, Resolution A.962(23), with amendments in force as of the date of this Contract:—

(a) Endeavour to take due account of the Vessel's ultimate disposal when designing and constructing the Vessel by:
  (i) using materials which can be recycled safely and in an environmentally sound manner; and
  (ii) minimising the use of materials known to be potentially hazardous to health and the environment."

It should, however, be noted that this wording imposes upon the builder only an obligation to "taking due account of [the Vessel's] disposal" by using materials which are not harmful to the environment. Whether or not intentionally, the equivalent wording in the CMAC Form is broader, appearing to impose a general obligation upon the builder to "maximise the use of the materials of green, low carbon" and "minimise the use of

6 Clause 34(b).
7 This may be a drafting error.
8 See pages 31–33, *supra*.
9 At Clause 4.

materials which have been known to be hazardous to human health and the environment"[10] during the course of the construction process.

It is also common practice in modern shipbuilding contracts for the parties to agree that a so-called "Green Passport", which provides details of hazardous materials used in the vessel's hull, systems and equipment, will form part of the documentation to be provided by the builder to the buyer on delivery. Each of the NEWBUILDCON[11] and CMAC[12] Forms address this issue.[13]

The production of inventories of this type was formally recognised as good practice by the International Maritime Organisation (IMO) in its December 2003 Guidelines on Ship Recycling[14] and the first such passport was issued for the Shell LNG tanker, "*Granatina*", in 2004. Although the system currently remains voluntary, the future entry into effect of the 2009 Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships will radically alter the regulatory position. This Convention is specifically aimed at eliminating or restricting the use of hazardous materials in shipbuilding[15] and thereby in particular addressing environmental concerns arising out of ship-breaking. It will in particular introduce a legal requirement that ships of greater than 500 gross tons should maintain an inventory of hazardous materials on board as evidenced by a certificate to be issued by the flag state or by the vessel's classification society on its behalf. It is envisaged that at least part of the inventory will be developed by the shipbuilder at the design and construction stage on the basis of the information provided by the subcontractors in its supply chain.

CONFIDENTIALITY

Given that international shipbuilding projects are invariably of significant financial value, it is common for the contracts which govern them to contain provisions protecting confidential project information in the possession of either the builder or the buyer. The contract will indeed sometimes contain provisions preventing unauthorised disclosure of its existence or terms, although this is more usually agreed at the Letter of Intent stage. More commonly, the parties will agree that commercial and technical information and documentation exchanged between them in furtherance of the project shall be used only for this specific purpose.[16]

10 Article IV.1.

11 Clause 4(b).

12 Article IV.1.

13 Both the CMAC and the NEWBUILDCON Forms also include detailed provisions, which the SAJ Form does not contain, regarding protective coatings and the source of origin of materials used in the vessel's construction.

14 See IMO Assembly's Resolution No. A.962(23) of 5 December 2003, as subsequently amended through IMO Assembly's Resolution No. A.980(24) of 1 December 2005 and implemented through various IMO MEPC's circulars. At its 63rd session in March 2012, IMO's MEPC adopted the "2012 Guidelines for Safe and Environmentally Sound Recycling" (resolution MEPC.210(63)) and the "2012 Guidelines for the Authorization of Ship Recycling Facilities" (Resolution MEPC.211(63)).

15 A similar approach is adopted in the IMO "Goal-based ship construction standards for the bulk carriers and oil tankers" with related amendments to Chapter II-1 of the International Convention for the Safety of Life at Sea (SOLAS).

16 If the contract contains such provisions, these are usually qualified to allow disclosure which is required by law or the rules of any regulatory regime (e.g., a stock market) to which either or both of the parties are subject.

Most shipbuilding contract forms address this issue within the framework of their provisions relating to intellectual property. Thus, for example, Article XVI.2 of the SAJ Form provides that the builder shall have the right to retain title to all the plans, drawings, other information and data relating to the design and construction of the vessel and that the buyer will not to disclose such information, other than where required for the purposes of the vessel's operation, without the builder's prior consent.

More elaborately, Clause 40 of the NEWBUILDCON Form states that:

"(a) Where they are owned and supplied by a Party, that Party shall retain copyright, trade mark, patent or similar rights ..with respect to Specification, Plans, Drawings, technical descriptions, calculations, tests results and other data, and information and documents concerning the design and construction of the Vessel. The other Party undertakes not to disclose the same or divulge any information contained therein to any third parties without the prior written consent of the first Party, except where it is necessary for usual operation, repair and maintenance of the Vessel and to subsequent owners. . . .

(c) Where it is necessary during the performance of this Contract for the first Party to make information available to the other Party, the other Party shall hold all such information in confidence and not disclose it to any third parties or use it for any purpose other than as provided therein without the prior written consent of the first Party, which shall not be unreasonably withheld."

For these purposes "information" is, however, limited to "technical information relating to the Vessel designated by one Party as confidential" and expressly excludes that which was previously known to the other party or which has entered the public domain without the latter's "wrongful act or failure to act".[17]

Where the unauthorised disclosure of confidential information by one party to the contract is likely or threatened, it is in principle open to other party to seek an injunction preventing such disclosure.[18]

EXCLUSIONS AND LIMITATIONS OF LIABILITY

Exclusion and limitation of liability provisions, which either eliminate or restrict the extent of the builder's financial responsibility for breach of contract, are not included in the SAJ Form, but are a common feature of modern shipbuilding contracts.[19] These normally provide either that the builder[20] shall have no liability at all for defined breaches of contract or that his liability in damages will be "capped" either to a fixed amount or to a percentage of the contract value, which may obviously vary in light of modifications made during the course of the construction.[21]

In English law exclusion and limitation clauses must be clearly expressed in order to be legally effective. Where the wording used is ambiguous, this will invariably be construed against the interests of the party seeking to invoke its protection. It is in particular well established that, unless the contract expressly or impliedly so provides, such a clause will

17 *Ibid*.

18 See, e.g., *Vestergaard Frandsen A/S* v. *Bestnet Europe Ltd* [2011] EWCA Civ 424. For an explanation of the principles governing the granting of injunctions to restrain the use of information in breach of confidence, see *19 Halsbury's Laws* (5th edn., 2011), at paragraphs 84–85.

19 It is in any event standard practice to exclude the parties' liabilities to each other for "consequential loss and damage"; see pages 185–186, *supra*.

20 And occasionally the buyer.

21 The "cap" may or may not include any amounts payable by the builder by way of liquidated damages for delay or breach of the vessel performance parameters established under the contract, *supra*, at pages 68–75.

not normally protect a party who has acted negligently in the performance of his obligations[22] and, further, that the English courts will strain against interpreting such provisions as excusing deliberate i.e. "calculated" decisions not to perform.[23]

Clause 37 of the NEWBUILDCON Form represents an example of a combined exclusion and limitation clause in comprehensive terms. The Clause addresses the consequences of defects discovered before, upon and after delivery, precludes the implication of any statutory implied terms and regulates the legal effect of death, injury and loss of personal property sustained by the parties' representatives during the construction process, each of which issues are considered in previous chapters.

Additionally, Clause 37 deals with the impact of termination of the contract under Clause 39, providing in this respect (at sub-clause(e)) that:

"In the event of termination in accordance with the provisions of Clause 39 (Suspension and Termination), neither Party shall have any liability to the other whatsoever or howsoever arising, except as expressly provided in that Clause.

In the event, however, that a Party fails to perform the Contract, or unequivocally indicates its intention not to perform it, in a way which thereby permits the other Party to treat the Contract as at an end other than under the terms of the Contract, any such claim that the other party may have shall not be limited or excluded by the terms of this Contract."

This language makes clear that, upon termination of the contract under Clause 39, the remedies expressly granted therein to the buyer and the builder[24] are exclusive of all other remedies unless the "guilty" party has in parallel committed a repudiatory breach of contract, in which event his liability in damages is not excluded or limited. A provision in these terms would have conclusively addressed the issue considered in the *Gearbulk* decision (see pages 199–201, *supra*) regarding the buyer's entitlement to claim damages, in addition to recovering his pre-delivery instalments of the contract, in circumstances of the builder's wrongful refusal to proceed with construction of the vessel.

22 . See *Canada Steamship Lines Ltd* v. *The King* [1952] 1 Lloyd's Rep. 1, [1952] A.C. 192 and, more recently, *E.E. Caledonia Ltd* v. *Orbit Valve Co. Europe* [1993] 2 Lloyd's Rep. 418, *per* Hobhouse J., at page 422: " . . . the parties to a contract are not to be taken to have agreed that a party shall be relieved of the consequences of its negligence without the use of clear words showing that that was the intention".

23 See *AstraZeneca UK Ltd* v. *Albemarle International Corporation* [2011] EWHC 1574 (Comm), where Flaux J. said (at paragraph 313 of his judgment) that the court will not permit such an outcome "unless no other conclusion is possible".

24 See pages 197–199 *supra*.

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PART 4

Agreements ancillary to the shipbuilding contract

In any major shipbuilding project, the contract will represent only one of a number of documents detailing the structure of the transaction and its associated financing. The ancillary agreements evidenced by this additional documentation will typically comprise some or all of the following:

(a) the specifications;
(b) guarantee(s) issued on behalf of the builder;
(c) guarantee(s) issued on behalf of the buyer;
(d) a letter of comfort;
(e) an assignment of the contract by the buyer;
(f) an option agreement.

I. THE SPECIFICATIONS

In any sale by description, it is plainly important that the parties should define in detail the characteristics of the goods intended to form its subject matter. Where, as in most shipbuilding projects, these are both valuable and complex in nature, it is essential in ensuring that the parties' contractual expectations are met that an adequate and accurate description of the goods be agreed at the outset.

In the majority of newbuilding projects, this description will be contained in the specifications. According to Lord Dunedin in *W. & S. Pollock & Co.* v. *Donald Macrae* (1922)[1]:

"The usual function of the specification is, as its name denotes, to specify exactly what the seller is to deliver to the buyer".[2]

As such, the terms of the specifications are usually both more extensive and more significant than those of the contract itself. To the extent that disputes arise between the buyer and the builder during the course of the project, it is most likely that these will be technical in nature and will concern the scope of the builder's obligations in relation to the physical construction and outfitting of the vessel. In most shipbuilding projects, these issues will fall to be determined by reference to the specifications, rather than the contract.

While the nature and extent of the specifications may vary substantially from one newbuilding to the next, these typically comprise sections or chapters:

1 (1922) 5 Ll.L.Rep. 299.
2 At page 302.

(a) describing in general terms the vessel, her machinery and equipment and defining the class and regulatory requirements which the builder must satisfy prior to delivery[3];
(b) detailing the general methods and processes (in particular the steel preparation, assembly and welding techniques) which must be employed by the builder in the vessel's construction. These will frequently include a definition of the internationally recognised Quality Assurance standards which the builder has agreed to follow;
(c) incorporating (often in several volumes of documents and plans) detailed descriptions of materials to be supplied and the work undertaken in relation to each aspect of the vessel's construction. This part of the specifications will be prepared by reference either to specific areas of the vessel (e.g., holds or tanks, accommodation areas and engine room) or to the nature of the work to be undertaken (e.g., piping, electrical installation, etc.); and
(d) defining the nature and extent of the tests on her machinery and equipment which must be completed successfully before the vessel may be tendered to the buyer for delivery.

The specifications will usually also incorporate, either physically or by reference, the principal plans and drawings for the vessel, which will include (at minimum) a General Arrangement Plan. As previously indicated,[4] the contract will in the normal course contain provisions defining, in the event of a conflict, the order of precedence between its terms, those of the specifications and the principal plans and drawings.

The origin of the specifications will vary depending upon the nature of the project itself. Where, as is common, the newbuilding is to be constructed to a standard design which has been developed and marketed by the builder, he will obviously supply the initial draft of both the specifications and the principal plans and drawings; in such circumstances, the technical discussion between the parties will often be limited to changes sought by the buyer to meet his particular operating requirements. Where, however, the vessel is to be constructed to a non-standard design, the specifications may initially be prepared by either party. In this situation the technical discussions between the buyer and the builder to finalise the specifications will be extensive and may well exceed in their length and complexity the negotiations relating to the contract itself.

Although, once completed, the contract and specifications should theoretically complement and explain each other, a perfect match is often difficult to achieve. This is normally the result of the operation of two related factors, namely the time constraints within which the terms of the project must usually be agreed and documented and the fact that the detailed negotiations in respect of the contract and the specification are normally undertaken by different teams of representatives (commercial and technical) from each party.

II. GUARANTEES ISSUED ON BEHALF OF THE BUILDER

During the course of the construction period, the purchaser of a newbuilding takes both a credit and a performance risk on the builder. He will usually wish to secure himself,

3 These standards may also be defined in the contract itself.
4 See page 275, *supra*.

wherever possible, against these risks by requiring the builder to procure for him appropriate third party guarantees.

Refund guarantees

Most shipbuilding contracts require the builder to provide to the buyer at the outset of the project a satisfactory refund guarantee, i.e., an undertaking of a bank or other surety acceptable to the buyer that, if the builder should for any reason fail to refund the advance instalments of the contract price upon the buyer's rescission, the bank or surety will make the payment on the builder's behalf. The refund guarantee usually represents the financial cornerstone of the entire shipbuilding project, without which the buyer will normally be unable or unwilling to make any advance payments whatsoever to the builder.[5] Its procurement by the builder in terms satisfactory to the buyer is therefore usually a condition precedent to the effectiveness of the contract.

The refund commitment given by the builder's bank may be expressed by way either of a conventional guarantee of the builder's obligations to repay the buyer's pre-delivery instalments upon rescission or as an "on demand" instrument, possibly in the form of a standby letter of credit, under which the amounts guaranteed are payable against a certificate issued by the buyer detailing the same and confirming that the builder has failed to honour his refund obligations. The guarantor's commitment will usually be limited in amount to the aggregate of the pre-delivery instalments repayable to the buyer upon rescission, together with interest at the rate agreed in the contract. Depending upon the terms of the contract, the guarantee may or may not extend to repayment of the buyer's instalments following rescission consequent upon a total loss of the vessel.

The guarantee will normally remain valid throughout the vessel's expected construction and outfitting period, with a margin to cover possible delays, but subject to an overall cut-off date. From the buyer's perspective, it is obviously important to ensure that the selection of the cut-off date takes into account potential delays in the completion of the project for which the builder will be entitled to an extension of the Delivery Date (and therefore the "cancelling date"), including in particular delays resulting from the arbitration of any disputes. Furthermore, if the buyer has to finance the pre-delivery portion of the contract price, he will usually need to assign the benefit of the refund guarantee to his bank. He must therefore ensure this is not expressly or impliedly prohibited by the terms of the guarantee.

The key issue in most refund guarantee discussions is whether the guarantor's liability should be engaged (i) upon the buyer's simple demand or (ii) only on a "secondary" basis after the builder's liability has been independently determined in arbitration or court proceedings and the builder has failed to make payment.

From the perspective of the buyer and his financing banks, the preferred approach is clearly to secure a primary, "on demand" instrument which will ensure repayment of the buyer's instalments without the need for potential lengthy legal proceedings under the shipbuilding contract to establish the builder's refund liability. This may be particularly important if, as is often the case, the buyer's financing arrangements are expressed to terminate in the event of rescission of the shipbuilding contract and the monies previously

5 Unless, exceptionally, the buyer takes title to the vessel during construction.

lent to him to pay the pre-delivery instalments of the price become immediately repayable to his financiers.[6]

It should furthermore be noted from the buyer's perspective that English law affords the secondary guarantor of another's liability a number of potential defences which are not available in relation to a claim under an "on demand" instrument. In particular, the guarantor will normally be entitled to avail himself of any defence to liability to which the builder is entitled under the contract.[7] Furthermore, he may alternatively be able to rely upon a failure by the buyer to disclosure to him material circumstances affecting his guarantee liabilities.[8] Finally, if there occurs any amendment of the shipbuilding contract which is potentially prejudicial to the guarantor, and to which he has not previously consented, he may be discharged from liability under the guarantee.[9]

The provision of an "on demand" instrument, which can be triggered by the submission to him of defined documents, is, however, be likely to be unattractive to the builder, who will wish to avoid a situation in which the buyer can successfully demand repayment of his pre-delivery instalments even if his rescission of the contract is being contested in good faith. Particularly where the beneficiary of the guarantee is a "shell" company without significant assets, there will in such circumstances exist a significant risk that monies paid away against a simple demand under the guarantee will prove unrecoverable by the builder in the event that he succeeds in due course in demonstrating that the buyer's purported rescission was unlawful.

In the majority of modern shipbuilding projects, even where refund security is given in the form of a demand bond, this conflict of interests is resolved in favour of the builder, the issuer's liability under the refund guarantee being expressly conditional upon receipt of (i) a written demand and (ii) either the builder's admission in writing of its liability to make the refund or an arbitration award or court judgment determining such liability. However, where clear language has not been used in the guarantee, significant uncertainty may arise as to the circumstances in which this can be called.

In *Caja de Ahorros del Mediterraneo and others* v. *Gold Coast Ltd* (2002),[10] the refund instrument provided that the Spanish bank issuers should repay an instalment of a newbuilding contract price "if and when the Instalment becomes refundable from the Builder under and pursuant to the terms and conditions of the Shipbuilding Contract". The guarantor also undertook, however, to make payment to the purchasers upon receipt of a certificate issued by Lloyds Bank plc, the purchasers' financier, "stating the amount of the Instalment under the [shipbuilding contract], the date of such payment that you have

6 For a discussion on the origins of "on demand" guarantees, see the judgment of Christopher Clarke J. in *Wuhan Guoyu Logistics Group Co. Ltd & Another* v. *Emporiki Bank of Greece S.A.* [2012] EWHC 1715 (Comm) at paragraph 26.

7 See *per* Sir William Blackburne in *Vossloh Aktiengesellschaft* v. *Alpha Trains (U.K.) Ltd* [2010] EWHC 2443 (Ch) at paragraph 24 that: "An essential distinguishing feature of a true contract of guarantee . . . is that the liability of the surety (i.e., the guarantor) is always ancillary, or secondary, to that of the principal, who remains primarily liable to the creditor. There is no liability on the guarantor unless and until the principal has failed to perform his obligation. The guarantor is generally only liable to the same extent that the principal is liable to the creditor." See also *Hyundai Shipbuilding and Heavy Industries Co. Ltd* v. *Pournaras* [1978] 2 Lloyds's Rep. 502; *BOC Group plc* v. *Centeon LLC* [1999] 1 All E.R. (Comm) 53. But note in this context *Anglomar Shipping Co. Ltd* v. *Swan Hunter Shipbuilders Ltd and Swan Hunter Group Ltd (The "London Lion")* (1980), *infra* at page 294.

8 See pages 298–299, *infra*.

9 See pages 300–303, *infra*.

10 [2002] 1 Lloyd's Rep. 617, C.A.

become entitled to a refund pursuant to the [shipbuilding contract] and that the Builder has not made such refund".

The purchasers rescinded the contract for delay in delivery in disputed circumstances and, while arbitration proceedings to resolve the dispute were pending, made a demand upon the guarantors on the basis of a certificate issued by Lloyds Bank. The refund guarantors resisted the demand on the grounds that, on its true interpretation, this did not permit the purchasers to demand payment without previously establishing in the arbitration proceedings an entitlement to refund under the shipbuilding contract.

Against this background, the Court of Appeal held in favour of the buyer that the wording of the instrument created an "on demand" obligation which arose independently of the shipbuilding contract. Tuckey L.J., giving the principal judgment, was clearly influenced by the absence of any reference in the document to the builder's underlying liability under the shipbuilding contract. Furthermore, the fact that the document required that payment should be made "if and when" an instalment became refundable in his view merely identified the circumstances which Lloyds Bank was obliged to take into account in issuing its certificate, this being determinative of the refund guarantors' liability. Finally, although the instrument contained "classic" guarantee language stating that any changes in the shipbuilding contract would not release the refund guarantor from liability,[11] this was not in itself sufficient to alter the overall character of the instrument.[12]

Where the provisions of a refund guarantee are unclear as to the circumstances in which it may be "called", the English courts have, at least in recent years, adopted a commercial approach to their interpretation. This was particularly evident in the important Supreme Court decision in *Rainy Sky S.A. and others* v. *Kookmin Bank* (2010).[13]

In *Rainy Sky* certain so-called "advance payment guarantees" contained contradictory provisions, one clause indicating that these would be triggered if the pre-delivery instalments of the contract became repayable under the shipbuilding contract, the other indicating that this was so only if the shipbuilding contract was first terminated. The builder applied for bankruptcy protection under Korean law, which entitled the buyer under the contract to claim repayment of his instalments but, oddly, did not give him the right to terminate. The Korean bank refund guarantor, Kookmin, refused to settle the buyer's claim under the guarantees.

Against this background, the Court of Appeal decided, by a 2:1 majority,[14] that there was no scope for interpreting these guarantees as permitting recovery against Kookmin in circumstances in which the shipbuilding contract had not been terminated—there were in the view of Patten L.J. a number of potential reasons why the parties to the guarantees

11 The existence of language of this type was a factor which persuaded the House of Lords in *Trafalgar House Construction (Regions) Ltd* v. *General Surety and Guarantee Co. Ltd* [1996] 1 A.C. 199 that the bond in question was a "true" guarantee.

12 For a detailed analysis of the authorities relating to this issue, see the judgments of the Singapore Court of Appeal in *American Home Assurance Co.* v. *Hong Lam Marine Pte Ltd* [1999] 3 S.L.R. 682 at pages 699–710 and *Master Marine AS* v. *Labroy Offshore Ltd* [2012] 3 S.L.R. 125. In *Master Marine* the Court held that refund guarantees which provided that payment would be made against receipt of a demand "stating that the Contract is cancelled or rescinded by the Owner, which statement shall be final and conclusive" were "on demand" undertakings rather than true guarantees.

13 [2011] UKSC 50.

14 Although one of the Court of Appeal judges comprising the majority, who gave no substantive judgment, candidly admitted that he found himself "in the invidious position of expressing an opinion in a field that is completely foreign".

might conceivably have agreed that these should not respond to the builder's bankruptcy, but it was not for the court to rewrite the terms of the bargain which the guarantor and beneficiary had reached.

However, giving a dissenting judgment, the third Court of Appeal judge, Sir Simon Tuckey, relied upon the views of Lord Diplock in *Antaios Cia Naviera* v. *Salen Rederierna A.B. ("The Antaios")* (1985)[15] that:

"If a semantic analysis of words in a commercial contract is going to lead to a conclusion which flouts business common sense, it must be made to yield to business common sense."

He considered that it made no commercial sense for the parties to have agreed that the guarantees would not secure the refund of the buyer's instalments in circumstances of the builder's bankruptcy, and accordingly held in favour of the buyer.

This dissenting judgment was ultimately upheld, and the Court of Appeal decision reversed, by the Supreme Court. Giving judgment, Lord Clarke accepted that the guarantees permitted more than one potential interpretation, but held that in such circumstances it was "appropriate for the court to have regard to considerations of commercial common sense in resolving the question what a reasonable person would have understood the parties to have meant". In his view it was "consistent with the commercial purpose" of the guarantees that these should cover the builder's bankruptcy—responding to Patten L.J.'s comment that there could have been a number of reasons why the advanced payment guarantees should not have responded to the builder's bankruptcy, his Lordship pointed out that:

"if . . . the Bank had been able to think of a credible reason for excluding repayments in the event of the Builder's insolvency, such a reason would have been at the forefront of the Bank's case".[16]

This "purposive", and plainly sensible, approach to the interpretation of a refund guarantee was also adopted in *Ostfrisiche Volksbank E.G.* v. *Fortis Bank N.V.* (2010),[17] another case in which the principles in *The "Antaios"* were applied.

In *Ostfrisiche* the advance payment guarantee given on behalf of the builder provided that the buyer should have a period of only 15 days to make a "valid claim" before it expired. If the buyer's right to cancel was disputed, the buyer was obliged to obtain a certificate from the classification society that the vessel had not been completed and/or did not comply with the underlying shipbuilding contract.

Following termination of the shipbuilding contract, a demand for payment was made upon the guarantor within the 15-day period, but the decision of the classification society was only obtained thereafter. The guarantor bank argued that the guarantee must be strictly construed, such that the decision of the classification society had to be rendered within the 15-day period; this was so even though the builder's notice that it disputed the termination (which circumstance triggered the requirement for the certificate) had been only issued after the expiry of such period.

The High Court held in these circumstances that the guarantees had to be interpreted "to avoid absurdity". It was absurd to suggest that, even if the notice of dispute had been issued within the 15-day period, the classification society could within that period make

15 [1985] A.C. 191; these views were also cited with approval by Lawrence Collins L.J. in *Chartbrook Ltd* v. *Persimmon Homes Ltd* [2008] EWCA Civ 183.

16 See paragraph 44 of the judgment.

17 [2010] EWHC 361 (Comm).

a determination of the vessel's compliance with the contract. The sensible commercial interpretation of the guarantee was that the demand was to be made by the buyer upon the guarantor within the 15-day period, the requirement for a decision by the classification society representing an additional condition of payment only if the builder disputed the buyer's right to cancel.[18]

Curiously, the SAJ Form imposes no obligation upon the builder to provide any form of refund guarantee to the buyer. In contrast, and in keeping with modern practice, the NEWBUILDCON Form requires[19] the builder to provide to the buyer a refund guarantee "*substantially in the form and substance*" of the draft set out at Annex A(i) to the Form. Such guarantee provides for the guarantor to make payment thirty days from the date of any demand by the buyer, unless within twenty-eight days he has received notice that the builder's liability for the amount claimed has been disputed. In this event the guarantor's liability is postponed until thirty days after a final award determining the dispute or the issuance of any appeal from such award. Broadly similar provisions are contained in the CMAC Form.[20]

Performance guarantees

If the buyer wishes to ensure recovery of his "reliance" or "expectation" losses in the event of the builder's failure to perform, he must obviously seek to negotiate contract terms to such effect[21] and ensure the provision of an adequate third-party guarantee upon which he can rely in the event of the builder's default. Third-party commitments of this nature are usually known as performance guarantees or bonds.

As previously noted, however, it is relatively uncommon in the context of international shipbuilding projects for the parties to contract on such a basis.[22] The best that can usually be achieved by the buyer is a contract under which either a parent company guarantee is provided on behalf of the builder or the builder and a substantial third party, usually a public or private export agency, accepts joint obligations to build and deliver the vessel. Thus, for example, shipbuilding projects with the smaller Japanese and Chinese shipyards are often concluded on the basis of a contract in which both the builder and a trading house are defined as builders/sellers and are jointly liable for the performance of the contract. Even in this situation, however, the builders/sellers will normally each be entitled to avail themselves of the benefit of contract terms limiting or excluding the buyer's rights to claim damages in the event of rescission.

Where a separate performance guarantee is provided to the buyer, this will, as indicated, frequently be issued by the builder's parent company or a major shareholder. In such circumstances, it is obviously important from the builder's perspective to ensure that the wording of the guarantee imposes upon the guarantor no greater obligations than those assumed by the builder under the contract.

18 The guarantor argued that this left the validity period of the guarantee uncertain, but the High Court (Burton J.) held that the buyer's obligation in these circumstances was to obtain the decision of the classification society within a reasonable time, which he had done.

19 See Clause 14(b).

20 See Article V.7 and Annex "A".

21 Or which at least do not exclude such a claim.

22 See pages 199–201, *supra*.

This cardinal rule was inadvertently breached in *Anglomar Shipping Co. Ltd* v. *Swan Hunter Shipbuilders Ltd and Swan Hunter Group Ltd (The "London Lion")* (1980),[23] which involved a contract for the construction by Swan Hunter Shipbuilders Ltd (SHS) of a large oil tanker. The agreement, which imposed upon SHS an obligation to build the vessel in a "sound and workmanlike manner", incorporated the usual post-delivery guarantee of 12 months and stated that SHS should not be liable for "any detention or consequential loss in respect of defects found after delivery unless arising out of the builder's default in the provisions of [the guarantee clause]". On the date of signature of the contract, the shipbuilder's parent company, Swan Hunter Group Ltd. (SHG), wrote to the plaintiffs stating that " . . . if [SHS] shall . . . commit any breach of its obligations, then we will indemnify you . . . against all losses, damages, expenses or otherwise you may incur by reason of any such default by [SHS] in performing and observing its obligations under the said contract".

Following her delivery the vessel was alleged to be fundamentally defective, as a result of which the purchasers brought a substantial claim for damages against SHS and SHG. As against SHG, the purchasers argued that their letter of undertaking was not qualified by the provisions of the contract exempting SHS from liability in damages for detention or consequential loss. It was further said that SHG were obliged to provide an indemnity in respect of any losses sustained as a result of the alleged breach by SHS in delivering a defective vessel.

The purchasers failed at first instance, Mocatta J. holding that SHG's undertaking constituted merely a guarantee of SHS's obligations and nothing more, i.e., SHG were entitled to the benefit of any exceptions of liability contained in the underlying contract. This decision was, however, overturned by the Court of Appeal which, applying a strict interpretation to the wording of SHG's undertaking, held that the words "any default . . . in performing its obligations under the . . . contract" meant any breach of contract by SHS, whether or not SHS was itself exempted from liability from the consequences thereof.[24] SHG had thus assumed a significantly greater financial exposure than that of its subsidiary.[25]

Completion bonds

As an alternative to either a refund or performance guarantee, the contract may provide for the builder to furnish a completion bond, i.e., a third party undertaking to the buyer that, in the event of termination of the contract resulting from the builder's failure to complete the vessel, the issuer of the bond will either complete the project himself or reimburse the buyer's costs of so doing.[26]

Instruments of this type, which are commonly used in the non-marine construction sector, are sometimes employed in a shipbuilding context where the builder has

23 [1980] 2 Lloyd's Rep. 456, C.A.

24 The judgments of all three Lord Justices nevertheless indicate a measure of unease as to the unreasonable nature of the result they had reached.

25 In contrast, in *Azimut-Benetti SpA (Benetti Division)* v. *Darrell Marcus Healey* [2010] EWHC 2234, Blair J. expressed the view, *obiter*, that where a contractual liability for liquidated damages was unenforceable as a penalty, there could be no claim against the guarantor for such amount; this was so even where the guarantee contained a clause seeking to render the guarantor responsible to the buyer in circumstances in which the underlying contract was unenforceable.

26 Confusingly, these instruments are often also called "performance bonds".

insufficient financial resources to arrange a satisfactory refund guarantee. In such circumstances, the parties will agree that the buyer should be granted title to the vessel under construction, together with all materials and equipment when appropriated to her,[27] and a contractual right to complete her in the event of the builder's default. The completion bond is intended to provide the buyer with the commitment of a substantial third party, often a bank or a major insurance company, that it will undertake or fund the completion of the vessel following such a default.

The precise scope of the issuer's commitment is nevertheless entirely dependent upon the language of the bond, and the wording used in many of the standard forms is, unfortunately, archaic and difficult in practice to understand.[28] As in relation to refund guarantees, particular difficulties tend to arise in determining whether the bond is an "on demand" instrument or a true guarantee, i.e., whether the commitment of the issuer is conditional upon the buyer establishing in arbitration or court proceedings that the builder is in default of his contractual obligations.[29] Various factors will bear upon this issue, including in particular whether the bond contains wording preserving the issuer's liability in the event of any change in the underlying shipbuilding contract; such wording is not needed in the case of an "on demand" instrument (where the obligations of the issuer are in any event wholly independent of the underlying shipbuilding contract) and tends clearly to indicate that the document in question is not a species of guarantee.[30]

However, even assuming that the wording is clear, the acceptance by the buyer of a completion bond will normally give rise to greater risks than a refund guarantee. Where the builder is in serious financial difficulties, the buyer's only means of "recovering" his pre-paid instalments of the contract price will lie in the completion and delivery of the vessel and, depending upon the stage of construction which has been reached, this will often prove in practice beyond the capabilities of either the buyer or the completion bond issuer, at least within the originally envisaged project timetable.[31] Unless, therefore, the extent of the buyer's pre-delivery payments is very limited, the provision of a completion bond will not normally represent a sufficient basis upon which the financial engineering required by a major shipbuilding project can be founded.

The enforceability of the builder's guarantees

Whether a third party guarantee or bond is given to the buyer, this will not necessarily be governed by the same law as that of the contract. Even if it is expressly provided that the guarantor's obligations should be triggered by a judgment or award obtained under the

27 See pages 139–143, *supra*; completion bonds are commonly found in ship conversion projects, where title to the vessel obviously vests throughout in the owner.

28 In *Trafalgar House Construction (Regions) Ltd* v. *General Surety and Guarantee Co. Ltd* [1994] 10 Const L.J. 240, C.A, Parker L.J. described the bond as "a most unsatisfactory document".

29 See in this context the House of Lords decision in *Trafalgar House Construction*, *supra*, at n. 11, and the cases cited therein.

30 See *American Home Assurance Co.* v. *Hong Lam Marine Pte Ltd* (*supra*, at n. 12), at page 705 and the authorities there cited.

31 Apart from the problems of securing physical possession of the vessel and its constituent elements, many of which may be in the hands of unpaid subcontractors, there may (depending upon the law of the place of construction) exist considerable difficulties in establishing the buyer's title to the same and the enforceability as against the builder's liquidator of rights to complete the vessel at the shipyard or elsewhere. Where, as is normally the case, the completion bond is for a maximum financial value and/or is limited in time, the buyer cannot simply leave these problems to be resolved by the bond issuers.

provisions of the contract, enforcement against him may be significantly complicated if no law is chosen to govern the guarantee or the law chosen is different from that of the contract.

It is accordingly important that the guarantee should include terms dealing with the parties' choice of law and jurisdiction and that these should so far as possible reflect the provisions of the contract itself. Although it will normally be inappropriate to incorporate within the guarantee similar arbitration provisions to those of the contract,[32] it is usual for the parties to confer jurisdiction over the guarantee upon the courts of the country selected as the arbitral forum.

Where the guarantee is governed by English law, it is important from the buyer's perspective[33] to ensure that:

(a) the requirements of the Statute of Frauds 1677 are complied with;
(b) the guarantee is duly authorised and other legal requirements, particularly those arising under the law of the guarantor's residence, are observed;
(c) the guarantor is made aware of the true nature of the contractual arrangements agreed with the builder and, in particular, that any "side letters" or collateral agreements are disclosed to him; and
(d) unless the guarantee expressly provides otherwise, the consent of the guarantor is obtained before any material variation is made to the contract.

(a) The Statute of Frauds 1677

The buyer's principal concern in relation to the creation of an enforceable refund guarantee is likely to derive from the rather archaic provisions of s. 4 of the Statute of Frauds Act, 1677. This states that:

"no action shall be brought . . . whereby to charge the defendant upon any special promise to answer for the debt default or miscarriages of another person . . . unless the agreement upon which such action shall be brought or some memorandum or note thereof shall be in writing and signed by the party to be charged therewith or some other person thereunto by him lawfully authorised."

In essence therefore a guarantee governed by English law will not be enforceable unless it is in writing and "signed" by the issuer. There are, however, no specific statutory requirements as to what constitutes signature. Provided that this is intended to act as a signature, it may appear anywhere in the document,[34] and may be no more than a first name, initials or even the nickname of the sending party used in an e-mail.[35] Furthermore, it is clear that, for the purposes of the statute, an agreement, "memorandum or note" may comprise more than one document and includes a chain of e-mails which set out the guarantee terms.[36]

32 Primarily because arbitration awards are not in English law immediately enforceable by way of execution against the debtor's property, arbitration is usually less appropriate than litigation (i.e. court proceedings) as a means of enforcing clearly-defined financial obligations.

33 These rules equally apply to guarantees issued to the builder on behalf of the buyer; see pages 303–306, *infra*.

34 *Knight* v. *Crockford* (1794) 1 Esp. 189; *Evans* v. *Hoare* [1892] 1 Q.B. 593; *Caton* v. *Caton* (1867) L.R. 2 H.L. 127 and *J. Pereira Fernandes S.A.* v. *Mehta* [2006] 1 W.L.R. 1543.

35 *Golden Ocean Group Ltd* v. *Salgaocar Mining Industries PVT Ltd* [2012] EWCA Civ 265, *per* Tomlinson L.J. (at paragraph 32 of his judgment).

36 *Ibid.*

In *W.S. Tankship B.V.* v. *The Kwangju Bank Ltd and Seoul Guarantee Insurance Co.* (2011)[37] the refund guarantee had, as is common practice, been transmitted between banks by a SWIFT message.[38] The name of the issuing bank did not appear in the body of the guarantee itself, but was contained in a document header generated automatically by SWIFT. Against this background, the issuing bank sought to argue that the refund guarantee had not been "signed" for the purposes of the Statute of Frauds, and relied upon *J. Pereira Fernandes S.A.* v. *Mehta* (2006),[39] which had held that an electronically generated address in an e-mail did not meet the requirements of s. 4. The High Court in *Tankship* decided, however, that in the context of a SWIFT exchange, and as a matter of common sense:

"authentication by sending was equivalent (in modern terms) to authentication by signing and so within the spirit, if not the letter, of section 4 of the Statute of Frauds".[40]

(b) Other formalities

The beneficiary of the guarantee must also ensure not only that the guarantee is duly authorised and validly executed on behalf of the guarantor, but also that this complies with local law in the place of its issuance, being a country with which the United Kingdom enjoys friendly relations.

In *Sea Emerald S.A.* v. *Prominvestbank Joint Stockpoint Commercial Industrial & Investment Bank* (2008),[41] a refund guarantee was held unenforceable against the Ukrainian guarantor bank because the bank's regional manager had no actual or ostensible authority to issue it on the bank's behalf.[42] Such an argument is unlikely to succeed if the guarantee is issued via the SWIFT network (because the system requires the use of input keys and codes which are typically available only to authorised signatories within the "issuing" bank), but potential problems regarding authority can in any event normally be addressed by seeking confirmation from the issuer independently of the guarantee itself.

As to compliance with local law, a specific geographical issue arises in relation to the requirement in China that foreign currency guarantees should be registered with the State Administration of Foreign Exchange ("SAFE"), a government agency responsible for the management of the country's foreign reserves.

Prior to 2010, where the underlying obligor was a Chinese entity, such as a shipyard, bank guarantees provided in a foreign currency to foreign entities, such as an export newbuilding purchaser, were required to be registered with, and approved by, SAFE in order to be enforceable in China. Although the administrative burdens of this requirement were reduced in 2010, when a "quota" system was introduced for certain banks issuing foreign currency guarantees, significant concerns continue arise from the perspective of a foreign buyer. It is, in particular, difficult to establish whether or not an issuing bank has exceeded its quota, and there is little guidance as to the effects in China if it has done so.

37 [2011] EWHC 3103 (Comm).

38 The SWIFT network is commonly used as the vehicle for the international transmission of letters of credit and guarantees.

39 *Supra*, at n. 34.

40 See paragraph 154 of Blair J.'s judgment.

41 [2008] EWHC 1979 (Comm).

42 For an explanation of the circumstances in which a contracting party can be bound by the doctrine of ostensible, or "apparent", authority, see Treitel, *Law of Contract* (13th edn.) pages 712–716.

Furthermore, foreign currency guarantees issued other than by banks operating within their quotas continue to require the issuer to obtain SAFE approval.[43]

In *Emeraldian Partnership Ltd* v. *Wellmix Shipping Ltd and Guangzhou Iron & Steel Corporation Ltd (*2010),[44] a Chinese company had issued a charterparty guarantee denominated in United States dollars, which guarantee the court found to be governed by English law. The guarantor and beneficiary had, however, overlooked the requirement of SAFE registration. In response to a claim under the guarantee, the guarantor contended that it would be contrary to English public policy for the court to enforce performance of an obligation thereunder (namely, payment) which would be unlawful in a friendly foreign state.

After hearing evidence from Chinese legal experts, Teare J. noted that notwithstanding that its issuance constituted an offence under Chinese law, the guarantee was still enforceable, albeit that the beneficiary could be penalised by the guarantor's liability being reduced by up to one-half of the amount secured.[45] Since Chinese law did not regard the guarantee as unenforceable *per se*, the judge held that there was no reason why it should be so regarded in English law, or why (since English law applied), the beneficiary should not be allowed to make a full recovery, i.e., without reference to the penalty applicable under Chinese law.

(c) The requirement of disclosure

The requirement that proper disclosure should be made to the guarantor of matters materially affecting the extent of his liability derives its origin from *Pidcock* v. *Bishop* (1825),[46] which involved a contract for the sale of consignments of pig iron. Unknown to a third party who had guaranteed the buyer's payment of the price, the buyer and seller had also entered into a side agreement that the former should pay 10s. 0d. per ton more than the market price on the basis that the excess would be applied in settlement of a pre-existing debt.

In these circumstances the guarantor avoided liability under the guarantee on the grounds of a material non-disclosure, namely that it had been agreed that part of the purchase price was to be appropriated to payment of the debt rather than in the discharge of the buyer's liability for the price. According to Bayley J.:

"It is the duty of a party taking a guarantee to put the surety in possession of all the facts likely to affect the degree of his responsibility, and if he neglects to do so it is at his peril. . . . Here the contract to guaranty is void, because a fact materially affecting the nature of the obligation created by the contract was not communicated to the surety."[47]

Subsequent decisions have, however, made clear that the duty of the beneficiary is not to disclose *all* potentially relevant facts but rather to point out to the guarantor any features of the transaction to be guaranteed which " . . . under the circumstances the [guarantor]

43 See the Circular of the State Administration of Foreign Exchange on the Administration of External Guarantees provided by Domestic Institutions: http://www.safe.gov.cn/model_safe_en/laws_en/laws_detail_en.jsp?ID=30600000000000000,64&type=&id=3, published on 30 July 2010.

44 [2010] EWHC 1411 (Comm).

45 See paragraph 179 of his judgment.

46 (1825) 3 Barn. & Cress. 605; see also *Espey* v. *Lake* (1852) 10 Hare 260. The caselaw relevant to the requirement of disclosure in the context of a guarantee was exhaustively reviewed by Newey J. in *North Shore Ventures Ltd* v. *Anstead Holdings Inc. and Ors* [2010] EWHC 1485; see in particular paragraphs 101–125 of his judgment.

47 At page 610.

would expect not to exist".[48] Thus, in *Levett* v. *Barclays Bank plc* (1995)[49] the High Court held that the guarantor's duty is to disclose:

" . . . contractual arrangements made between the principal debtor and the creditor which make the terms of the principal contract something materially different in a potentially disadvantageous respect from those which the [guarantor] might naturally expect."[50]

In *Coal Distributors Ltd* v. *National Westminster Bank Ltd* (1981),[51] a shipbuilding case, the contract provided that the builders were to procure a bank guarantee of their obligations in the maximum amount of £85,000. However, as title to the newbuilding was to pass continuously to the purchasers throughout construction, the builders were also expressly permitted to substitute the guarantee originally furnished with progressively smaller guarantees as the work progressed. By the terms of a side letter, the existence of which was not disclosed to the guarantor bank, the builders nevertheless agreed with the purchasers not to exercise this option. The question arose whether such non-disclosure vitiated the guarantee.

Having held on the evidence that the bank had always assumed that the option might not be exercised, Neill J. distinguished *Pidcock* v. *Bishop* on the grounds that knowledge of the terms of the side letter would not have altered its willingness to issue the guarantee.[52] It is nevertheless quite clear from the judgment that, had such knowledge been material to the bank's assessment of the risk, concealment of the side letter would have discharged the guarantee.[53]

In *W.S. Tankship B.V.* v. *The Kwangju Bank Ltd and Seoul Guarantee Insurance Co.* (2011),[54] the issuer of certain "advance payment guarantees" argued that it had been discharged from liability thereunder because the beneficiary shipowner had failed to disclose various loans previously made by it to the builder. The High Court (Blair J.) held that the duty of disclosure did not apply because the instruments in question were demand bonds, rather than "true" guarantees, but said *obiter* that if they had been guarantees, there would in any event have been no obligation on the beneficiary to make disclosure of the loans—it was known to the guarantor that the builder was a "start-up" shipyard, and there must accordingly have been a close relationship between the shipyard and its first customer. The making of the loans did not, therefore, change the financial position of the shipyard from that which the bank "might naturally expect".[55]

It should be noted that the duty of disclosure resting upon the beneficiary can in principle be excluded by appropriate wording in the guarantee,[56] although this is not in practice achieved by the wording of the NEWBUILDCON Form standard guarantee.

48 *Per* Lord Campbell in *Hamilton* v. *Watson* (1845) 12 Cl. & F. 109 at page 119.

49 [1995] 1 W.L.R. 1260 *per* Michael Burton Q.C., sitting as a deputy judge, at page 1275.

50 See also *Royal Bank of Scotland plc* v. *Etridge (No. 2)* [2001] 3 W.L.R. 1021, *per* Lord Scott at page 1083: ". . . the obligation [of disclosure] should extend to unusual features of the contractual relationship between the creditor and the principal debtor . . . that would or might affect the rights of the surety."

51 Unreported, QBD, 4 February 1981.

52 See the similar finding of fact (i.e., that knowledge would not have affected the guarantor's willingness to issue its guarantee) in *American Home Assurance Co*, *supra*, at n. 12.

53 See also *Far Eastern Shipping Co. Public Ltd* v. *Scales Trading Ltd* [2001] Lloyd's Rep. Bank. 29, P.C. (N.Z.), where the guarantor was discharged from liability in circumstances in which the underlying contract had been operated in part to effect an exchange control fraud on the Russian Government and this had not been disclosed to him.

54 *Supra*, at n. 37.

55 See paragraph 150 of the judgment. This finding nevertheless seems very curious in light of the reported facts of the matter.

56 See paragraph 180 of the judgment in *North Shore Ventures Ltd* v. *Anstead Holdings*, *supra*, at n. 46.

(d) The effect of variations to the underlying contract

The *Coal Distributors* decision is also authority in a shipbuilding context for proposition (c) above, i.e., that unless the guarantee otherwise provides, any unauthorised variation of the underlying contract which is capable of prejudicing the interests of the guarantor discharges him from liability. This is the so-called "rule" in *Holme* v. *Brunskill* (1878).[57]

In *Coal Distributors*, the contract, which was signed in December 1975, provided that instalments of the price should be paid by the purchasers at specified "milestones" in her construction against a written declaration of the shipbuilders and a certificate, signed by the classification society surveyor, each stating that the relevant stage in the works had been reached. In July 1976 the parties to the contract entered into a formal variation of its terms under which (*inter alia*) certain of the stage payments were agreed to be payable against the shipbuilders' declaration alone, i.e., without the requirement of an independent stage certificate. The bank's approval was not requested at any stage.

Following the shipbuilders' liquidation, the purchaser claimed under the guarantee.[58] The bank denied liability, arguing that its guarantee had been discharged by reason of the unapproved variation to the contract and this defence was upheld by the High Court. In the view of the trial judge (Neill J.):

"the amended [i.e., July 1976] scheme contained less stringent safeguards than the December scheme against payments being made to [the shipbuilders] before it had been clearly established that the relevant stage had been reached . . . there can be no doubt that had the amendments provided for payments to be made earlier than in the original scheme, the guarantee would quite plainly have been discharged. The amendments which were made did not provide for different dates for the total sums payable but it did reduce the protection against the possibility of the sums being paid before the relevant work as certified by Lloyd's surveyor being completed. . . . This variation was a material variation."

More recently, in *Marubeni Hong Kong and South China Ltd* v. *Government of Mongolia* (2004),[59] which concerned a guarantee issued in connection with the purchase of machinery and equipment, the High Court (Cresswell J.) held that the guarantor would not be discharged by reason of an alteration of the underlying contract where it is "without inquiry" evident that (a) the alteration is insubstantial or (b) that the alteration cannot be otherwise than beneficial to the surety; where, however, neither of these circumstances are self-evident, the court will discharge the guarantor from liability without inquiring as to the materiality or practical effect of the alteration, including whether or not it is to the prejudice of the guarantor.

Although it is plainly impossible to formulate a comprehensive definition of "materiality" or "substantiality" in this context, it is clear that, unless the guarantee provides to the contrary, any unauthorised change to the amount or time of payment of the buyer's instalments will discharge the guarantor from liability. Thus, for example, in *The General*

57 (1878) 3 Q.B.D. 495. As previously indicated, the rule in *Holme* v. *Brunskill* does not apply to "on demand" undertakings and guarantees, which are "autonomous" contracts, *per* Blair J. in *CIMC Raffles Offshore (Singapore) Ltd and Yantai CIMC Raffles Offshore Ltd* v. *Schahin Holdings S.A.* [2012] EWHC 1758 (Comm) at paragraph 27 of his judgment.

58 The claim was in fact for the additional costs of completing the vessel elsewhere. The court ruled that the bank had in effect issued a performance guarantee.

59 [2004] EWHC 472 (Comm) at paragraph 206. The judgment was upheld by the Court of Appeal (see *Marubeni Hong Kong and South China Ltd* v. *Government of Mongolia* [2005] EWCA Civ 395).

Steam Navigation Co. v. *Rolt* (1859),[60] a purchaser's agreement to advance the date of payment of certain instalments of the contract price, undertaken to assist the shipbuilder in his financial difficulties, discharged the latter's guarantor from any liability under his guarantee.[61]

The application of this principle is, however, by no means limited to the payment provisions of the contract, as any significant change in the nature or timing of the works themselves may also have this effect. This is clearly demonstrated by the somewhat curious case of *Mercers of the City of London* v. *New Hampshire Insurance Co.* (1992),[62] which is also of significance in considering a further issue, namely whether a unilateral breach of the underlying contract (as opposed to a mutually agreed variation) will discharge the guarantor from liability under his guarantee.

In *Mercers*, the parties to a substantial non-marine building contract agreed that the employer would make an advance payment of £4.5 million of the price to avoid the impact of the expected introduction of increased rates of Value Added Tax. The employer's payment was secured by a bond issued jointly by the contractor and the defendant, New Hampshire, the latter being paid a fee by the employer to act as surety for the contractor.

The contractor thereafter became insolvent at an early stage of the project with the consequence that the building contract terminated in accordance with an express term to such effect. The employer claimed under the bond the amount of the advance instalment he had paid to the contractor.

In the Commercial Court, the defendant guarantors denied liability on the grounds that the contract had been materially varied. They relied in this respect upon the terms of an agreement, allegedly reached between the contractor and the employer's architects, that the date upon which possession of the site would be given to the contractor to commence the works should be delayed for 24 days beyond the latest date stipulated in the contract.

Although conceding that the date for commencement of the works had been of "no significance" to New Hampshire when their bond was originally issued, Phillips J. held that this defence succeeded and that the insurance company was wholly discharged from any obligation thereunder. In the judge's view:

"The postponement of the date for possession of the site would have been unlikely to have had a material effect on the perceived risk [i.e., the risk perceived by New Hampshire]. But it does not follow from this that the variation was unsubstantial or manifestly incapable of prejudicing New Hampshire. . . . The evidence suggests that had the work commenced when, under the building contract, it should have started, approximately £500,000 worth of additional work would have been carried out before the group failed so that the bond would have been further liquidated by that amount. It follows that . . . the variation of the date for possession of the site, and the consequent deferment of the entire timetable, had the effect of discharging New Hampshire from liability under the bond."

60 (1859) 6 C.B.(N.S.) 550.

61 The English courts have also confirmed the discharge of the guarantor where the beneficiary of the guarantee had given the principal debtor additional time to pay (*Polack* v. *Everett* (1876) 1 Q.B.D. 669) and where, to the potential prejudicial of the guarantor, a variation agreement had increased the number of interest "rests" in the agreed payment schedule under the underlying contract (*Credit Suisse* v. *Allerdale Borough Council* [1995] 1 Lloyd's Rep. 315 at 356).

62 [1992] 1 Lloyd's Rep. 431, Commercial Court; [1992] 2 Lloyd's Rep. 365, C.A.

At the hearing of the appeal, however, and following further investigations in the interim, it was conceded by the defendant guarantors that there had been no agreed variation to the building contract, the plaintiffs having instead merely breached the contract by failing to give possession of the site to the contractors until four weeks after the latest date on which it was agreed they would do so. The case then proceeded on an entirely new factual basis, the defendants arguing instead that the plaintiffs had in effect forfeited the benefits of the bond by their breach of the terms of the underlying contract.

This argument was, however, rejected by the Court of Appeal which held the defendants liable under the bond.[63] In reaching this decision two members of the court[64] relied directly upon *National Westminster Bank plc* v. *Riley* (1986),[65] an earlier Court of Appeal decision in which it was held that a "non-repudiatory" breach of the underlying contract[66] does not discharge a guarantor unless it amounts to a "not unsubstantial" departure from a term of the contract, which has either expressly or by implication been "embodied" in the guarantee.

The test for determining whether a contractual term has been impliedly incorporated into an associated guarantee is, however, in practice difficult to apply, as the third judge, Scott L.J., pointed out in his judgment.

According to Scott L.J., the real question to be determined in such a case is whether the breach of contract by the beneficiary has affected the guarantor's risk. In his view:

"The substantiality of the breach of contract ought . . . to be assessed by reference to the impact of the breach on the risk undertaken by the surety. I would think it possible that even a repudiatory breach of contract would not necessarily discharge a surety. Discharge should, in my opinion, depend on the importance of the breach in relation to the risk undertaken. Similarly, a non-repudiatory breach might, in particular circumstances, significantly alter the risk and so enable the surety to claim to be discharged. In the present case, however, I can see no sensible argument that would treat the four week delay caused by the (plaintiffs) as altering the risk undertaken by the (defendants) under the bond."[67]

The "risk analysis" test proposed by Scott L.J. is, it is submitted, simpler to apply in practice than that of determining whether the term breached formed part of the contract of guarantee and, if so, whether the departure from the agreed terms was "not unsubstantial". It is also broadly in conformity with the test which applies to determine issues of "non-disclosure" by the beneficiary in the context of the original issuance of guarantees and bonds.

More generally, in *Sea Emerald S.A.* v. *Prominvestbank Joint Stockpoint Commercial Industrial & Investment Bank* (2008),[68] the High Court[69] endorsed the view expressed in *Chitty on Contracts*[70] that:

63 Although the decision of Phillips J. was overruled by the Court of Appeal, its correctness in the context of a material variation (as opposed to a breach) of the underlying contract was not questioned.

64 Parker and Nolan L.JJ.

65 [1986] B.C.L.C. 268.

66 That is, a breach which does not go to the "root" of the contract by denying the innocent party a substantial part of the benefits he expected thereunder. Where, in contrast, the breach of the underlying contract by the beneficiary of the guarantee is indeed "repudiatory" in nature and is accepted as such by the other party, such circumstance will, *per* May L.J. in the Court of Appeal in *Riley*, "certainly" discharge the guarantor from any continuing liability under the guarantee (see page 275 of the report).

67 At pages 366–367 of the report.

68 *Supra*, at n. 41.

69 *Per* Andrew Smith J. at paragraph 147 of his judgment.

70 29th edn., paragraph 44–107.

" . . . there is no general principle that 'irregular' conduct on the part of the creditor, even if prejudicial to the surety, will discharge him. Short of bad faith, misrepresentation or concealment amounting, to misrepresentation, connivance with the default of the principal creditor, or variation of the terms of the contract to the possible prejudice of the surety, the creditor can act as he chooses".

Finally in this context, it should be noted that, in light of strictness of the rule in *Holme* v. *Brunskill*, the issuers and beneficiaries of many commercial guarantees, including shipbuilding refund guarantees, routinely agree to include wording specifically permitting amendment of the terms of guaranteed contract without the consent of the guarantor. Such language is, for example, included as paragraph 3 of standard form refund guarantee attached as Annex A(i) to the NEWBUILDCON Form.

Wording of this type, if clearly expressed in the guarantee, is normally effective in achieving its contractual purpose[71]; it will nevertheless not apply to extend the obligations of the guarantor beyond the "purview" (i.e., the original purpose) of the guarantee.

In *Triodos Bank N.V.* v. *Dobbs* (2005),[72] a personal guarantee given by a company director to secure certain borrowings provided that the loan terms could be amended without reference to him. The loans were thereafter twice replaced by further advances, with the second advance being significantly greater than that of the original loan and expressed as intended for a different commercial purpose.

Against this background, the Court of Appeal held that the "new" facility constituted a "replacement [agreement] on terms so different from the original agreement" that it "[could not] be an amendment or variation of the initial contract" and accordingly did not bind the guarantor.[73] The Court also decided, however, that the effect of the amendment was not to discharge the guarantee in its entirety, but rather to restrict the guarantor's liability to the obligations he had assumed before the amendment was made.[74]

III. GUARANTEES ISSUED ON BEHALF OF THE BUYER

Most newbuildings are contracted in the name of purchasing companies incorporated for such purpose and usually located in tax-efficient, "convenience" jurisdictions.[75] Where the buyer is of limited financial worth, it will be an issue of primary importance to the builder to secure adequate and appropriate third party guarantees of his performance of the contract.

The nature and extent of the guarantees normally required of the buyer will be determined by a variety of factors, including the identity of his shareholders, the amount and time of payment of his pre-delivery instalments and the transfer of title provisions of the contract. Where the builder requires an export credit guarantee, the bank or

71 See, in another context, the comments of Field J. in *Associated British Ports* v. *Ferryways and anor* [2008] EWHC 1265 (Comm) at paragraph 87 of his judgment.

72 [2005] EWCA Civ 630.

73 *Per* Longmore L.J. at paragraphs 13 and 15 of his judgment.

74 See also the more recent decision of Blair J. in *CIMC Raffles Offshore (Singapore) Ltd and Yantai CIMC Raffles Offshore Ltd* v. *Schahin Holdings S.A.* (2012), *supra,* at n. 57, decided on the basis that the rule in *Holme* v. *Brunskill* did not apply to the guarantee in question.

75 Such companies were described by Roskill L.J. in *Hyundai Shipbuilding and Heavy Industries Co. Ltd* v. *Pournaras* [1978] 2 Lloyd's Rep. 502 as "not . . . notorious for the size of their assets, apart from the ship which they are going to acquire . . . " (at page 504).

government agency making this available will normally dictate the form of security to be provided by the buyer. This will then be assigned to the bank or agency as counter-security for its own guarantee to the builder.

Guarantees furnished by the buyer fall into two categories: pre-delivery and post-delivery.

Pre-delivery guarantees

The buyer may agree to a schedule of pre-delivery instalments which will leave the builder partially secured in the sense that their aggregate value will at all stages exceed the builder's costs of construction. In such circumstances, provided that he retains title to the vessel until her delivery and acceptance, the builder may sometimes be willing to contract without the benefit of a third party guarantee of the buyer's obligations.

Unless the buyer is a company of considerable financial worth, the builder will, however, insist in almost all other situations that his obligations are guaranteed by the buyer's parent or other substantial third party.

Although the buyer's primary obligations under most shipbuilding contracts are limited to payment of the price in instalments and acceptance of the vessel following her delivery, he also assumes a number of commitments of secondary importance. Thus, for example, the buyer may be obliged to provide the fuel and stores required for the vessel's trials[76] and to make good any shortfall in the builder's receipts following his rescission and the forced sale of the vessel.[77]

Given these various possibilities, it is usual for the buyer's guarantee to encompass all of his commitments to the builder in the pre-delivery period. The SAJ Form standard guarantee provides simply that the guarantor shall:

> " . . . irrevocably and unconditionally guarantee . . . due and faithful performance by the BUYER of all of its liabilities and responsibilities under the contract and any supplement, amendment, change or modification hereafter made thereto, including but not limited to, due and prompt payment of the Contract Price. . . . "

The guarantor's obligations are not expressed to be limited in time nor to expire upon the delivery and acceptance of the vessel. Where, therefore, the contract involves the provision of a builder's credit secured by separate post-delivery guarantees, it is important that the SAJ Form guarantee be amended to restrict its validity to the pre-delivery period.

From the builder's viewpoint, the SAJ Form wording is almost certainly flexible enough to accommodate a broad range of changes to the contract without impairing its validity. It is submitted, however, that the requirement, based upon *Pidcock* v. *Bishop*,[78] that the builder should at the outset make clear to the buyer's guarantor the true nature of his contractual arrangements with the buyer is not excluded by the SAJ Form wording and remains of material importance.

Finally, it should be noted that, on the basis of the decisions of the Court of Appeal and the House of Lords in *Hyundai Shipbuilding & Heavy Industries Co. Ltd* v. *Pournaras*

76 Article VI.3 (b) of the SAJ Form.
77 Article XI.4 (e) of the SAJ Form.
78 *Supra*, at n. 46.

(1978)[79] and *Hyundai Heavy Industries Co. Ltd* v. *Papadopoulos* (1980),[80] guarantees of this type will almost certainly continue to secure the builder in respect of instalments already accrued due but unpaid, notwithstanding that he chooses either to treat the buyer's non-payment as a repudiatory breach of his obligations or to rescind the contract pursuant to its express terms.[81]

Post-delivery guarantees

Where, somewhat unusually in the current shipbuilding climate, the terms of sale involve the provision of a builder's credit, the buyer will normally be required to execute promissory notes prepared by the builder in the amount of the post-delivery instalments of the price and interest thereon. The buyer's payment of the promissory notes upon their maturity will be secured by a mortgage over the vessel in favour of the builder, coupled with assignments of her insurances and earnings, and/or a bank guarantee. The securities will usually be assigned to the builder's bank or the government agency which has agreed to finance the credit upon delivery and acceptance of the vessel.

Where the builder is given security over the vessel, its precise form will obviously depend upon her flag registration. The substance of such security is, however, unlikely to vary significantly from one registry to another, although it may well be affected by the buyer's other financing agreements.

Where, alternatively, bank security for performance of the buyer's post-delivery obligations is demanded by the builder, this may sometimes take the form of a simple guarantee issued upon delivery. In the context of most shipbuilding projects involving credit terms, the builder will, however, wish to know at the outset that a bank guarantee will be forthcoming if the vessel is duly completed. In such cases the builder will normally require that a bankers' commitment letter be provided to him as a condition of the effectiveness of the contract; it will in these circumstances be for the buyer to negotiate with his bank for a guarantee facility under which the latter will agree to provide such a letter.

As its name suggests, a commitment letter is a written undertaking, given by a bank or other financial institution, that, upon delivery and acceptance of the vessel prior to a stipulated cut-off date, it will issue in favour of the builder a guarantee in a pre-agreed form securing the buyer's post-delivery obligations. Commitment letters, although imposing upon the issuer only an obligation to furnish a further guarantee, are invariably intended to be legally binding and usually contain both choice of law and jurisdiction provisions to assist in their enforcement in practice, however, it is almost unknown for this to occur.

It should be noted in this context that, although the bank's obligation to furnish its guarantee often arises only upon receipt of an original copy of a duly executed protocol of delivery and acceptance, the buyer's wrongful refusal to execute this document will not necessarily leave the builder unsecured. In such circumstances the High Court has a discretionary power under s. 39 of the Senior Courts Act 1981 to order that the required delivery documentation be executed on behalf of the buyer by a designated third party.[82]

79 [1978] 2 Lloyd's Rep. 502.
80 [1980] 2 Lloyd's Rep. 1.
81 See pages 220–221, *supra*.
82 See page 131, *supra*.

It will in such circumstances be no answer to a demand by the builder for production of the promised guarantee that the protocol was not signed by the buyer himself. In practice, it is likely that the bank will at this point choose to exercise rights under its assignment of the contract to take delivery of the vessel in its own name (see further below).

IV. LETTERS OF COMFORT

In circumstances in which either the builder or the buyer is unable or unwilling to furnish a formal guarantee of its obligations under the shipbuilding contract, it may sometimes be agreed that it will provide to the other a "comfort letter" or "letter of support", issued by its parent company.

Although the form of such letters will obviously vary in detail from case to case, these will usually incorporate statements by the issuer:

(a) that it is aware of the assumption by its subsidiary of indebtedness or other liabilities to the beneficiary;
(b) that the issuer will, for a defined period, not dispose of its ownership interest in its subsidiary without the prior consent of the beneficiary; and
(c) that the issuer's "policy" or "intention" is to continue to provide financial support to its subsidiary to permit it to meet its contractual obligations.[83]

Whether such a letter gives rise to legal, as opposed to purely moral, obligations on the part of the issuer is always a matter of interpretation of the letter in light of its express wording and, in the case of ambiguity, the factual background against which it was given. In *Kleinwort Benson Ltd* v. *Malaysia Mining Corporation Berhad* (1989),[84] which concerned a letter given by the defendant to induce the granting of a loan to its subsidiary, the letter included a statement that:

"it is our policy to ensure that the business of [our subsidiary] is at all times in a position to meet its liabilities to you under the above arrangements."

Against this background, it was decided by Hirst J. at first instance, applying *Edwards* v. *Skyways* (1964),[85] that the defendant had failed to discharge the burden of proof upon him of showing that the words were not intended to give rise to a legal liability. This decision was, however, overruled by the Court of Appeal which held that the above language constituted a mere "affirmation" of the defendant's existing policy and not a contractual promise or warranty regarding its future conduct. It was accordingly open to the defendant to change its policy after the letter had been issued.

In *Hong Kong and Shanghai Banking Corporation* v. *Jurong Engineering Ltd.* (2000), a Singapore decision,[86] a similar outcome was reached in respect of a so-called "letter of awareness" given in connection with loans made by the plaintiff to the defendant's subsidiary. Under the terms of the letter the defendant undertook (*inter alia*) to maintain a 51% interest in a subsidiary company, " . . . to cause the [subsidiary] to be operated and

83 See *per* Ralph Gibson L.J. in *Kleinwort Benson*, *infra*, reciting (at page 385) Counsel's submissions as to market practice.
84 [1988] 1 W.L.R. 799 (Comm. Ct), [1989] 1 W.L.R. 379, C.A.
85 [1964] 1 W.L.R. 349.
86 [2000] 2 S.L.R. 54.

maintained in such a way as to be in a financial position to meet all its obligations from time to time to the [plaintiff]", and to take no action itself to prevent the subsidiary from meeting such obligations. The subsidiary was wound up upon the application of a third party creditor but the defendant refused to recognise any obligation to the plaintiff.

This position was (surprisingly) upheld by the High Court of Singapore, which considered that the letter was "drafted in the language of deliberate equivocation, in keeping with a 'gentlemen's agreement' and thus amounted to no more than a confirmation by the issuer that he will abide by his moral obligations".[87]

Although the decision in *Hong Kong and Shanghai Banking* seems very questionable in light of its facts,[88] it will be unusual following *Kleinwort Benson* for a letter of comfort, at least in the "classic" form, to do more than its name suggests, i.e., to provide reassurance but no legal security.[89] Conversely, however, the mere labelling of the document as a "letter of comfort" will not in itself prevent the same from being enforced if, upon its true construction, it contains words of promise or undertaking on the part of the issuer. The position will obviously be quite clear where the letter itself states that it is not intended to create legal obligations on the part of the issuer.[90]

V. CONTRACT ASSIGNMENTS

Where the buyer's pre-delivery instalments are to be financed by a bank or other financial institution, he will usually be required to execute in favour of the lender a security assignment of the benefit of the contract.

The purpose of such an instrument is twofold. First, the assignment will ensure that, in the event of the buyer's insolvency during the course of construction, the bank will be entitled to require the builder to complete the vessel for the bank's account in return for payment of the remaining instalments of the contract price as these fall due. The vessel will then be sold, either immediately or upon delivery, in order to recoup the buyer's loan outstandings.

Secondly, in the event of rescission of the contract consequent upon the builder's default, the assignment will permit the bank to make direct demand upon him for repayment of the pre-delivery instalments it has financed.[91] An assignment of the contract may indeed be vital to the enforcement of the bank's rights as assignee of the refund guarantee. In English law a claim for non-payment under a guarantee arises in damages, rather than in debt[92]; if the bank has no interest in the contract itself, it may be unable to prove that it has suffered a loss by reason of dishonour of the guarantee.

Pending the occurrence of an event of default as defined in the loan agreement, the bank will, however, have no interest in enforcing its rights under the assignment and will

87 *Per* Tay, J.C., at page 76.

88 See Lloyd's Maritime and Commercial Law Quarterly, May 2002 at page 169.

89 The position is perhaps best summarised at paragraph 27 of Field J.'s judgment in *Associated British Ports* v. *Ferryways N.V. and another* [2009] EWCA Civ 189 as being that: " . . . a document expressed to be a letter of comfort will usually not give rise to legal obligations (except, perhaps, as a warranty, of present intention) but sometimes a primary continuing legal obligation may arise as a matter of construction".

90 See, by way of an example, *National Australian Bank* v. *Soden* [1995] B.C.C. 696.

91 The events triggering the bank's rights under the assignment will usually include (i) default by the buyer under the terms of the loan agreement and (ii) the rescission of the shipbuilding contract by either party.

92 *Lep Air Services Ltd.* v. *Rolloswin* [1973] A.C. 331, *per* Lord Diplock at page 348.

usually wish to play no part in the organisation and supervision of the vessel's construction. It is therefore normal for the assignment to provide expressly that a formal notice of its terms should be given to the builder immediately but that the bank's rights should be suspended until the bank notifies the buyer to the contrary following the occurrence of an event of default.

As previously noted,[93] most shipbuilding contracts include provisions excluding or limiting the buyer's right of assignment and arrangements of this type will therefore usually require the consent of the builder. Given the values typically involved, the bank will normally be unwilling to rely upon informal indications of such consent and will require that the buyer should procure that a specific acknowledgement of the assignment be provided by the builder to the bank. This will confirm the builder's receipt of the notice of assignment and his agreement to complete the vessel for the bank's account in the event of the buyer's default.

VI. OPTION AGREEMENTS

In placing a newbuilding order, the buyer will often seek to negotiate with the builder terms upon which the latter is prepared to grant him an option for the construction of additional vessels. This issue will frequently be of vital importance to the commercial viability of the entire shipbuilding project and, as such, specifically addressed in the letter of intent concluded between the parties at the outset of their negotiations.[94]

The option arrangements will then be re-affirmed when the contract itself is signed, although these may often be contained in a side letter rather than in the body of the document itself.[95] Provided that the option is granted within the context of a contract for at least one "firm" vessel, it is unlikely that the agreement will be held void by an English court or arbitration tribunal for want of consideration. For the avoidance of any doubt, the option will, however, often be expressed as granted for a nominal consideration, e.g., US$1 payable by the buyer.

While the builder may be perfectly willing to grant one or more options in the interests of developing a long-term customer relationship, these will invariably confer a benefit on the buyer alone; their primary value will be to allow the buyer to speculate against the possibility of an upturn in the newbuilding market. For this reason, the period of validity of an option is often as important to him as the price at which it may be exercised. Where options are granted for the construction of a number of vessels, their aggregate worth will also depend upon whether they are capable of being exercised individually or must be declared together.

These issues will largely be determined by commercial factors, including in particular the contract price, the nature of the parties' previous business relationship and the state of the newbuilding market at the time their negotiations take place. Legal considerations are, however, also relevant because the apparent value of an option may be significantly

93 See pages 251–252, *supra*.

94 See pages 9–12, *supra*.

95 Unusually, the NEWBUILDCON Form includes (at Clause 44) provision for option arrangements, including boxes for the parties to complete regarding the number of additional vessels to be built (Box 26), their dates of delivery (Box 27) and the time frame within which the option must be declared (Box 28). The Form does not, however, include a pro forma notice for the exercise of the option.

affected by the terms of the shipbuilding contract on which it has been agreed that the option may be exercised. Where, for example, the parties have agreed upon a contract form which is subject to an Effective Date clause, the builder's reliance upon conditions precedent contained in such a clause may effectively defeat the buyer's exercise of the option.

This situation arose in *Gyllenhammar & Partners International Ltd* v. *Sour Brodogradevna Split* (1989),[96] the facts of which are set out at pages 267–268, *supra*. In holding that the shipbuilders were entitled to treat the optional contract as null and void whether or not they had made reasonable efforts to satisfy the conditions precedent contained in the Effective Date clause, the trial judge (Hirst J.) determined in effect that the option originally granted to the purchasers was commercially worthless.

Somewhat similarly, in *Ravennavi SpA* v. *New Century Shipbuilding Co. Ltd* (2007)[97] the terms of the shipbuilding contract created upon the exercise of an option were different from those the buyer had envisaged, depriving him of a substantial element of the commercial benefit he had envisaged.

In *Ravennavi* the agreement, which was concluded in conjunction with certain "firm" shipbuilding contracts, provided that, if the buyer exercised his option, other newbuildings would be constructed for him and delivered either on a fixed delivery date or before that date if an earlier "slot" became available at the builder's yard. After the buyer had exercised the option, such earlier slots became available but the builder allocated them to other buyers.

Against this background, the Court of Appeal held in favour of the builder that the exercise of the option created new contracts on the same terms as those for the firm vessels, which provided only for fixed delivery dates. In the Court's view, the builder's obligation to use the earlier slots for the optional vessels did not, as the buyer contended, survive in time until the construction of the vessels had commenced, but lapsed upon the exercise of the option.[98]

Where the parties have agreed upon a newbuilding option, any exercise of the same must normally be made strictly in accordance with the agreed terms. In *Haugland Tankers A.S.* v. *RMK Marine Gemi Yapim Sanayii ve Deniz Taşimaciliği Işletmesi A.S.* (2005),[99] the parties had agreed that any notice of exercise of the option granted by the builder should be accompanied by the "simultaneous" payment of a so-called commitment fee equivalent to 1% of the contract price. Against this background, the buyer's failure to pay the commitment fee when giving notice of the exercise of the option rendered the notice invalid.

If the builder refuses to honour the terms of an option agreement, it will be very rare indeed for the court to order specific performance of his obligations. In the normal course, the buyer's rights will be limited to a claim in damages based upon the difference between the contract price at which the option was declared and the market price payable on the date of such declaration for a newbuilding contract on equivalent terms.

96 [1989] 2 Lloyd's Rep. 403.

97 [2007] EWCA Civ 58.

98 Consequently, the Court did not consider it necessary to decide the further issue of whether the builder's obligation was affected by an entire agreement clause in the new contract for the optional vessels. See generally pages 275–278, *supra*.

99 [2005] EWHC 321 (Comm).

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PART 5

Ship conversion contracts

Where the capital cost of a newbuilding cannot be justified in light of hire and freight rates anticipated in the period following her delivery, the shipowner seeking additional tonnage will often choose to enter the market for a second-hand vessel. Purchasing an existing ship may, however, prove an unsatisfactory means of meeting the shipowner's tonnage requirements for the simple reason that the vessels available in the market place will not have been built to his specifications and standards and may not therefore entirely meet his specific needs.

One method by which the shipowner can overcome this problem is to employ shipbuilding and ship repair methods to convert an existing ship into the vessel he needs. Although not a new technique, ship conversion has become increasingly important in recent years. It is now frequently employed as an alternative to newbuilding in a number of sectors, in particular the "offshore" and cruise industries, which typically require the use of highly specialised and costly vessels.

The market for ship conversions is nevertheless distinct from that for newbuildings. Although the works undertaken in a large-scale conversion project are essentially those of construction rather than refurbishment and maintenance, conversion is usually regarded as a specialised area of ship repair, rather than as an adjunct of the newbuilding industry. The shipyards which undertake the majority of large and medium-sized conversion projects accordingly tend to be those from a ship repair, rather than a shipbuilding, background.[1]

I. THE DISTINCTIVE FEATURES OF THE CONVERSION PROJECT

It is difficult to identify a "typical" ship conversion project. Conversion techniques are now widely applied and the vessel in question may range in size from a small trawler to a Very Large Crude Carrier, the works involving minor modifications to machinery and equipment up to a full-scale rebuild of her hull form and superstructure.[2] Many of the major conversion projects undertaken in recent years relate to the adaptation of large tankers for use as floating production storage and offtake ("FPSO") vessels for the oil and gas sector; these involve not only extensive modification of the existing hull and

1 There are, of course, a number of large shipyards (particularly in Western Europe and Southeast Asia) with substantial experience in both the shipbuilding and repair sectors.

2 Recent years have in particular seen an increasing number of projects involving the so-called "jumboisation" of cruise vessels, ferries and container vessels, i.e., the insertion of a new mid-section to increase length and deadweight. The technique is not, however, new. For an example of an early such project, see *Merchants' Trading Co.* v. *Banner* (1871) L.R. 12 Eq. 18, cited at pages 202–203, *supra*.

superstructure but also the addition of sophisticated mooring equipment as well as "topside" plant and machinery for the processing of crude oil at the offshore wellhead site.

There are, however, a number of features which are common to most projects for the conversion of existing vessels.

First, and obviously, the project will necessarily involve the blending of "old" and "new" designs and materials within a single structure, which must thereafter operate efficiently as an integrated whole. Depending upon the age of the vessel in question, these designs and materials may differ very greatly in terms of quality, and in particular structural strength, from those parts of the vessel which are not to be replaced and which are intended to continue in use.

There is thus an "interface" between "old" and "new" materials, which does not occur in the context of a newbuilding project, and which may give rise to serious technical and commercial problems both before and after the vessel's redelivery to the shipowner.

Particular difficulties arise in this context where the new materials alter the balance of stresses and forces in the old, "non-renewed", sections of the vessel, causing damage to previously effective components within the latter areas. The problems can be further compounded if the failure does not occur prior to redelivery of the vessel but at a time when the works are still covered by the contractor's customary post-redelivery guarantee of workmanship and material.[3] Given that the works themselves will almost certainly have been approved by the shipowner and the classification society, is the contractor still required to replace or repair parts of the vessel which have failed as a direct or indirect consequence of the changes he has made?[4]

The second significant feature of the typical conversion project is that the vessel will (unlike a newbuilding) usually represent for the shipowner an operational, revenue-generating asset before the works are commenced. Although the shipowner will have factored into his "cost–benefit" analysis of the project his loss of operating revenue during the expected duration of the works, he will obviously wish to ensure that his actual loss does not exceed his budgeted figure. As a consequence, conversions are frequently structured on terms that the contractor is both allowed the bare minimum of time required to complete the agreed works and asked to accept a substantial potential liability to compensate the shipowner in liquidated damages for any delay in the vessel's redelivery beyond the agreed period.[5]

The contractor's difficulties may also be compounded by his inability, in light of the vessel's trading commitments, to undertake a detailed inspection of the vessel before she arrives at the shipyard to commence the conversion works. In order to meet the time schedule, he may also be required to undertake substantial prefabrication works prior to the vessel's arrival, which may generate substantially increased technical and commercial risks.

Finally, it should also be noted that, whatever may be the agreed position as regards the ownership of materials and equipment added to the vessel by the contractor, title to the

3 See pages 171–173, *supra*.

4 The risks are particularly acute where (rather than converting one of his existing fleet of vessels) the shipowner has purchased a ship with the specific intention of altering her to meet his trading requirements. In such circumstances, both parties to the contract may be unfamiliar with her technical layout and characteristics, in which event the "interface risks" will increase substantially.

5 These are frequently very significant issues in the context of cruise ship conversions, where the timetabling of the works is often very restricted given their scale and technical complexity.

vessel, together with her machinery and equipment on board at the time of her arrival at the shipyard, will always vest in the shipowner.[6] It is equally likely that physical possession of the vessel will be retained by the shipowner, who will often wish to maintain either a full or "skeleton" crew on board throughout the period of the works.

The existence of these specific features of the conversion project gives rise to a number of legal problems which need to be addressed by the shipowner and the contractor in the contract to be concluded between them.

II. THE NATURE OF THE CONVERSION CONTRACT

In common with non-marine construction contracts, conversion contracts are categorised in English law as "mixed" contracts for the provision of work and materials. In this respect they differ somewhat from shipbuilding contracts, which (as previously noted) have historically been treated by the English courts as agreements for the sale and purchase of goods.[7]

Contracts for work which involve the supply of materials are governed by the common law, as supplemented and amended by the Supply of Goods and Services Act 1982 (the "1982 Act") and the Sale and Supply of Goods Act 1994 (the "1994 Act"). In the absence of contrary agreement between the parties, such contracts are, as regards any materials supplied thereunder, subject to the same implied terms as arise under a contract for the sale of goods, i.e. the materials must be of "satisfactory quality" and "reasonably fit" for any particular purpose expressly or impliedly made known to the contractor.[8]

However, in so far as concerns the provision of work or services under such a contract, the contractor's duty is limited to the exercise of "reasonable care and skill" in the performance of the same[9]; the contractor is as such required to exercise "the ordinary skill of an ordinary competent man exercising that particular art".[10] This standard is nevertheless capable of being varied by agreement between the parties[11] and will, in particular, be inapplicable to the extent that the contractor has specifically agreed to achieve a given result, e.g., a particular speed or deadweight for the vessel as converted.[12]

III. THE KEY TERMS OF THE CONVERSION CONTRACT

Unlike the newbuilding industry, there is no standard form of contract in widespread use for large-scale conversion projects.[13] Most such projects proceed on the basis of an *ad hoc*

6 This is the converse of the situation in the majority of shipbuilding projects, in which title to the newbuilding vests in the builder prior to delivery; see page 135, *supra*.

7 See pages 1–3, *supra*.

8 Section 4 of the 1982 Act, confirming *Young & Marten Ltd* v. *McManus Childs Ltd* [1969] 1 A.C. 454, as amended by Schedule 2, paragraph 6 of the 1994 Act.

9 Section 13 of the 1982 Act.

10 *Per* McNair J. in *Bolam* v. *Friern Hospital Management Committee* [1957] 2 All E.R. 118.

11 Section 16 of the 1982 Act. Note that clauses seeking to reduce or exclude the contractor's liability may in certain circumstances be rendered ineffective by the provisions of the Unfair Contract Terms Act 1977, where applicable; see on this subject generally, pages 188–192, *supra*.

12 *Greaves & Co. (Contractors) Ltd* v. *Baynham Meikle & Partners* [1975] 2 Lloyd's Rep. 325.

13 For minor conversion projects, the parties may sometimes agree to use a standard form repair contract such as the BIMCO Repaircon 2002 form; this will, however, not normally be sufficiently detailed to address the additional risks associated with significant conversion works.

agreement negotiated between the parties directly and containing terms dealing with the following issues of fundamental importance:

The scope of the works

It is obviously vital that the parties should agree upon the precise scope of the contract works before these are commenced. In practice, this is (as in shipbuilding projects) usually achieved by incorporating within the framework of the contract a detailed technical specification, often incorporating a number of the principal plans and drawings outlining the contract works.

In addition, the contract will normally lay down the standards to which both the conversion works and the completed vessel must conform. The contract may seek to define the contractor's quality obligations by reference to "first-class" international or national shipbuilding or ship repair standards or, more specifically, by comparison with an existing vessel with which the contractor is familiar. It will also typically impose upon the contractor obligations to ensure that upon redelivery the vessel will have secured both a defined classification status and any necessary approvals of the national and international regulatory authorities which will license her operations.

Such provisions will, however, not usually be sufficient in themselves to deal with all aspects of the "interface risks" during the conversion period, and the allocation of these risks will often be separately addressed.

If it is intended that the contractor should bear all of these risks, it will usually be sufficient to provide simply that it shall do whatever is required to convert the vessel to meet the requirements as to description, quality and performance contained in the specification. Where, alternatively, it has been agreed that the contractor should be afforded a measure of protection against these risks, the contract may provide for specific representations and warranties by the shipowner as to the condition and performance of the vessel (or the accuracy of her plans and drawings) before the commencement of the conversion works. In such event the contractor will usually be entitled to recover from the shipowner any additional costs he has incurred by reason of a pre-existing "defect" in the vessel in breach of such a representation or warranty.

Price

In any substantial conversion project it will usually be agreed that the works detailed in the specifications should be undertaken for a "lump sum" price, which is payable by the shipowner in instalments linked to completion of specific stages of the conversion work.

Any additional works resulting from modifications to the specifications after the contract has been signed will usually be paid for by the shipowner on a basis to be agreed between the parties before the modifications are implemented. It will usually benefit the contractor to keep these provisions as loose as possible (thereby permitting him to incorporate within any quotation for additional works all of his direct and indirect costs of undertaking the same). From the shipowner's perspective, however, it is obviously advantageous to agree at the outset upon "unit rates" for labour, steel, etc. which will apply whenever he seeks to modify the specifications.

Time-frame

As previously indicated, the fact that the vessel is already physically in existence and (usually) operational imposes substantial time-pressures on both parties to the conversion project. The structure normally employed to address these issues is similar to that applied to newbuilding projects, i.e., the parties will agree that the works should be completed by a defined date, normally known as the "Redelivery Date", on the basis that, in the event of delay after such date, the contractor will pay liquidated damages to compensate the shipowner for his continuing loss of use of the vessel. Furthermore, where the delay exceeds a certain agreed period, the shipowner will usually be entitled to rescind the contract and—assuming that this is practical at the time of such rescission—to remove the vessel in order to complete the works elsewhere.

Force majeure

The contractor's obligations in relation to redelivery are, however, usually tempered by the inclusion within the contract of a "*force majeure*" clause. Provisions of this type, which represent a vital protection for the contractor, normally operate on the same basis as in shipbuilding contracts, i.e. in the event of delay in completion of the works by reason of events beyond the contractor's control, the Redelivery Date is automatically extended by an equivalent period. However, in order to ensure that the contract is not potentially "open ended", it is also usual for the parties to agree upon a "cap" on the total *force majeure* delay which is claimable by the contractor; where the "cap" is exceeded, the shipowner is again permitted an option to rescind the contract.

Title to the works

As indicated previously, the question of ownership of the materials which are added to the vessel in the course of the conversion works is one of the most difficult commercial issues of all. Much will depend upon the law applying in the country in which the works are to be undertaken but the usual agreement between the parties is for title to such materials to pass to the shipowner as soon as these have been unconditionally "appropriated" to the contract.[14]

Where title does pass in this fashion the contract will often specifically provide for a lien over the materials in question to secure the contractor against non-payment of the contract price. In certain jurisdictions and depending upon the nature of the works undertaken, the contractor may in any event enjoy a shiprepairer's lien, which will permit him to retain and, possibly, to sell the vessel by way of security and enforcement of his claim for the unpaid portion of the contract price.

Risk of loss and insurance

It is obviously vital for the parties to agree in their contract how the risks of physical loss or damage during the contract works are to be allocated between them.

14 For an analysis of the concept of "appropriation" in this context of shipbuilding, see pages 136–138, *supra*.

Although practice varies from project to project, the usual course is for the shipowner to maintain the vessel's hull and P. & I. insurances during the course of the contract works, if necessary by specific agreement with his underwriters, and for the contractor to agree to assume a specific maximum level of liability for damage to the vessel caused by his negligence (or that of his subcontractors). In the event of a loss, the shipowner will accordingly seek recovery in the first instance from his own underwriters who will thereafter normally be subrogated to the shipowner's contractual rights (if any) against the contractor. Where it is agreed that the contractor will arrange the insurances in respect of the vessel, these will often be effected under the London MarCAR 2007 (Marine Construction All Risks 01/09/07) clauses which have been drafted specifically to permit the insurance of both newbuilding and conversion contract risks.[15]

Contractor's warranty

It is customary in conversion contracts for the contractor to furnish a warranty of his workmanship and materials for a defined period (usually six or 12 months) after the redelivery of the vessel to the shipowner. This gives rise to a number of issues, the most important of which being the allocation of the "interface" risks mentioned earlier. Practice varies in this respect although it is common for the contractor to limit his liability to the replacement of his defective materials or workmanship and to accept no responsibility whatever for any loss or damage of any description caused to the shipowner by reason of the same.

Rescission

Both parties will wish to incorporate in the contract provisions dealing with the legal consequences of a serious default by the other. From the shipowner's perspective, he will usually wish to have the option to move the vessel from the contractor's yard and complete the works elsewhere, on the basis that he will be entitled to reimbursement by the contractor in respect of the additional costs he incurs. From the contractor's viewpoint, he will wish to ensure that, in the event of the shipowner's default, e.g., in failing to pay an instalment of the contract price, he can rescind the contract and claim the losses he will have sustained as a result.

Law and jurisdiction

It is obviously in both parties' interests to agree upon the law governing the conversion contract and a mechanism to resolve their differences. As in the shipbuilding sector, the usual forum is arbitration but it is equally possible for the parties to agree to resolve their disputes by litigation.[16] The alternative or additional approach is to agree that all disputes of a technical nature should be submitted for determination by an expert, acting as such and not as an arbitrator.[17]

15 See pages 227–228, *supra*
16 That is, in court-based proceedings.
17 See pages 236–237, *supra*.

APPENDIX A

BIMCO Standard Newbuilding Contract (NEWBUILDCON Form)[1]

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BIMCO

NEWBUILDCON

STANDARD NEWBUILDING CONTRACT

PART I

1. **Place and date of Contract** (Cl. 3, Cl. 44(b), Cl. 47)

2. **Builder's name, full style address and contact details** (Definitions)
Name:
Address:

Country:
Phone/Fax:
E-mail:

Company registration No.

Additional names, addresses and contact numbers:

Name:
Address:

Country:
Phone/Fax:
E-mail:

Company registration No.

3. **Buyer's name, full style address and contact details** (Definitions)
Name:
Address:

Country:
Phone/Fax:
E-mail:

Company registration No.

Additional names, addresses and contact numbers:

Name:
Address:

Country:
Phone/Fax:
E-mail:

Company registration No.

4. **Vessel description/type** (Definitions, Cl. 2(b))

State vessel type:
(i) Dry bulk carrier:
(ii) Tanker:
(iii) Container vessel:
(iv) Other (state type):

A. **Main dimensions** (Cl. 2(b)):
(i) LOA (m):
(ii) Lenght between perpendiculars (m):
(iii) Deadweight capacity DWT (mts):
(iv) Mean draft in salt water (m):

B1. Cargo capacity (Cl. 2(b)(v) and Cl. 11):
(i) Cubic capacity:
(ii) Bale capacity:
(iii) Grain capacity:

B2. TEU carrying capacity (only if applicable) (state number of containers):
(i) Total on deck
a. 20'/40'/45" TEU:
b. No. of reefers:
(ii) Total under deck
a. 20'/40'/45"TEU:
b. No. of reefers:
(iii) No. of TEU homogenous loaded at 14 mts:

C. Main engine(s): (Cl. 2(b)(ii), Cl. 2(b)(iv) and Cl. 9)
(i) Maker/Type:
(ii) Max. Continuous Rating (MCR) (kilowatts at MCR):
(iii) RPM at MCR:
(iv) Specific Fuel Oil Consumption at MCR:
(v) Normal Continuous Rating (NCR):
(vi) RPM at NCR:
(vii) Type of fuel and specification (including Calorific Value (kcal/kg)):

NEWBUILDCON
Standard Newbuilding Contract **PART I**

D. **Average speed** (Cl. 2(b)(i) and Cl. 8)

(i) Service speed at design draft (m):
(ii) Min. number of knots:
(iii) Engine output (kilowatts at MCR):
(iv) Percentage of engine's max. continuous power/sea margin:
(v) RPM:

E. **Other matters** (Optional)(State any other technical requirements for the particular vessel type)(Cl. 2(b)(vi) and Cl. 12)

5. **Shipyard(s)** (if different from Box 2) (Full style address and contact details) (Definitions)

Name:
Address:

Country:
Phone/Fax:
E-mail:

Additional names, addresses and contact numbers:

Name:
Address:

Country:
Phone/Fax:
E-mail:

Name:
Address:

Country:
Phone/Fax:
E-mail:

Additional names, addresses and contact numbers:

Name:
Address:

Country:
Phone/Fax:
E-mail:

6. **Builder's Hull Number** (Definitions, Cl. 2(a))

7. **Flag State** (Definitions)

8. **Classification Society/Class Notation** (Definitions, Cl. 3)

9. **Contract Price and Currency** (Definitions, Cl. 7)
(a) Price
(b) Currency

10. **Contractual Date of Delivery** (Definitions, Cl. 14(c)(iii)(1))

11. **Payment Amounts and Time Due** (Definitions, Cl. 7, Cl. 15, Cl. 39(c))

1st Instalment (see Cl. 15(a)(i))

2nd Instalment and time due

3rd Instalment and time due

4th Instalment and time due

Final Instalment (see Cl. 15(a)(iv))

12. **Builder's Bank Account Deta** (Cl. 15(d))

Name:
Address:

Country:
Phone/Fax:
E-mail:
Sort code:
Account number:
Account name:

13. **Speed Deficiency** (Cl. 8, Cl. 39(a)(iv))
(i) Contract Price reduction amount:
(ii) Maximum amount: (state monetary limit).

14. **Excessive Fuel Consumption** (Cl. 9, Cl. 39(a)(v))
(i) Contract Price reduction amount:
(ii) Maximum amount: (state monetary limit):

15. **Deadweight Deficiency** (Cl. 10, Cl. 39(a)(vi))

(i) Deadweight tolerance:
(ii) Contract Price reduction amount:
(iii) Maximum amount: (state monetary limit)

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Standard Newbuilding Contract **PART I**

16. **Cubic Deficiency** (Cl. 11; Cl. 39(a)(vii)) (i) Cubic capacity tolerance: (ii) Contract Price reduction amount: (iii) Maximum amount: (state monetary limit):	17. **Other Deficiencies** (Optional)(Cl. 12, Cl. 38(a)(viii))
18. **Late Delivery Compensation** (Cl. 13 and Cl. 39(a)(iii)) (i) Amount per day: (ii) Maximum amount: (state monetary limit):	19. **Guarantees** (Cl. 14(a) and (b)) (a) Buyer's guarantees (i) Number of days after signing Contract: (ii) Buyer's Instalment/Performance Guarantee: (b) Builder's guarantees (i) Number of days after signing Contract:
20. **Guarantee Period** (state number of months. If left blank 12 months shall apply) (Cl. 35(e)) 21. **Additional Guarantee Period** (state number of months) (Cl. 35(e))	22. **Suspension and Termination** (Cl. 39) (i) Running period (state number of days: (ii) Notice period (state number of days)
23. **Applicable law and Dispute Resolution** (Cl. 41) (a) Governing law: (b) Place of dispute resolution:	24. **Guarantee Engineer** (state monthly lump sum) (Cl. 36(b))
25. **Effective Date of Contract** (state conditions to be satisfied) (Cl. 44(a))	26. **State number of days within which conditions have to be satisfied** (Cl. 44(b))
27. **Optional additional vessels** (state number) (Cl. 46)	28. **Optional additional vessels delivery dates** (Cl. 46)
29. **Declaration of Options** (state number of months after Effective Date) (Cl. 46)	30. **Interest** (state rate of interest) (Cl. 18, Cl. 38(b)(ii)(2)(i), Cl. 39(e) and 39(f)(iv))
31. **Buyer's Guarantor** (state name of bank or party as appropriate, full style address and contact details((Cl. 14(a)) Name: Address: Country: Phone/Fax: E-mail:	32. **Builder's Guarantor** (state name of bank or party as appropriate, full style address and contact details((Cl. 14(b), Cl. 27(d)(iv)(3)) Name: Address: Country: Phone/Fax: E-mail:
33. **Additional Annexes**	34. **Numbers of Additional Clauses**

This Contract consists of Part I including additional clauses, if any agreed and stated in Box 34, and Part II as well as any Annexes agreed and attached hereto and shall be performed subject to the conditions contained herein. In the event of a conflict of conditions the provisions of Part I shall prevail over those of Part II to the extent of such conflict, but no further.

The Specification, Maker's List, Plans, and/or Drawings hereafter approved by the Buyer shall form part of this Contract, but in the event of conflict between the provisions of this Contract and the Specification, Maker's List, Plans and/or drawings, the provisions of this Contract shall prevail. In the event of inconsistency between the Specification and Maker's List, on the one hand and the Plans and/or Drawings on the other, the Specifications/Maker's List shall prevail. In the case of inconsistency between any of the Plans and/or Drawings, the later in date shall prevail.

Signature (Builder)	**Signature** (Buyer)

NEWBUILDCON - Standard Newbuilding Contract - PART II

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NEWBUILDCON - Standard Newbuilding Contract - PART II

DEFINITIONS
In this Contract:

"Banking Day" means a day on which banks are open in the places stated in **Box 2** and **Box 3** and, where a remittance is in US dollars, in New York.

"Builder" means the company or companies stated in **Box 2**, organised and existing under the laws of the country or countries stated in **Box 2** having their principal office at the address stated in **Box 2** and including their personnel. If more than one company is stated in **Box 2** then they shall be jointly and severally liable.

"Buyer" means the company or companies stated in **Box 3**, organised and existing under the laws of the country or countries stated in **Box 3** having their principal office at the address stated in **Box 3** and including their personnel.

"Buyer's Representative" means the named representative of the Buyer who may be present at the Shipyard throughout the construction of the Vessel.

"Buyer's Supplies" means all of the items to be provided by the Buyer in accordance with the Specification at its own risk, cost and expense.

"Classification Society" means the classification society stated in **Box 8**.

"Contract Price" means the amount stated in **Box 9** as may be adjusted in accordance with the terms of this Contract.

"Contract" means this BIMCO Standard Newbuilding Contract consisting of Part I including additional clauses, if any agreed, and Part II as well as any Annexes (including the Specification and Maker's List) and Plans and Drawings attached hereto.

"Contractual Date of Delivery" means the contractual date of delivery stated in **Box 10**.

"Defects" means any deficiencies or defects in the design, construction, material and/or workmanship on the part of the Builder or its sub-contractors.

"Delivery Date" means the Contractual Date of Delivery as may be adjusted in accordance with the terms of this Contract.

"Final Instalment" means the last instalment payable at delivery calculated in accordance with Clause 15 (Payments).

"Flag State" means the State of the flag which the Vessel will fly when registered, as stated in **Box 7**.

"Instalments" means the amounts payable in accordance with **Box 11**.

"In writing" means any method of legible communication.

"Maker's List" means the list of suppliers for equipment, machinery and services approved by the Parties and stated in Annex C.

"Parties" means the Builder and the Buyer.

"Party" means the Builder or the Buyer, as the case may be.

NEWBUILDCON - Standard Newbuilding Contract - PART II

"Permissible Delays" means delays to the construction and/or delivery of the Vessel and which entitle the Builder to extend the Delivery Date in accordance with Clause 34 (Permissible Delays).

"Personnel" means the employees, agents, servants, suppliers and independent contractors engaged by either Party in order to perform work or duties under this Contract for which that Party is responsible.

"Plans and Drawings" means the plans and drawings attached hereto or listed and/or described in the Specification.

"Regulatory Authorities" means the regulatory authorities whose rules and regulations must be complied with in the construction and delivery of the Vessel. Such bodies shall include the Flag State together with the other bodies listed in the Specification.

"Shipyard" means the place or places stated in **Box 5** where the Vessel will be assembled and/or constructed.

"Specification" means the technical details contained in Annex B.

"Sub-contractor" means any person (not being a servant or employee of the Builder) or company with whom the Builder has entered into a contract for the design, construction, manufacture or supply of any item, equipment, work or service for the Vessel.

"Vessel" means the vessel described in **Box 4** (including its machinery, equipment and appurtenances described in the Specification) with hull number as per **Box 6**, built in accordance with this Contract.

INTERPRETATION

Singular/Plural

In this Contract the singular includes the plural and vice versa as the context admits or requires.

Headings

The index and headings to the clauses and Annexes to this Contract are for convenience only and will not affect its construction or interpretation.

Jointly and severally

All covenants, agreements, undertakings, indemnities, representations and warranties by more than one person are entered into, given or made by such persons jointly and severally.

NEWBUILDCON - Standard Newbuilding Contract - PART II

SECTION 1 – VESSEL

1. Builder's and Buyer's obligations

It is mutually agreed between the Builder and the Buyer that:

(a) the Builder shall design, construct, test and survey, launch, equip, complete, sell and deliver the Vessel to the Buyer all in accordance with good international shipbuilding and marine engineering practice; and

(b) the Buyer shall purchase, take delivery of and pay for the Vessel.

2. Description

(a) The Vessel shall be constructed at the Shipyard and shall have the Builder's Hull Number stated in **Box 6**.

(b) The Vessel shall have the dimensions and characteristics as stated in **Box 4** and the Specification. These shall be defined, measured and calculated in accordance with the Specification or, if omitted from the Specification, in accordance with the following:

(i) Speed – The Vessel's average speed on a sea trial undertaken in both directions over a measured distance of one (1) nautical mile, with clean hull, in weather with wind speed and sea state not exceeding Beaufort Wind Force Scale 3 and Douglas Sea State Scale 2 respectively on a draft as stated in **Box 4D(i)** shall be at least the number of knots stated in **Box 4D(ii)**. During such a sea trial the engine's output in kilowatts shall be as stated in **Box 4D(iii)** corresponding to the percentage of the engine's maximum continuous power output stated in **Box 4D(iv)** at the approximate revolutions per minute stated in **Box 4D(v)**.

(ii) Fuel Consumption - The fuel consumption of the main engine on the test bed using fuel of the type and specification stated in **Box 4C(vii)** shall not exceed the number of grams per kilowatt/hour stated in **Box 4C(iv)** when the engine develops the number of kilowatts with an effective calorific value of the number of kilocalories per kilogram stated in **Box 4C(ii)** and **Box 4C(vii)** respectively.

(iii) Deadweight - The Vessel's deadweight shall be the number of metric tons stated in **Box 4A(iii)** on international summer freeboard, corresponding to a mean draft in saltwater (specific gravity 1.025) as stated in **Box 4A(iv)**. The specified deadweight shall include fuel, provisions, stores, freshwater, crew and passengers in addition to spare parts not less than the requirements of the Classification Society.

(iv) Propulsion - The Vessel's propulsion machinery shall be of the type and with maximum continuous power in kilowatts at the number of revolutions per minute as stated in **Box 4C(i), 4C(ii)** and **4C(iii)**.

(v) Cargo Capacity – The Vessel's cargo capacity shall be the capacities stated in **Box 4B1** and **4B2**.

(vi) Other matters – The Vessel shall meet the technical requirements stated in **Box 4E**.

3. Classification, Rules and Regulations

(a) The Vessel shall be designed, constructed, surveyed, tested and delivered in compliance with the applicable laws, rules, regulations and requirements of the Classification Society stated in **Box 8**, and the Regulatory Authorities:

(i) in force as of the date of this Contract stated in **Box 1**, or

(ii) if not in force as of the date of this Contract, which are ratified and promulgated on or before the date of this Contract and which will be compulsory for the Vessel on or before the delivery of the Vessel in accordance with Clause 28 (Delivery).

All such laws, rules, regulations and requirements of the Classification Society and the Regulatory Authorities shall be complied with without qualification (see Clause 26 (Changes in Rules and Regulations)).

(b) The final decisions of the Classification Society or Regulatory Authorities shall be binding on the Parties as to the Vessel's compliance with their respective applicable laws, rules, regulations and requirements.

(c) All costs, fees and charges incidental to and in respect of compliance with the applicable laws, rules, regulations and requirements of the Classification Society or Regulatory Authorities referred to above shall be for the Builder's cost and expense.

4. IMO Hazardous Materials Inventory

The Builder shall, in accordance with the IMO Guidelines on Ship Recycling, Resolution A.962 (23), with amendments in force as of the date of this Contract:

(a) Endeavour to take due account of the Vessel's ultimate disposal when designing and constructing the Vessel by:

(i) using materials which can be recycled safely and in an environmentally sound manner; and

(ii) by minimising the use of materials known to be potentially hazardous to health and the environment.

(b) In consultation with equipment manufacturers provide the Buyer with a Green Passport Statement of Compliance issued by the Classification Society containing information including the Vessel's hull number and main particulars and listing any and all materials known to be potentially hazardous utilised in the construction of the Vessel, its equipment and systems.

The list of the materials known to be potentially hazardous shall contain the location and the approximate quantity/volume of each identified material on board the Vessel.

5. Protective Coatings

The Vessel's double-side skin spaces and dedicated seawater ballast tanks shall be coated in accordance with the Specification. In any event the minimum coating standard shall be in accordance with the requirements of the IMO Performance Standard for Protective Coatings for dedicated seawater ballast tanks in all types of ships and double-side skin spaces of bulk carriers (IMO PSPC, Resolution MSC. 215(82)) and, where applicable, in accordance with the IACS Common Structural Rules for Bulk Carriers and for Oil Tankers or subsequent modifications or replacement applicable in accordance with Clause 3(a) (Classification, Rules and Regulations).

6. Source of Origin

If so requested by the Buyer, the Builder shall identify the country of origin of all the main components listed in the Maker's List and Specification.

NEWBUILDCON - Standard Newbuilding Contract - PART II

SECTION 2 – FINANCIAL

7. Contract Price

The Contract Price shall be the amount stated in **Box 9(a)** as may be adjusted in accordance with the terms of this Contract.

The Contract Price and any other payments to be made to the Builder pursuant to this Contract shall be paid in the currency stated in **Box 9(b)** and in accordance with the payment terms stated in **Box 11** and Clause 15 (Payments).

8. Speed Deficiency

If the speed of the Vessel as stated in **Box 4D(ii)** is not achieved in the manner stated in the Specification or Clause 2(b)(i) the following shall apply:

(a) There shall be no adjustment of the Contract Price except to the extent provided in Sub-clause 8(b).

(b) If the reduction in speed is greater than 2/10ths of a knot, the Contract Price shall be reduced by the amount stated in **Box 13(i)** for each whole 1/10th of a knot reduction in speed in excess of 2/10th of a knot as liquidated damages up to the maximum amount stated in **Box 13(ii)**.

(c) If the reduction in speed would entitle the Buyer to a reduction in the Contract Price greater than the maximum amount stated in **Box 13(ii)**, the Buyer shall have the option to terminate this Contract in accordance with Clause 39(a)(iv) (Suspension and Termination).

9. Excessive Fuel Consumption

If the fuel consumption of the Vessel's main engine on the test bed using the fuel specified in **Box 4C(vii)** exceeds the figure stated in **Box 4C(iv)** the following shall apply:

(a) There shall be no adjustment of the Contract Price except to the extent provided in Sub-clause 9(b).

(b) If the excess fuel consumption is greater than 2% (two percent) of the specified fuel consumption the Contract Price shall be reduced by the amount stated in **Box 14(i)** for each whole percentage in excess of 2% as liquidated damages up to a maximum amount as stated in **Box 14(ii)**.

(c) If the excess fuel consumption would entitle the Buyer to a reduction in the Contract Price greater than the maximum amount stated in **Box 14(ii)**, the Buyer shall have the option to:

(i) accept the main engine at a reduction in the Contract Price corresponding to the maximum amount stated in **Box 14(ii)** or

(ii) reject the main engine and either

(1) require the Builder to rectify the deficiency and repeat the trial or replace the main engine with one that conforms to the requirements of the Contract. (The time taken to rectify the deficiency and repeat the trial or replace the main engine in accordance with this Sub-clause shall not be a Permissible Delay) or

(2) terminate this Contract forthwith in accordance with Clause 39(a)(v) (Suspension and Termination).

NEWBUILDCON - Standard Newbuilding Contract - PART II

10. Deadweight Deficiency

If the actual deadweight of the Vessel determined in accordance with the Specification is less than the deadweight stated in **Box 4A(iii)** the following shall apply:

(a) There shall be no adjustment of the Contract Price except to the extent provided in Sub-clause 10(b).

(b) If the reduction in deadweight is greater than the number of metric tonnes stated in **Box 15(i)** then for each whole metric tonne in excess of the figure in **Box 15(i)** below the deadweight stated in **Box 4A(iii)** the Contract Price shall be reduced by the amount stated in **Box 15(ii)** as liquidated damages up to a maximum amount as stated in **Box 15(iii)**.

(c) If the reduction in deadweight would entitle the Buyer to a reduction in the Contract Price greater than the maximum amount stated in **Box 15(iii)** the Buyer shall have the option to terminate this Contract in accordance with Clause 39(a)(vi) (Suspension and Termination).

11. Cubic Capacity Deficiency

If the actual cubic capacity of the Vessel determined in accordance with the Specification is less than the cubic capacity specified in **Box 4B1(i)** the following shall apply:

(a) There shall be no adjustment of the Contract Price except to the extent provided in Sub-clause 11(b).

(b) If the reduction in cubic capacity is greater than the number of cubic metres stated in **Box 16(i)** then for each full cubic metre in excess of the figure in **Box 16(i)** below the cubic capacity stated in **Box 4B1(i)** the Contract Price shall be reduced by the amount stated in **Box 16(ii)** as liquidated damages up to a maximum amount as stated in **Box 16(iii)**.

(c) If the reduction in cubic capacity would entitle the Buyer to a reduction in the Contract Price greater than the maximum amount stated in **Box 16(iii)** the Buyer shall have the option to terminate this Contract in accordance with Clause 39(a)(vii) (Suspension and Termination).

12. Other Deficiencies (optional clause)

NOTE: *This clause has been left blank intentionally to allow the parties to insert, where appropriate, a liquidated damages provision covering deficiencies in any special technical requirements for a particular vessel type and specified by the parties in **Box 4E** and **Box 17**. (See also Clause 39(a)(viii)).*

13. Late Delivery for non-permissible delays

If delivery takes place more than 30 days after the Delivery Date then for each day thereafter the Contract Price shall be reduced by the amount stated in **Box 18** per day as liquidated damages up to a maximum delay of 180 days (comprising a 30 day grace period plus 150 days).

If the delay exceeds 180 days the Buyer shall have the option to terminate this Contract in accordance with Clause 39(a)(iii) (Suspension and Termination).

14. Guarantees

(a) Buyer's Instalment/Performance Guarantee

To secure the Buyer's obligation to pay the instalments of the Contract Price prior to delivery the Buyer shall, within the number of days stated in **Box 19(a)(i)** after the signing of this Contract, deliver to the Builder an irrevocable and unconditional guarantee issued

by the bank or party stated in **Box 31** substantially in the form and substance set out in Annexes A(i) (Instalments) or A(ii) (Performance) as stated in **Box 19(a)(ii)**, failing which the Builder shall have the option to terminate this Contract in accordance with Clause 39(b)(iv) (Suspension and Termination).

(b) Builder's Refund Guarantee
To secure the Builder's obligation to refund the Buyer's pre-delivery instalments pursuant to this Contract the Builder shall, within the number of days stated in **Box 19(b)(i)** after the signing of this Contract and before the date for payment of the first instalment in accordance with Clause 15(a)(i) (Payments – Instalments), provide the Buyer with a Refund Guarantee issued by the bank or party named in **Box 32** substantially in the form and substance set out in ANNEX A(iii)(Refund Guarantee), failing which the Buyer shall have the option to terminate this Contract in accordance with Clause 39(a)(ix) (Suspension and Termination).

(c) Guarantee Compliance and Expiry
The Parties shall ensure that any guarantee issued on their behalf shall:

(i) comply with the laws, regulations, constitution and procedures of the guarantor and its country of issue, including but not limited to, its registration with any necessary authorities; and

(ii) on expiry be returned to the guarantor; and

(iii) in the case of the Refund Guarantee (sub-clause 14(b)), remain in force until either

(1) a date at least 300 days after the Contractual Date of Delivery stated in **Box 10** or 30 days after the final resolution of any dispute under Clause 42 (Dispute Resolution), whichever is the later; or

(2) delivery of the Vessel to, and acceptance of the Vessel by, the Buyer whichever is the sooner.

15. Payments

(a) Instalments
The Contract Price shall be paid by the Buyer to the Builder by instalments, when due and payable in accordance with **Box 11** and this Clause, the pre-delivery instalments being paid as advances and not deposits as follows:

(i) Unless otherwise stated in **Box 11** the first Instalment shall be due and payable by the Buyer five (5) Banking Days after the Refund Guarantee has been provided in accordance with Clause 14(b) (Builder's Refund Guarantee).

(ii) The Builder shall give the Buyer invoices for each Instalment under this Contract. With the exception of the first and Final Instalment the Builder shall give the Buyer an invoice to cover the sum due to it not less than ten (10) Banking Days prior to the due date of each Instalment.

(iii) All Instalments other than the first and Final Instalment shall be payable within four (4) Banking Days of the due date thereof.

(iv) The Final Instalment shall be due and payable upon delivery of the Vessel in accordance with **Box 11** and Clause 28 (Delivery).

(b) Payment for Modifications and other items

(i) The sums due or refundable as a result of modifications and changes, and changes in Rules and Regulations under Clause 24 (Modifications and Changes) and Clause 26 (Changes in Rules and Regulations) shall be added to or deducted from the Final Instalment.

(ii) All expenses payable in accordance with Clause 27(c)(iii) (Conduct of the Sea Trial) and Clause 22(b) shall be paid together with the Final Instalment.

(iii) Sums due for other items shall be paid within fifteen (15) Banking Days after receipt by the Buyer of the Builder's invoice.

(c) Payment of Liquidated Damages

Any amounts for liquidated damages under Clause 8 (Speed Deficiency), Clause 9 (Excessive Fuel Consumption), Clause 10 (Deadweight Deficiency), Clause 11 (Cubic Capacity Deficiency), Clause 12 (Other Deficiencies) and Clause 13 (Late Delivery for non-permissible delays) shall be calculated and determined before delivery and may be deducted from the Final Instalment.

(d) Payment Procedures

(i) If the date on which any payment is due in accordance with the provisions of this Contract does not fall on a Banking Day, payment shall be made on the next Banking Day.

(ii) Payment of sums due in accordance with the provisions of this Contract shall be made, in the case of payments to the Builder, by electronic transfer to the Builder's account stipulated in **Box 12** and, in the case of payments to the Buyer by electronic transfer to such bank as the Buyer by notice to the Builder nominates to receive payments on its behalf.

(iii) The cost of remitting payments shall be for the account of the payer.

(iv) Payments by either Party to the other under this Contract, and their receipt, shall not be deemed a waiver of any right or claim either Party may have against the other.

(v) In the event of late payment of Instalments by the Buyer, the Builder shall have the right to suspend work under this Contract in accordance with Clause 39(c) (Suspension of Work).

16. Taxes, duties, stamps, dues and fees

(a) The Builder shall bear and pay all taxes, duties, stamps, dues and fees imposed in the place stated in **Box 2** in connection with the execution and/or performance of this Contract, excluding any taxes, duties, stamps, dues and fees imposed in the place stated in **Box 2** upon the Buyer's Supplies which shall be for the Buyer's cost and expense.

(b) The Buyer shall bear and pay all taxes, duties, stamps, dues and fees imposed outside the place stated in **Box 2** in connection with the execution and/or performance of this Contract, except for taxes, duties, stamps, dues and fees imposed upon those items and services procured by the Builder for construction of the Vessel.

(c) If either Party pays any taxes, duties, stamps, dues and fees for which the other Party is responsible under this Clause, the other Party shall reimburse the paying Party within fifteen (15) Banking Days of receipt of notice to that effect, together with evidence of the amount paid.

NEWBUILDCON - Standard Newbuilding Contract - PART II

17. Right to set-off

The Buyer shall not have the right to retain or set-off any amount against any payment due to the Builder under this Contract except in relation to the Final Instalment as specifically provided in this Contract (see Clause 15 (Payments) and Clause 30 (Final Instalment)).

18. Interest

If either Party fails to pay any sum due in accordance with the terms of this Contract, the other Party shall have the right to charge interest from the due date at the rate stated in **Box 30** on such outstanding sums (see also Clause 39 (Suspension and Termination)).

NEWBUILDCON - Standard Newbuilding Contract - PART II

SECTION 3 – PRODUCTION

19. Sub-contracting

The Builder shall employ the sub-contractors as set out in the Specification or Maker's List. Except for minor work, the Builder shall not employ other sub-contractors without the Buyer's approval, which shall not be unreasonably withheld.

Notwithstanding any sub-contracting, the Builder shall remain fully responsible for the due performance of such work as if undertaken by the Builder at the Shipyard.

20. Approvals

The times and numbers specified in this Clause shall apply unless otherwise stated in the Specification.

(a) As soon as possible and not later than sixty (60) running days after the effective date of the Contract (see Clause 44 (Effective date of Contract)) the Builder shall provide the Buyer with proposed detailed building and testing schedules. The Buyer shall comment on the schedules as soon as possible and at the latest within fourteen (14) running days after receipt of the proposals. The Builder shall thereafter prepare and issue in writing amended building and testing schedules incorporating the Buyer's comments within fourteen (14) running days thereafter.

(b) The Builder shall despatch to the Buyer a total of three (3) full sets of the Plans and Drawings for the Buyer's approval and shall also submit such other technical information as the Buyer may reasonably require, not less than thirty (30) running days before any construction works commence. The Builder shall give notice to the Buyer advising the date of despatch of the Plans and Drawings and the Buyer shall give notice to the Builder confirming receipt thereof. The Buyer shall within fourteen (14) running days of receipt send to the Builder one (1) set of the Plans and Drawings with the Buyer's approval or approval with comments, amendments or reservations.

In the event that the Buyer needs additional time to consider the Plans and Drawings submitted pursuant to this Clause, it shall request the same in writing of the Builder whose agreement shall not be unreasonably withheld. In the event that the Buyer's comments, amendments or reservations are unclear, unspecified or illegible, the Builder may give notice requesting clarification. If the Buyer fails to respond to the request to provide clarification within five (5) running days of receipt of the Builder's notice, the Builder shall determine whether and to what extent it can adopt the comments, amendments or reservations.

If requested by the Buyer in writing, the Plans and Drawings shall also be sent in an agreed electronic format.

(c) The Builder shall take due note of the Buyer's comments, amendments or reservations (if any) on Plans and Drawings submitted pursuant to this Clause and, if such comments, amendments or reservations are not of such a nature or extent as to constitute a modification or change of the Specification within the meaning of Clause 24 (Modifications and Changes), then the Builder shall commence or continue construction of the Vessel in accordance with the corrected or amended Plans and Drawings.

(d) If the Builder considers the comments, amendments or reservations to the Plans and Drawings are of a nature or extent that constitutes a modification or change under Clause 24 (Modifications and Changes), the Builder shall notify the Buyer accordingly and proceed in accordance with Clause 24 (Modifications and Changes). If the Buyer disagrees the matter shall be resolved in accordance with Clause 24(e).

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(e) In the event that the Buyer fails to return any Plans and Drawings to the Builder with approval or approval with comments, amendments or reservations, if any, within the time limit stated above, such Plans and Drawings shall be deemed to have been approved by the Buyer.

(f) The Buyer's approval or deemed approval of any Plans and Drawings shall not affect the obligations of the Builder to design, construct and deliver, or the obligations of the Buyer to take delivery of, and pay for, the Vessel in accordance with the other provisions of this Contract; nor shall it diminish the Builder's responsibility in respect of its obligations under this Contract nor shall it constitute any acceptance by the Buyer of any responsibility for any defect in the Vessel.

(g) The Builder shall give the Buyer, as soon as practicable, copies of all relevant correspondence relating to the Vessel to and from the Classification Society and the Regulatory Authorities, together with all plans approved by the Classification Society.

21. Buyer's Supplies

(a) Buyer

(i) The Buyer shall, at its own risk, cost and expense, supply and deliver to the Builder all of the Buyer's Supplies. Such items shall be delivered at a warehouse or other storage facility at the Shipyard or as otherwise directed by the Builder in a proper condition ready for installation by the Builder or Sub-contractor in or on the Vessel (hereinafter "Installation"), in accordance with the building and testing schedules in Clause 20(a) (Approvals) or as may reasonably be required by the Builder.

(ii) To assist Installation, the Buyer shall provide the Builder with the necessary documentation including specifications, plans, drawings, instruction books, manuals, test reports and certificates required to comply with all applicable rules and regulations. If so requested by the Builder, the Buyer shall, if reasonably possible and at no cost to the Builder, arrange for the representatives of the manufacturers of the Buyer's Supplies to assist the Builder in Installation and/or to carry out the Installation of the Buyer's Supplies by themselves or to make necessary adjustments at the Shipyard in accordance with the manufacturer's instructions, including commissioning.

(iii) The Builder may reject any and all of the Buyer's Supplies when and if found on reasonable grounds to be unsuitable or in improper condition for Installation or not in compliance with the Classification Society or Regulatory Authorities' requirements.

(iv) If delay in delivery of any of the Buyer's Supplies in accordance with Sub-clause (a) (i) exceeds thirty (30) days and will cause actual delay to the delivery of the Vessel, the Builder shall have the right to proceed with the construction of the Vessel without Installation of the delayed items. The Buyer shall accept and take delivery of the Vessel so constructed.

(b) Builder

(i) The Builder shall safely store and handle the Buyer's Supplies after delivery thereof at a warehouse or other storage facility at the Shipyard or elsewhere as determined by the Builder and shall, at its own cost, expense and responsibility, install them in or on the Vessel in accordance with the Specification, provided that the Builder shall not be responsible for the quality, efficiency and/or performance of any of the Buyer's Supplies.

(ii) The Buyer's Supplies shall be at all times the property of the Buyer but shall be at the Builder's risk from the time of their delivery to the Shipyard until the time of their redelivery to the Buyer whether or not as part of the Vessel.

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22. Buyer's Representative, Assistants, Officers and Crew

(a) The Buyer may, at its own cost and expense, have one representative present at the Shipyard throughout the construction together with a reasonable number of assistants and, as appropriate, officers and crew. The Buyer shall notify the Builder in advance in writing of:

(i) the names of the Buyer's Representative, assistants and, as appropriate, officers and crew; and

(ii) the scope of the Buyer's Representative's authority which, in particular, shall include the extent to which the Buyer's Representative has authority to approve plans, drawings and calculations, agree modifications and invoices and attendance at and approval of tests, trials and inspections relating to the Vessel at the Shipyard and/or premises of Sub-contractors; and

(iii) any other information reasonably required by the Builder to facilitate access to the Shipyard and/or premises of Sub-contractors.

(b) The Builder shall, at its own cost and expense, provide the Buyer's Representative and assistants with reasonable office accommodation and facilities (including communication equipment, such as telephone, fax and appropriate internet access, and printers or a connection to the Builder's printers) as the Buyer may reasonably require. The Buyer shall bear the costs of all communication expenses arising from the use by the Buyer's Representative and assistants of the communications equipment provided by the Builder. Such expenses shall be payable by the Buyer on receipt of an invoice from the Builder in accordance with Clause 15(b) (Payments - Payment for Modifications and other items).

(c) The Builder shall have the right to request the Buyer to replace the Buyer's Representative or any assistants but only if the Builder shows that they are carrying out their duties in an unreasonable manner detrimental to the proper progress of the construction of the Vessel, in which case the Buyer shall make proper replacement as soon as possible.

(d) The Buyer's Representative shall have the right to communicate directly with the Classification Society, provided such communication does not unreasonably interfere with the Builder's communication with the Classification Society.

(e) The Builder shall render reasonable assistance to the Buyer in helping to provide suitable accommodation, obtain necessary visas, residence and work permits and any other administrative assistance as the case may be for the Buyer's Representative, assistants and, as appropriate, officers and crew.

23. Inspections, Tests and Trials

(a) To enable the Buyer's Representative and assistants to carry out their duties and inspect the work being done, the Buyer's Representative and/or assistants shall have the right to inspect the Vessel throughout the period of the construction of the Vessel and until its delivery and acceptance.

(b) The Buyer's Representative and/or assistants shall have the right to attend all tests, trials and inspections, including those supervised by the Classification Society and Regulatory Authorities, on any parts of the Vessel whether or not installed. The Builder shall give the Buyer reasonable notice in advance of all such tests, trials and inspections to enable the Buyer's Representative and/or assistants to attend. If the Buyer's Representative and/or

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assistants becomes aware of non-conformity of any aspect of the design, construction, material or workmanship arising out of such tests, trials and inspections he/they shall notify the Builder as soon as possible.

(c) For the purposes of attending such inspections, tests and trials the Builder shall, at any time during working hours or at any other time when work is being performed, provide the Buyer's Representative and/or assistants with unimpeded access to the Shipyard, Vessel, workshops, and anywhere else where work on or storage of items connected with the construction of the Vessel is being performed. The Builder shall use its best efforts to arrange similar access for inspection purposes to sub-contractor's premises during working hours or at any time when work is being performed.

(d) Neither the Buyer's Representative's and/or assistants' inspection and/or attendance at any inspection, test or trial, nor the Buyer's Representative's and/or assistants' failure to notify the Builder of any non-conformity shall relieve the Builder from its obligations under this Contract or be deemed to be or construed as a waiver of any objection to, or any acceptance of, faulty design, construction, material and/or workmanship, or any admission that any materials or workmanship are of the standard required for due performance of this Contract.

24. Modifications and Changes

(a) The Buyer shall have the right at any time to request reasonable modifications or changes in the Specification and/or Plans and Drawings. The Buyer shall request such modifications and/or changes in writing, giving sufficient particulars, documentation and details fully to describe the modifications and/or changes requested.

(b) The Builder shall, as soon as possible after receipt of the written request for modifications or changes, give the Buyer a written proposal of the consequences of implementing such modifications and/or changes. These consequences may include changes in the Contract Price, Delivery Date, capacity, draft, speed, fuel consumption, or any other provisions of this Contract. If in the Builder's reasonable judgement, such modifications and/or changes will adversely affect the Builder's planning or programme in relation to the Builder's other commitments, the Builder shall notify the Buyer that it declines to give such a proposal for the requested modifications and/or changes or part thereof.

(c) The Builder shall use reasonable efforts to minimise the extra costs, delay or other negative impact on the Vessel's capacity, performance or other factors caused by the Buyer's request. The Builder's proposal shall be reasonable for such work.

(d) On the basis of the Builder's proposal the Buyer may elect in writing to agree to the necessary amendments to this Contract, in which case the Builder shall build the Vessel in accordance with this Contract so amended.

(e) If the Buyer does not accept the Builder's notice as provided in Clause 20(d) (Approvals) or if in the Buyer's opinion the Builder's proposal for modifications and/or changes under this Clause is unreasonable, the Buyer may, by giving notice to the Builder, order the Builder to proceed with the requested modifications and/or changes but the consequences of implementing such modifications and/or changes shall be decided in accordance with Clause 42 (Dispute Resolution).

(f) If the Buyer elects not to continue with the request for modifications and/or changes, the Buyer shall notify the Builder accordingly.

(g) If the Buyer does not respond within seven (7) running days after receipt of the Builder's notice in Sub-clause (b), the Buyer shall be deemed to have withdrawn the request for modifications and/or changes.

25. Builder's Modifications and Substitution of Materials

The Builder shall have the right to make minor modifications and/or changes to the Specification and/or plans if so required by virtue of changes to the Builder's local conditions or facilities, the availability of materials and equipment, the introduction of improved methods or for any other reason of a similar nature provided that the Builder shall first obtain the Buyer's written approval, which shall not be unreasonably withheld or delayed.

Such modifications and/or changes shall satisfy the requirements of the Classification Society and the Regulatory Authorities and shall not relieve the Builder from its obligation to otherwise deliver the Vessel in accordance with this Contract. Any savings obtained shall be credited to the Buyer and the Buyer shall not be obliged to pay any extra for, or suffer any delay in delivery or other adverse consequences of, such modifications and/or changes.

26. Changes in Rules and Regulations

If, after the date of Contract, there are any changes in applicable laws, rules, regulations or requirements (or their application) of the Classification Society or Regulatory Authorities, the following shall apply:

(a) Upon receipt of notice of such changes either Party shall promptly notify the other Party thereof.

(b) If such changes will be compulsory for the Vessel at the time of delivery, the Builder shall, unless the Buyer at its sole discretion seeks and obtains a waiver from the Classification Society or Regulatory Authorities (as appropriate), incorporate such modifications and/or changes into the construction of the Vessel. The Parties shall endeavour to agree on such adjustments to the Contract Price, Delivery Date or other Contract terms as are a direct consequence of the change in applicable laws, rules, regulations or requirements. If the Parties fail to agree on the adjustments, the Builder shall proceed with the required changes and the matter shall be decided in accordance with Clause 42 (Dispute Resolution).

(c) If such changes are not compulsory but the Buyer requires the changes to be incorporated, Clause 24 (Modifications and Changes) shall apply.

27. Sea Trials

The times and numbers specified in this Clause shall apply unless otherwise stated in the Specification.

(a) Notice

The Buyer's Representative, together with a suitable number of assistants, officers and crew, shall have the right to be present at sea trials. The Builder shall give the Buyer at least fourteen (14) running days notice of the time and place and expected duration of sea trials and the Buyer shall promptly acknowledge receipt of such notice.

If neither the Buyer's Representative nor any authorised assistants attend the sea trials for any reason after such notice to the Buyer, such absence shall be deemed to be a waiver by the Buyer of its right to be present. The Builder may then conduct the sea trials without the Buyer's Representative being on board, provided that a representative of the Classification Society and Regulatory Authorities is present. In such circumstances, the

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results and conditions of the sea trials shall be as confirmed in writing by the Classification Society and/or Regulatory Authorities.

(b) Weather Conditions

The sea trials shall be conducted in weather conditions as described in this Contract and/or Specification. If the sea trials are interrupted or prevented by weather conditions in excess of the stated conditions, any resulting delay in delivery of the Vessel shall be deemed a Permissible Delay in accordance with Clause 34 (Permissible Delays). In such an event, the sea trials shall be discontinued or postponed until the first favourable day thereafter when weather conditions permit.

(c) Conduct of the Sea Trials

(i) The sea trials shall be conducted in the presence of representatives from the Classification Society and Regulatory Authorities and in the manner described in this Contract. The sea trials shall be of sufficient scope and duration to enable the Parties to verify and establish that the Vessel conforms in all respects with the performance requirements of this Contract. The Builder shall have the right to repeat any sea trials, subject to appropriate notice to the Buyer.

(ii) The Builder shall provide sufficient crew necessary for the safe navigation of the Vessel.

(iii) All expenses in connection with the sea trials, including the provision of bunkers, lubricating oil, grease, fresh water and stores needed to undertake the sea trials shall be for the Builder's cost and expense. Together with the Final Instalment, the Buyer shall reimburse the Builder at cost price for any quantities of bunkers and unbroached lubricating oil, grease, fresh water and stores remaining on board at delivery.

(d) Method of Acceptance or Rejection

(i) Upon completion of the sea trials the Builder shall give the Buyer the results of the sea trials in writing. If the Builder considers that the results thereof demonstrate that the Vessel conforms to the requirements of this Contract, the Builder shall give the Buyer notice of when delivery will take place. Such notice shall state where and when the Vessel will be ready for delivery, which will be at least fifteen (15) running days after the notice is given. Within five (5) running days after receipt of this notice and the trial results, the Buyer shall notify the Builder in writing of its acceptance for delivery or rejection of the Vessel.

(ii) If the results of the sea trials demonstrate that the Vessel or any part or equipment thereof does not conform to the requirements of this Contract, or if the Buyer rejects the Vessel for other reasons which the Builder accepts as valid, the Builder shall take all necessary steps to rectify such non-conformity. If necessary the Builder shall for its own cost and expense carry out a further sea trial in accordance with this Clause to ascertain that the Vessel complies with the terms of this Contract. Upon demonstration by the Builder that the deficiencies have been corrected, the procedure set out in this Sub-clause (d) shall apply.

(iii) If the Buyer gives notice of rejection under (i) above or rejects the Vessel under (ii) above, the Buyer shall state in which respects the Vessel does not conform to the requirements of this Contract (hereinafter "Delivery Defects").

(iv) If the Delivery Defects are of minor importance and do not affect Class or the operation of the Vessel in its intended trade but the Builder is unable to rectify the matter within a reasonable time and in any event before the accrual of the Buyer's right to terminate in accordance with Clause 39 (Suspension and Termination), the Builder

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may nevertheless require the Buyer to take delivery of the Vessel, on condition that the Builder first:

(1) undertakes to remedy the Delivery Defects for its own cost and expense as soon as possible; and

(2) agrees in writing to indemnify the Buyer for any loss incurred as a consequence thereof, including loss of time; and

(3) provides the Buyer with a guarantee issued by the party named in **Box 32** (or if **Box 32** is not filled in, a bank guarantee from a first class bank) substantially in the form and substance set out in Annex A(iv) for a sum which the Buyer reasonably requests to cover (1) and (2) above, failing agreement such sum to be resolved in accordance with Clause 42 (Dispute Resolution);

whereupon the Buyer shall accept delivery of the Vessel.

(v) If the Builder disputes the rejection of the Vessel by the Buyer, the dispute shall be resolved in accordance with Clause 42 (Dispute Resolution).

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SECTION 4 - DELIVERY

28. Delivery

Subject to Clause 27(d) (Sea Trials - Method of Acceptance or Rejection) the Vessel shall be delivered to the Buyer on or after the Delivery Date at the Shipyard or at a safe place in the immediate vicinity thereof in a clean and orderly condition, ready for service, upon:

(a) exchange and acceptance by the Parties hereto of a Protocol of Delivery and Acceptance signed by each Party acknowledging delivery of the Vessel by the Builder and acceptance thereof by the Buyer; and

(b) the provision by the Builder of the other documents listed in Clause 29 (Documents on delivery); and

(c) payment by the Buyer of the Final Instalment in accordance with Clause 30 (Final Instalment).

29. Documents on Delivery

Upon exchange of the Protocols of Delivery and Acceptance the Builder shall provide at no cost to the Buyer the following additional documents:

(a) Protocol of Trials made pursuant to the Specification.

(b) Protocol of Inventory and Equipment of the Vessel, including spare parts, as detailed in the Specification.

(c) Protocol of Surplus Consumable Stores which are payable by the Buyer to the Builder.

(d) Plans and Drawings pertaining to the Vessel together with all necessary instruction manuals, as detailed in the Specification.

(e) All certificates including the documents required to be furnished on delivery pursuant to this Contract. All certificates shall be issued without qualification.

If, however, the Classification certificate and/or other required certificates are not available at the time of delivery, the Buyer shall accept interim certificates provided that the Builder, at its cost and expense, provides the Buyer with final certificates as promptly as possible.

The Builder warrants that:

(i) such interim certificates shall enable the Vessel to be registered and trade and operate without restriction; and

(ii) final certificates shall be provided as above.

If the Builder fails to perform (i) and/or (ii) above, the Builder shall compensate the Buyer for any loss incurred as a consequence thereof, including loss of time.

(f) Declaration of Warranty by the Builder that the Vessel is free and clear of any liens, claims, charges, mortgages and other encumbrances.

(g) Builder's Certificate.

(h) Certificate of Non-Registration.

(i) Commercial invoices covering Final Instalment and modifications.

(j) Bill of Sale or other document that certifies that the title of the Vessel passes to the Buyer.

(k) IMO Hazardous Material Inventory Statement of Compliance in accordance with IMO Resolution A.962(23) (as referred to in Clause 4 (IMO Hazardous Materials Inventory)).

(l) Any other documents reasonably required by the Buyer.

The Buyer may require the Builder by giving reasonable notice, prior to delivery, to arrange for any documents listed above to be duly notarised and, if required, legalised at the Buyer's cost and expense.

30. Final Instalment

(a) The Final Instalment shall be adjusted in acc-ordance with this Contract and notified by the Builder to the Buyer not later than seven (7) Banking Days prior to the notified date of delivery (see Clause 27(d)(Sea Trials – Method of Acceptance or Rejection)). Not later than two (2) Banking Days prior to the notified date of delivery the amount of the Final Instalment, as adjusted, shall be deposited with the Builder's Bank as set out in **Box 12**, with irrevocable instructions that, subject to Sub-clause (c) below, the amount shall be released to the Builder against presentation by the Builder of a copy of the Protocol of Delivery and Acceptance of the Vessel signed by the Builder and the Buyer. Interest, if any, accruing on such deposit shall be for the benefit of the Buyer.

(b) If the Buyer does not agree the amount of the Final Instalment as adjusted and notified by the Builder, the Buyer shall notify the Builder within five (5) running days. Thereafter the Buyer may take delivery of the Vessel on payment of the Final Instalment as adjusted (or such other amount as the Builder may agree) but without prejudice to the Buyer's rights and remedies under this Contract and the dispute shall be resolved in accordance with Clause 42 (Dispute Resolution).

(c) If the Protocol of Delivery and Acceptance is not so presented within seven (7) days following the date for delivery of the Vessel as notified by the Builder in accordance with Clause 27(d) (Sea Trials - Method of Acceptance or Rejection), the Buyer shall have the right to withdraw the said deposit plus accrued interest. However, if and when a new date for delivery of the Vessel is notified to the Buyer by the Builder in accordance with Clause 27(d) (Sea Trials - Method of Acceptance or Rejection), the Buyer shall make a further cash deposit for the Final Instalment in accordance with the same terms and conditions as set out above.

31. Title and Risk

Title and risk of loss of or damage to the Vessel shall rest with the Builder until exchange of the Protocols of Delivery and Acceptance is effected, immediately upon which title and risk shall pass to the Buyer.

At the time of delivery the Vessel shall be free of all liens, claims, charges, mortgages and other encumbrances.

32. Possession and Removal of the Vessel

(a) The Buyer shall take physical possession of the Vessel immediately upon Delivery and Acceptance thereof.

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(b) The Buyer shall remove the Vessel from the place of delivery within five (5) running days after Delivery and Acceptance as aforesaid. If the Buyer does not so remove the Vessel within the said period, the Buyer shall pay to the Builder reasonable mooring charges for the Vessel. The Builder shall also have the right to move the Vessel from the place of delivery to another safe place at its convenience at any time after the five (5) running days' period has expired provided the Buyer is notified accordingly.

33. Vessel Registration

The Buyer shall register the Vessel at its own cost and expense.

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SECTION 5 – LEGAL

34. Permissible Delays

(a) The Delivery Date shall be extended if any of the following events cause actual delay to the delivery of the Vessel:

(i) Force majeure events

(1) acts of God;

(2) any government requisition, control, intervention, requirement or interference;

(3) threat or act of war, warlike operations, terrorism or the consequences thereof;

(4) riots, civil commotions, blockades or embargoes;

(5) epidemics;

(6) earthquakes, landslides, floods, tidal waves or extraordinary weather conditions;

(7) strikes, lockouts or other industrial action, but only if of a general nature and not limited solely to the Builder and/or the sub-contractors or their employees;

(8) fire, accident, explosion (whether in the Shipyard or elsewhere);

(9) any interruption to the supply of public utilities to the Builder;

(10) any other cause of a similar nature to the above beyond the control of the Builder or its Sub-contractors;

(11) delays to sea trials in accordance with Clause 27(b) (Sea Trial – Weather Conditions).

(ii) Other events

(1) Late delivery of, or delivery of, any defective Buyer's Supplies in accordance with Clause 21(a)(iv) (Buyer's Supplies);

(2) Delays due to modifications and changes in accordance with Clause 24(b) or (e) (Modifications and Changes);

(3) Delays due to changes in rules and regulations in accordance with Clause 26 (Changes in Rules and Regulations);

(4) An actual or constructive total loss in accordance with Clause 38(b)(ii) (Insurances – Allocation of Insurance Proceeds);

(5) Suspension of work pursuant to Clause 39(c) (Suspension and Termination – Suspension of Work).

(iii) Provided that in respect of (i) and (ii) above:

(1) such events were not caused by the error, neglect, act or omission of the Builder or its Sub-contractors; and

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(2) were not, or could not reasonably have been, foreseen by the Builder at the date of the Contract; and

(3) the Builder shall have complied with Sub-clause (b) hereunder; and

(4) the Builder shall have made all reasonable efforts to avoid and minimise the effects such events have on the delivery of the Vessel.

(b) The Builder shall notify the Buyer within ten (10) running days of when the Builder becomes aware of the occurrence of any event of delay on account of which the Builder asserts that it may have the right to claim an extension of the Delivery Date. A failure to so notify shall bar the Builder from claiming an extension to the Delivery Date. The Builder shall also advise the Buyer in writing (A) within two (2) running days of the ending of any event notified under this Clause that the event has ended, and (B) as soon as reasonably possible after (A), the length of extension of the Delivery Date claimed by the Builder.

35. Builder's Guarantee

(a) The Builder shall guarantee the Vessel against any Defects (see Definitions) provided such Defects are:

(i) discovered within the number of months stated in **Box 20** (hereinafter "the Guarantee Period") after delivery of the Vessel in accordance with Clause 28 (Delivery); and

(ii) notice thereof is given to the Builder as soon as reasonably possible after the discovery thereof and latest thirty (30) running days after the expiry of the Guarantee Period describing such Defects so far as reasonably practical

(hereinafter called "Guarantee Defects").

(b) The Builder shall make any necessary repairs or replacements to rectify any Guarantee Defects or damage to the Vessel caused as a direct and immediate consequence of such Guarantee Defects. Such repairs and replacements shall be made at the Shipyard at the Builder's cost and expense.

(c) The Buyer shall have the right to arrange for the necessary repairs to rectify any Guarantee Defects or damage to the Vessel caused as a direct and immediate consequence of such Guarantee Defects to be made elsewhere or obtain any necessary replacement parts and materials:

(i) if it is impractical to bring the Vessel to the Shipyard; or

(ii) if the Builder cannot supply necessary replacement parts and materials without impairing or delaying the operation or working of the Vessel.

(d) In the event that the Buyer makes the necessary repairs or replacements at any other shipyard or works other than the Shipyard, the Buyer shall first, but as soon as possible, give the Builder notice of the time and place such repairs will be made. The Builder shall have the right, without prejudice, to inspect through its own representative the nature and extent of the Guarantee Defects to be replaced or repaired. The Builder shall, in such case, promptly advise the Buyer in writing, after such examination has been completed, of its acceptance or rejection of such Guarantee Defects as ones that are covered by the guarantee.

(i) The Builder shall pay the Buyer in the currency stated in **Box 9** the reasonable cost and expenses of such repairs or replacements.

(ii) Where applicable, the Buyer shall return replaced parts to the Builder at the Builder's request and cost and expense provided the Builder makes such request at the time of the replacement. In the event that they are the subject of a dispute under Clause 42 (Dispute Resolution), the Builder shall hold the replaced parts available for inspection by the Buyer. Upon their replacement, the ownership of replaced parts shall revert to the Builder.

(e) The Builder guarantees repairs or replacements to the Vessel made under sub-clause (b) above for an additional Guarantee Period of the number of months stated in **Box 21** from the date of completion of such repairs or replacements provided such work has been performed by the Builder or its Sub-contractors. The additional Guarantee Period shall, however, not end on a date earlier than the end of the original Guarantee Period for any such item.

(f) If, as a result of the guarantee works, the Vessel has been lying idle continuously for a period in excess of thirty (30) days, the Guarantee Period shall be extended by the total number of such days (counting from the first day the Vessel is idle) that fall within the Guarantee Period, whether or not other work was carried out during such period.

(g) Without prejudice to any other rights the Buyer may have under this Contract, following the expiry of the Guarantee Period or in the event that the Builder is in breach of its obligation to rectify Guarantee Defects in accordance with this Clause, the Builder shall at the Buyer's request assign (to the extent to which it may validly do so) to the Buyer, or as the Buyer may direct, the right, title and interest of the Builder in and to all guarantees or warranties given by the Sub-contractors or suppliers of any of the materials or equipment used in the construction of the Vessel.

36. Guarantee Engineer

(a) The Buyer shall have the right to require the Builder to, or the Builder may, appoint a Guarantee Engineer to attend onboard the Vessel for such portion of the Guarantee Period as the Buyer may reasonably require. The Buyer and its employees shall provide the Guarantee Engineer with full co-operation in carrying out his duties. The Guarantee Engineer shall act as the Builder's representative on board and shall give the Buyer full co-operation to enable the Buyer to obtain the most efficient use of the Vessel's machinery and equipment.

(b) The Buyer shall provide the Guarantee Engineer with accommodation and provisions to a standard comparable to the Vessel's Chief Engineer, at no cost to the Builder. The Buyer shall pay the Builder the monthly lump sum stated in **Box 24**, or pro rata thereof for part of a month, as compensation for part of the cost and charges to be borne by the Builder in connection with the Guarantee Engineer. The Buyer shall also arrange and pay for the transportation of the Guarantee Engineer between the Vessel and his home country.

(c) The Guarantee Engineer shall, at all times and in all respects, be deemed to be the employee of the Builder.

(d) If the Buyer decides not to exercise its right to require the Builder to provide a Guarantee Engineer on board the Vessel, this shall not prejudice the Buyer's rights under the provisions of Clause 35 (Builder's Guarantee).

37. Responsibilities and exclusions from liabilities

Builder's exclusion clauses

(a) Liability for Defects discovered before or at the time of delivery

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The Buyer's remedy for delay in delivery of the Vessel, or for Defects discovered before or at the time of such delivery, are set out in Clauses 8 to 13 inclusive and Clause 27(d) (Sea Trials - Method of Acceptance or Rejection).

(b) Liability for Defects discovered after delivery
Except to the extent expressly provided in Clause 35 (Builder's Guarantee), the Builder shall have no liability in contract, tort (including negligence), breach of statutory duty or otherwise for:

(i) any Defect discovered after delivery of the Vessel or

(ii) any loss, damage or expenses caused as a consequence of such Defect (which shall include, but not be limited to, loss of time, loss of profit or earnings or demurrage directly or indirectly incurred by the Buyer).

(c) Liability for third party replacement or repair
The Builder shall not be responsible for any Defects in any part of the Vessel which may, subsequent to delivery of the Vessel, have been replaced or in any way repaired by any contractor, other than the Builder or its Sub-contractors, or for any such Defects which have been caused in whole or part by omission or improper use or maintenance of the Vessel on the part of the Buyer or by ordinary wear and tear.

(d) Implied terms
The guarantee contained in Clause 35 (Builder's Guarantee) replaces and excludes any other liability, guarantee, warranty and/or condition and/or innominate term imposed or implied by the law, customary, statutory or otherwise, by reason of the construction and sale of the Vessel by the Builder for and to the Buyer.

Mutual exclusion clauses
(e) Liability following termination
In the event of termination in accordance with the provisions of Clause 39 (Suspension and Termination), neither Party shall have any liability to the other whatsoever or howsoever arising, except as expressly provided in that Clause.

In the event, however, that a Party fails to perform the Contract, or unequivocally indicates its intention not to perform it, in a way which thereby permits the other Party to treat the Contract as at an end other than under the terms of the Contract, any such claim that the other party may have shall not be limited or excluded by the terms of this Contract.

Responsibility Clauses
(f) Responsibility for death and personal injury
Each Party to this Contract shall accept responsibility and liability for the death and personal injury of its Personnel, unless the death or personal injury was inflicted by the other Party or its Sub-contractors with the intent to cause such death or injury, or recklessly and with knowledge that such death or injury would probably result.

Each Party further agrees to indemnify and hold harmless the other Party, as regards both liability and legal costs, in the event of claims relating to or resulting from death or personal injury of its Personnel against the Party who is not responsible for them under this Sub-clause 37(f).

(g) Responsibility for damage to or loss of property
Unless otherwise provided in this Contract, each Party shall accept responsibility and liability for damage to or loss of its property and the property belonging to its Personnel unless such damage or loss was caused by the other Party or its Sub-contractors with

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the intent to cause such damage or loss, or recklessly and with knowledge that such damage or loss would probably result.

Each Party further agrees to indemnify and hold harmless the other Party, as regards both liability and legal costs, in the event of claims relating to or resulting from damage to or loss of property against the Party who is not responsible for them under this Sub-clause 37(g).

38. Insurances

(a) Builder's Insurances

From the time of first steel cutting or equivalent (or delivery of the Buyer's Supplies, whichever is earlier) until the Vessel is completed, delivered to and accepted by the Buyer, the Builder shall (in the joint names (as assureds) of the Builder and the Buyer) effect and maintain at no cost to the Buyer, Builder's Risk Insurance for the Vessel and Buyer's Supplies. Such Builder's Risk Insurance shall:

(i) be provided by insurers reasonably acceptable to the Buyer; and

(ii) be on terms no less wide than Institute Clauses for Builder's Risk terms (1/6/88) including Institute War and Institute Strike Clauses ; and

(iii) be in an amount not less than the aggregate of the payments made by the Buyer to the Builder plus the value of the Buyer's Supplies at the Shipyard.

If specifically requested by the Buyer, the Builder shall increase the amount insured under the policy to cover the rebuilding costs of the Vessel or such other amount as the Buyer may request. Any additional premium charged for this shall be paid by the Buyer.

The Builder shall provide the Buyer with copies of the insurance policy as placed.

The Buyer shall notify the Builder of the value of any subsequent changes in the value of the Buyer's Supplies for insurance purposes. Upon receipt of notice of change in value the Builder shall amend the insured value for the Buyer's Supplies accordingly.

(b) Allocation of Insurance Proceeds

(i) In the event that the Vessel is at any time prior to or at delivery damaged by any insured cause and provided such damage does not constitute an actual or constructive total loss of the Vessel, the Builder shall make good such damage and shall apply any amounts recovered under the insurance referred to in Sub-clause (a) to the costs of any repair or replacement, including repair or replacement of lost or damaged Buyer's Supplies. Such damage shall be made good so as to comply with this Contract and all repairs shall be carried out in compliance with the requirements of the Classification Society and Regulatory Authorities as appropriate without qualification.

(ii) Should the Vessel become an actual or constructive total loss from any insured cause:

(1) the Builder and the Buyer may agree that a new vessel is built or the Vessel reconstructed in accordance with the terms of this Contract provided agreement is reached in writing to an extension of the Delivery Date and/or any other necessary amendment to the Contract, in which case any amounts recovered under the insurance referred to in Sub-clause (a) will be applied to the construction or reconstruction of the Vessel if appropriate; or

(2) If the Builder and Buyer are unable to agree within a reasonable time on an

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extension to the Delivery Date and/or any other necessary amendment to the Contract as provided for in Sub-clause (b)(ii)(1) the Builder shall:

(i) promptly refund to the Buyer the full amount of sums paid by the Buyer to the Builder together with interest thereon at a rate per annum as stated in **Box 30** from the date of payment to the date of refund; and

(ii) make payment to the Buyer of the insured value of the Buyer's Supplies or alternatively, at the Builder's cost, deliver the Buyer's Supplies to the Buyer in undamaged condition.

Once all payments have been made by the Builder to the Buyer in accordance with Sub-clause (b)(ii)(2) this Contract shall be deemed terminated and all future rights and obligations of each of the Parties to the other shall cease whereupon the guarantees provided under this Contract shall be returned.

39. Suspension and Termination

(a) Buyer's Termination

The Buyer shall have the right to terminate this Contract forthwith upon giving notice in the event that:

(i) the guarantor providing the Refund Guarantee on behalf of the Builder in accordance with Clause 14(b) (Guarantees – Builder's Refund Guarantee) is deemed insolvent pursuant to Sub-clause (d) below, unless the Builder provides a replacement Refund Guarantee acceptable to the Buyer within 30 days of the Buyer's notice requiring a replacement Refund Guarantee to be provided, during which period no further payments shall be made to the Builder by the Buyer and provided that notice of termination is given before an acceptable replacement Refund Guarantee is received by the Buyer, or

(ii) the Builder fails to perform any work relating to the construction of the Vessel for a running period of at least the number of days stated in **Box 22(i)**, excluding Permissible Delays, provided that thereafter the Buyer gives the Builder at least the number of days' written notice stated in **Box 22(ii)** of its intention to terminate this Contract under this Clause and within that period the Builder fails to remedy its breach and provided further that the notice of termination is given before the Builder has remedied its breach; or

(iii) (1) the delivery of the Vessel is delayed by more than 180 days by virtue of events that fall within Clause 34(a)(i) (Permissible Delays - Force Majeure events); or
(2) the delivery of the Vessel is delayed by more than 180 days by virtue of events which do not fall within Clause 34(a)(i) or 34(a)(ii) (Permissible Delays); or
(3) the aggregate of delays to the delivery of the Vessel in (1) and (2) above is more than 270 days.

The Builder may at any time after the right to terminate has occurred give notice requesting that the Buyer either agrees to a new delivery date or terminates this Contract. Such new delivery date shall be a reasonable estimate by the Builder of the date when the Vessel will be ready for delivery. Within fifteen (15) days of the Builder's request, the Buyer shall notify the Builder of its decision. If the Buyer does not terminate this Contract then the new delivery date shall be deemed to be the Delivery Date provided it does not occur later than thirty (30) days prior to the expiry of the Refund Guarantee (Clause 14(b) (Guarantees - Builder's Refund Guarantee)). Notwithstanding Clause 34(a)(i) (Permissible Delays - Force majeure events) and this Clause 39(a)(iii)(1), (2) or (3) but subject to Clause 34(a)(ii) (Permissible Delays

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- Other events), if the Vessel is not delivered by that date, the Buyer shall have the right to terminate this Contract. The Builder's right to request the Buyer to agree a new delivery date shall operate on each and every occasion the events stated in this Sub-clause (a)(iii) give rise to the Buyer's option to terminate.

(iv) The reduction in speed would entitle the Buyer to a reduction in the Contract Price greater than the amount stated in **Box 13(ii)**; or

(v) The Buyer rejects the main engine and terminates the Contract in accordance with Clause 9(c)(ii)(2); or

(vi) The reduction in deadweight would entitle the Buyer to a reduction in the Contract Price greater than the amount stated in **Box 15(iii)**; or

(vii) The reduction in cubic capacity would entitle the Buyer to a reduction in the Contract Price greater than the amount stated in **Box 16(iii)**; or

(viii) The condition of the Vessel is deficient in the manner stated in Clause 12 (Other Deficiencies) and **Box 17**; or

(ix) The Builder is in breach of Clause 14 (Guarantees).

(b) Builder's Termination

The Builder shall have the right to terminate this Contract forthwith upon giving notice to the Buyer in the event that:

(i) The guarantor providing the Instalment Guarantee or Performance Guarantee on behalf of the Buyer under Clause 14(a) (Buyer's Instalment/Performance Guarantee) is deemed insolvent pursuant to Sub-clause (d) below, unless the Buyer can provide a replacement Performance Guarantee acceptable to the Builder within 30 days and provided that notice of termination is given before an acceptable Buyer's Instalment or Performance Guarantee is received by the Builder, or

(ii) The Buyer fails to pay any sums due under this Contract for a period of twenty-one (21) Banking Days provided that the Builder thereafter gives the Buyer at least 5 Banking Days notice of its intention to terminate under this Clause, and within that period the Buyer fails to remedy the breach and provided that notice of termination is given before the Buyer pays the outstanding sums due, or

(iii) The Buyer fails to take delivery of the Vessel tendered in accordance with this Contract, or

(iv) The Buyer is in breach of Clause 14 (Guarantees).

(c) Suspension of Work

Without prejudice to Sub-clause (b) above the Builder shall have the right to suspend work under this Contract if the Buyer fails to pay any instalment stated in **Box 11** due for a period of fifteen (15) Banking Days until payment of such outstanding sums.

(d) Deemed Insolvency

A Party or the guarantor providing the Refund Guarantee shall be deemed insolvent if proceedings are commenced against the insolvent Party or the guarantor for winding up, dissolution or reorganisation (otherwise than for the purpose of amalgamation or reconstruction), liquidation, the appointment of a receiver, trustee or similar officer, bankruptcy, suspension of payments or similar events.

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A Party shall have the right to terminate this Contract forthwith upon giving notice if the other Party or the guarantor is deemed insolvent.

(e) Effect of Buyer's Termination
If this Contract is terminated by the Buyer, the Builder shall refund all sums paid by the Buyer to the Builder under Clause 7 (Contract Price) and Clause 15 (Payments) hereof plus interest thereon at the rate stated in **Box 30** per annum from the date of payment to the date of refund. The Builder shall also return the Buyer's Supplies, or if they cannot be returned, the Builder shall pay to the Buyer an amount equal to the Buyer's cost for such Buyer's Supplies.

(f) Effect of Builder's Termination
If this Contract is terminated by the Builder, the Builder shall have the right to retain the Buyer's Supplies together with any instalments paid by the Buyer and shall have the right and power either to complete or not to complete the Vessel as it deems fit but in any event shall sell the Vessel (either in its complete or incomplete form), including those Buyer's Supplies which are installed or have been utilised on board the Vessel, at the best price reasonably obtainable at a public or private sale on reasonable terms and conditions.

(i) In the event of the sale of the Vessel in its complete form the proceeds of the sale received by the Builder shall be applied in the following order:

(1) to payment of all expenses incurred by the Builder in respect of the sale and otherwise incurred by the Builder as a result of the Buyer's default;

(2) to payment of all unpaid instalments of the Contract Price including any which would have been payable after the date of termination and interest on such instalments at the rate of interest stated in **Box 30** from the respective due dates thereof to the date of application.

(ii) In the event of the sale of the Vessel in its incomplete form the proceeds of sale received by the Builder shall be applied in the following order:

(1) to payment of all expenses incurred by the Builder in respect of the sale and otherwise incurred by the Builder as a result of the Buyer's default;

(2) to payment of all unpaid instalments of the Contract Price to the extent due but not yet paid at the date of termination and interest on such instalments at the rate of interest stated in **Box 30** from the respective due dates thereof to the date of application;

(3) to payment of all costs of part construction of the Vessel less any paid instalments and less any sums credited under (2) above;

(4) to payment of the Builder's reasonable net loss of profit caused by the Buyer's default.

(iii) In either of the above events if the proceeds of sale exceed the sums to which such proceeds are to be applied as aforesaid the Builder shall promptly pay any such excess to the Buyer without interest thereon, provided that the amount of such payment to the Buyer shall in no event exceed the total amount of instalments paid by the Buyer. The Builder shall at the same time either permit the Buyer to remove the Buyer's Supplies which are not installed or utilised onboard the Vessel (if any) from the Shipyard for the cost and expense of the Buyer, or give credit to the Buyer for the full value thereof.

(iv) If the proceeds of sale are insufficient to pay the Builder the total amounts due from the Buyer as aforesaid, the Builder may sell the Buyer's Supplies which are not installed or utilised onboard the Vessel (if any) at the best price reasonably obtainable at a public auction or private sale on reasonable terms and conditions, applying the proceeds of such sale toward the unsatisfied amounts due from the Buyer, and giving credit to the Buyer for any excess.

(v) If the proceeds of sale are still insufficient to pay the Builder the total amounts due from the Buyer as aforesaid, the Buyer shall pay to the Builder the amount of such deficiency, plus interest at the rate stated in **Box 30** to cover periods whenever payments from the Buyer became overdue.

40. Copyrights, Trade Marks and Patents

(a) Where they are owned and supplied by a Party, that Party shall retain all copyright, trade mark, patent or similar rights (hereinafter called "Intellectual Property Rights") with respect to the Specification, Plans and Drawings, technical descriptions, calculations, test results and other data, and information and documents concerning the design and construction of the Vessel. The other Party undertakes not to disclose the same or divulge any information contained therein to any third parties without the prior written consent of the first Party, except where it is necessary for usual operation, repair and maintenance of the Vessel and to subsequent owners.

(b) Each Party shall ensure that any manufacture and/or supply according to specifications, drawings, models or other instructions supplied by it shall not infringe any Intellectual Property Rights of third parties. Should claims nevertheless be made against the other Party in respect of Intellectual Property Rights arising out of or in any way related to the performance of the Contract, the first Party shall keep the other Party indemnified against the cost of such claims, including any legal costs in connection therewith.

(c) For the purpose of this Sub-clause (c), "Information" means technical information relating to the Vessel designated by one Party as confidential, except information which corresponds in substance to information which:

(i) was developed by and in possession of the other Party prior to first receipt from the first Party; and/or

(ii) at the date hereof or hereafter, through no wrongful act or failure to act on the part of the other Party, enters the public domain.

Where it is necessary during the performance of this Contract for the first Party to make Information available to the other Party, the other Party shall hold all such Information in confidence and not disclose it to any third parties or use it for any purpose other than as provided herein without the prior written consent of the first Party, which shall not be unreasonably withheld.

41. Governing law

This Contract shall be subject to English law unless another law is stated in **Box 23(a)** in which case the law stated in **Box 23(a)** shall apply.

42. Dispute Resolution

(a) Classification/Regulatory Authorities

Any dispute concerning the Vessel's compliance or non compliance with the rules, regulations and requirements of the Classification Society or other Regulatory Authorities shall be referred to the Classification Society or other Regulatory Authorities, as the case

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may be, the final decision of which shall be final and binding upon the Parties hereto. All other disputes shall be referred to expert determination or arbitration in accordance with Sub-clauses (b) through (e).

(b) Expert determination
Unless Sub-clause (a) applies or Sub-clauses (c) to (e) apply, in the event that a dispute arises under this Contract either Party may require by notice in writing to the other Party that such dispute be referred to an independent third party (an "Expert") as the Parties jointly nominate in writing, subject to the following procedure:

(i) if the Parties fail to nominate an Expert within seven (7) days of the date of the notice referred to in this Sub-clause (b), the dispute shall be resolved in accordance with Sub-clauses (c) to (e) below;

(ii) the Expert shall act as an expert and not as an arbitrator and his decision shall be final and binding upon the Parties;

(iii) the Expert's determination shall be conducted in accordance with the following rules, unless otherwise agreed by the Parties:

(1) the Parties may make written representations within seven (7) days of the Expert's appointment and shall copy in full such written representations to the other Party within such time period;

(2) the Parties shall have a further seven (7) days to make written comments on each other's representations and shall copy in full such written comments to the other Party within such time period;

(3) the Expert may call for such other documents and written evidence from the Parties as the Expert may reasonably require and the Parties shall provide such documents and written evidence within the period specified by the Expert. The Parties shall copy, in full, such documents and written evidence to the other Party within such time period provided that if either Party claims any such information is confidential to it then, provided in the reasonable opinion of the Expert that Party has properly claimed the same as confidential, the Expert shall not disclose the same to the other Party or to any third party;

(4) the Expert shall decide whether or not to take oral representations from or on behalf of either Party, but if he does so he shall give the other Party the opportunity to be present;

(5) the Expert shall have regard to all representations and evidence before him when making his decision, which shall be in writing, and give full reasons for his decision; and

(6) the Expert shall use all reasonable endeavours to publish his decision within twenty-eight (28) days of his appointment.

(iv) Unless the Parties agree otherwise, each Party shall bear its own costs of a reference to the Expert, and fees and expenses of the Expert shall be borne equally between the Parties.

(v) Without prejudice to the rest of this Sub-clause (b) the Parties shall consider on an ongoing basis whether or not it would be suitable to refer any dispute to an Expert or to enter into mediation in accordance with Sub-clause (e).

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(c) *) Arbitration and Mediation
Unless Sub-clause (a) or (b) applies and unless **Box 23(b)** states a place other than London, any dispute arising out of or in connection with this Contract shall be referred to arbitration in London in accordance with the Arbitration Act 1996 or any statutory modification or re-enactment thereof save to the extent necessary to give effect to the provisions of this Clause.

The arbitration shall be conducted in accordance with the London Maritime Arbitrators Association (LMAA) Terms current at the time when the arbitration proceedings are commenced.

The reference shall be to three arbitrators. A Party wishing to refer a dispute to arbitration shall appoint its arbitrator and send notice of such appointment in writing to the other Party requiring the other Party to appoint its own arbitrator within fourteen (14) calendar days of that notice and stating that it will appoint its arbitrator as sole arbitrator unless the other Party appoints its own arbitrator and gives notice that it has done so within the fourteen (14) days specified. If the other Party does not appoint its own arbitrator and give notice that it has done so within the fourteen (14) days specified, the Party referring a dispute to arbitration may, without the requirement of any further prior notice to the other Party, appoint its arbitrator as sole arbitrator and shall advise the other Party accordingly. The award of a sole arbitrator shall be binding on both Parties as if he had been appointed by agreement.

Nothing herein shall prevent the Parties agreeing in writing to vary these provisions to provide for the appointment of a sole arbitrator.

In cases where neither the claim nor any counterclaim exceeds the sum of US$100,000 (or such other sum as the Parties may agree) the arbitration shall be conducted in accordance with the LMAA Small Claims Procedure current at the time when the arbitration proceedings are commenced.

(d) *Unless Sub-clauses (a), (b) or (c) apply, any dispute arising out of or in connection with this Contract shall be referred to arbitration at the place stated in **Box 23(b)**, subject to the procedures applicable there.

(e) Notwithstanding Sub-clauses (c) and (d) above, the Parties may agree at any time to refer to mediation any difference and/or dispute arising out of or in connection with this Contract.

In the case of a dispute in respect of which arbitration has been commenced under (c) or (d) above, the following shall apply:

(i) Either Party may at any time and from time to time elect to refer the dispute or part of the dispute to mediation by service on the other Party of a written notice (the "Mediation Notice") calling on the other Party to agree to mediation.

(ii) The other Party shall thereupon within fourteen (14) calendar days of receipt of the Mediation Notice confirm that they agree to mediation, in which case the Parties shall thereafter agree a mediator within a further fourteen (14) calendar days, failing which on the application of either Party a mediator will be appointed promptly by the Arbitration Tribunal ("the Tribunal") or such person as the Tribunal may designate for that purpose. The mediation shall be conducted in such place and in accordance with such procedure and on such terms as the Parties may agree or, in the event of disagreement, as may be set by the mediator.

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(iii) If the other Party does not agree to mediate, that fact may be brought to the attention of the Tribunal and may be taken into account by the Tribunal when allocating the costs of the arbitration as between the Parties.

(iv) The mediation shall not affect the right of either Party to seek such relief or take such steps as it considers necessary to protect its interest.

(v) Either Party may advise the Tribunal that they have agreed to mediation. The arbitration procedure shall continue during the conduct of the mediation but the Tribunal may take the mediation timetable into account when setting the timetable for steps in the arbitration.

(vi) Unless otherwise agreed or specified in the mediation terms, each Party shall bear its own costs incurred in the mediation and the Parties shall share equally the mediator's costs and expenses.

(vii) The mediation process shall be without prejudice and confidential and no information or documents disclosed during it shall be revealed to the Tribunal except to the extent that they are disclosable under the law and procedure governing the arbitration.

(Note: The Parties should be aware that the mediation process may not necessarily interrupt time limits.)

* Sub-clauses (c) and (d) are alternatives; state place of dispute resolution in **Box 23(b)**.

If **Box 23(b)** is not appropriately filled in, Sub-clause (c) of this Clause shall apply.

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SECTION 6 – SUNDRY

43. Notices

(a) All notices given by either Party or their agents to the other Party or their agents in accordance with the provisions of this Contract shall be in writing and shall, unless specifically provided in this Contract to the contrary, be sent to the address for that other Party as set out in **Box 2** or **Box 3** as appropriate or to such other address as the other Party may designate in writing.

(b) A notice may be sent by post, facsimile, electronically or delivered by hand in accordance with Sub-clause (a).

(c) Any notice given under this Contract shall take effect on receipt by the other party and shall be deemed to have been received:

(i) if posted, on the seventh (7th) day after posting;

(ii) if sent by facsimile or electronically, on the day of transmission;

(iii) if delivered by hand, on the day of delivery.

And in each case proof of posting, transmission or handing in shall be proof that notice has been given.

44. Effective date of Contract

(a) This Contract shall become effective when the conditions stated in **Box 25** have been satisfied. If no conditions are stated in **Box 25** then the effective date of the Contract shall be the date stated in **Box 1**. The Parties shall immediately notify each other when the conditions stated in **Box 25** relevant to that Party have been satisfied.

(b) If any of the conditions referred to above have not been satisfied within the number of days stated in **Box 26** after the date of this Contract stated in **Box 1**, this Contract shall be deemed null and void and both Parties shall immediately be relieved of any obligations or liabilities to the other Party under this Contract.

45. Assignment

(a) Builder's assignment

The Builder shall have the right to assign the benefits of this Contract to the Builder's financiers for the purpose of securing the Builder's financing.

(b) Buyer's assignment

(i) The Buyer shall have the right to assign the benefits of this Contract to the Buyer's financiers for the purpose of securing the Buyer's financing.

(ii) The Buyer shall have the right, subject to the Builder's consent which shall not be unreasonably withheld, to assign, transfer or novate this Contract to any other third party.

46. Options

The Buyer shall have the option for the construction by the Builder of additional vessels as stated in **Box 27** at the contract price and delivery dates stated in **Box 28**, but otherwise on the same terms and conditions as this Contract with logical amendments. Such option must be declared by the Buyer to the Builder within the number of months stated in **Box 29** following the Effective date of this Contract referred to in Clause 44 (Effective date of Contract).

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47. Entire Agreement

This Contract constitutes the entire agreement between the Parties and no promise, undertaking, representation, warranty or statement by either Party prior to the date of this Contract stated in **Box 1** shall affect this Contract. Any modification of this Contract shall not be of any effect unless in writing signed by or on behalf of the Parties.

48. Third party rights

Unless expressly identified in this Contract, no third parties shall have the right to enforce any term of this Contract.

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ANNEX "A" – (GUARANTEES)
BIMCO STANDARD NEWBUILDING CONTRACT
CODE NAME: NEWBUILDCON

ANNEX A(i)

BUYER'S IRREVOCABLE LETTER OF GUARANTEE FOR THE 2ND & 3RD INSTALMENTS

To: [here insert name and address of the Builder]

1. In this Guarantee, the following terms have the following meanings:

'Award Interest' means any interest which may be awarded against the Buyer in connection with the final determination of any dispute notified to us in accordance with paragraph 5 below.

'Contract' means the contract dated [here insert date] made between the Buyer and you for the construction of the Vessel, as the same is amended at any time.

'Contractual Interest' means the sum payable on an Instalment at the Interest Rate in accordance with the terms of the Contract.

'Demand' means a written demand for payment under this Guarantee.

'Instalment' means the amount of each of the [here identify the instalments to be guaranteed] payments in respect of the contract price under the Contract (to the extent that it has not been paid) which is made on, before or after the date of this Guarantee to you by the Buyer.

'Interest Rate' means the rate of interest prescribed by the Contract as applicable to any part of an Instalment which the Buyer is obliged to pay under the terms of the Contract calculated from such date as is prescribed by the Contract to the date of your receipt of the payment.

'Maximum Liability' means our maximum liability under this Guarantee, including Contractual Interest which shall be [here insert amount] plus any Award Interest.

'Buyer' means [here insert name and address of Buyer]

'Vessel' means [here insert technical description and/or name]

2. In consideration of you entering into the Contract, agreeing to construct the Vessel in accordance with the terms of the Contract, and agreeing to accept this Guarantee pursuant to the Contract, at the request of the Buyer we irrevocably and unconditionally guarantee (but as primary obligor and not by way of secondary liability only) that in the event that the Buyer fails punctually to pay to you any Instalment we shall, upon receipt by us from you of a Demand for the same (together with a copy of a demand made by you against the Buyer for payment), pay to you or to your order upon the expiry of thirty (30) days from receipt of such Demand the sum demanded by you by way of the payment of any Instalment together with Contractual Interest and Award Interest (if any) provided that our total liability shall not exceed the Maximum Liability.

This Guarantee shall become effective in the amount corresponding to the amount of each Instalment with effect from the date when it becomes due to you under the Contract together with Contractual Interest, if any.

3. This Guarantee shall not be affected by any indulgence or delay allowed to the Buyer nor by any amendment to, or variation of, the Contract whether as to time or otherwise that may be agreed between you and the Buyer nor by any circumstances that would otherwise discharge our liability as guarantor.

4. Subject to paragraph 5 below, this Guarantee shall remain in force until the first to occur of (a) due delivery of the Vessel to, and acceptance of the Vessel by, the Buyer, (b) the payment to you by the Buyer or by us of all sums secured by this Guarantee, and (c) the Buyer's valid and lawful cancellation and/or rescission of the Contract pursuant to the terms of the Contract. However, notwithstanding the foregoing, if within twenty-eight (28) days of our receipt of a Demand we receive a written notice from you or the Buyer that your claim for payment of the sums referred to in the Demand has been disputed and that such dispute will be resolved in accordance with the Contract, the period of validity of this Guarantee shall be extended until thirty (30) days after the dispute has been finally determined in accordance with paragraph 5 below.

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5. Notwithstanding the other terms of this Guarantee, if within twenty-eight (28) days of our receipt of a Demand we receive written notice from you or from the Buyer stating that your claim for payment of the sums referred to in the Demand has been disputed and that such dispute will be resolved in accordance with the Contract (including, as may be, by Class, an Expert, a Mediator or in arbitration), then we shall not be obliged to make any payment to you under this Guarantee until thirty (30) days after the dispute has been finally determined or in the event of an appeal from an arbitration award, until thirty (30) days after delivery of the final unappealable judgment; or in the event that the court remits the matter to the arbitrator, until thirty (30) days after the publication of the revised final award or in the event of an appeal from the award, until thirty (30) days after delivery of the final unappealable judgment.

6. All payments to be made under this Guarantee shall be made without any set off or counterclaim and without deduction or withholding for or on account of any taxes, duties or charges whatsoever unless we are compelled by law to deduct or withhold the same in which case we shall make the minimum deduction or withholding permitted and will pay such additional amounts as may be necessary in order that the amount received by you after such deductions or withholdings shall be equal to the amount which would have been received had no such deduction or withholding been made.

7. All payments to be made under this Guarantee shall be made in [here insert currency].

8. Notwithstanding any provision in the Contract, this Guarantee shall be freely assignable by you and by any assignee. Upon assignment, all references in this Guarantee to "you" shall be read as references to the assignee or subsequent assignees.

9. This Guarantee is governed by the laws of [here state applicable law. In the absence of any statement the law of England and Wales shall apply] and we hereby submit to the exclusive jurisdiction of [here state place of dispute resolution. In the absence of any statement the High Court of England and Wales shall apply]. [We hereby authorise and nominate the following agent to accept service of any court proceedings on our behalf: [here insert name and address.]]

10. Any notice, claim or Demand to be given or made by you under this Guarantee shall be in writing signed by one of your officers and may be served on us either by post or by tested telex/authorised SWIFT or equivalent, and if sent by post to [here insert address] (or such other address as we may notify to you in writing) and if by tested telex at [here insert number] or if by SWIFT or equivalent at [here insert number] via your bank and shall be effective only upon actual receipt.

11. To the extent that we may be or may hereafter become entitled, in any jurisdiction, to claim for ourselves or our property, assets or revenue immunity (whether by reason of sovereignty or otherwise) in respect of our obligations under this Guarantee from service of process, suit, jurisdiction, judgment, order, award, attachment (before or after judgment or award), set off, execution of a judgment or other legal process and to the extent that in any such jurisdiction there may be attributed to us or any of our property, assets or revenue such an immunity (whether or not claimed) we hereby irrevocably agree not to claim and hereby irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction.

12. We hereby warrant that we are permitted by any relevant law to which we are subject (including, where relevant, the laws of the place or places of each of our incorporation, establishment, regulation, registration and residence) to:
12.1 issue a guarantee in this form.
12.2 make payment under this Guarantee in a currency other than that of the place of (where relevant) each of our incorporation, establishment, regulation, registration and residence in case of a Demand for payment under this Guarantee, and
12.3 designate the place stated in paragraph 9 above as the forum and the place of jurisdiction to which we irrevocably submit.

13. We hereby warrant that this Guarantee has been, or will be, duly registered with the relevant State authority in any legal jurisdiction in which such registration is required for any reason.

14. We hereby warrant that we have obtained all necessary approvals and authorisations to issue this Guarantee.

Dated the day of 2

..... (signature)

for and on behalf of [here insert name of Guarantor]

NEWBUILDCON - Standard Newbuilding Contract - PART II

ANNEX A(ii)

IRREVOCABLE LETTER OF GUARANTEE FOR PERFORMANCE OF BUYER'S OBLIGATIONS

To: [here insert name and address of the Builder]

1. In this Guarantee, the following terms have the following meanings.

'Contract' means the contract dated [here insert date] made between the Buyer and you for the construction of the Vessel, as the same may be amended at any time.

'Buyer' means [here insert name and address of Buyer]

'Vessel' means [here insert technical description and/or name]

2. In consideration of you entering into the Contract, agreeing to construct the Vessel in accordance with the terms of the Contract, and agreeing to accept this Guarantee pursuant to the Contract, at the request of the Buyer we irrevocably and unconditionally guarantee (but as primary obligor and not by way of secondary liability only) performance by the Buyer of all its liabilities and responsibilities under the Contract, including but not limited to due and punctual payment of any instalment of the contract price by the Buyer to you under the Contract, and we shall, upon receipt by us from you of a written demand for the same (together with a copy of a demand made by you against the Buyer for payment), pay to you or to your order upon the expiry of thirty (30) days from receipt of such written demand the sum demanded by you together with interest due under the Contract.

3. This Guarantee is governed by the laws of [here state applicable law. In the absence of any statement the law of England and Wales shall apply] and we hereby submit to the exclusive jurisdiction of [here state place of dispute resolution. In the absence of any statement the High Court of England and Wales shall apply]. [We hereby authorise and nominate the following agent to accept service of any court proceedings on our behalf: [here insert name and address.]]

Dated the day of 2

..... (signature)

for and on behalf of [here insert name of Guarantor]

NEWBUILDCON - Standard Newbuilding Contract - PART II

ANNEX A(iii)

REFUND GUARANTEE

To: [here insert name and address of the Buyer]

1. In this Guarantee, the following terms have the following meanings:

'Award Interest' means any interest which may be awarded against the Builder in connection with the final determination of any dispute notified to us in accordance with paragraph 5 below.

'Contract' means the contract dated [here insert date] made between the Builder and you for the construction of the Vessel, as the same is amended at any time.

'Contractual Interest' means the sum payable on an Instalment at the Interest Rate in accordance with the terms of the Contract.

'Demand' means a written demand for payment under this Guarantee.

'Instalment' means the amount of each payment in respect of the contract price under the Contract (to the extent that it has not been refunded) which is made on, before or after the date of this Guarantee to the Builder (or at the Builder's direction) by you or on your behalf.

'Interest Rate' means the rate of interest prescribed by the Contract as applicable to any part of an Instalment which the Builder is obliged to repay under the terms of the Contract calculated from the date on which the Builder received the Instalment to the date of your receipt of the repayment.

'Maximum Liability' means our maximum liability under this Guarantee, including Contractual Interest which shall be [here insert amount] plus any Award Interest.

'Builder' means [here insert name and address of shipbuilder]

'Vessel' means [here insert technical description and/or name]

2. In consideration of you entering into the Contract, agreeing to pay an Instalment or Instalments to the Builder, and agreeing to accept this Guarantee pursuant to the Contract, at the request of the Builder we irrevocably and unconditionally guarantee (but as primary obligor and not by way of secondary liability only) that if the Builder becomes liable under the Contract to repay any part of any Instalment we shall, upon receipt by us from you of a Demand for the same (together with a copy of a demand made by you against the Builder for repayment), pay to you or to your order upon the expiry of thirty (30) days from receipt of such Demand the sum demanded by you by way of the repayment of any Instalment together with Contractual Interest and Award Interest (if any) provided that our total liability shall not exceed the Maximum Liability.

This Guarantee shall become effective in the amount corresponding to the amount of each and every Instalment paid to the Builder under the Contract together with Contractual Interest as and when each such Instalment has been received by the Builder.

3. This Guarantee shall not be affected by any indulgence or delay allowed to the Builder nor by any amendment to, or variation of, the Contract whether as to time or otherwise that may be agreed between you and the Builder nor by any circumstances that would otherwise discharge our liability as guarantor.

4. Subject to paragraph 5 below, this Guarantee shall remain in force until the first to occur of (a) due delivery of the Vessel to, and acceptance of the Vessel by, you (b) the payment to you by the Builder or by us of all sums secured by this Guarantee[, and (c) three-hundred (300) days after the Contractual Date of Delivery]. However, notwithstanding the foregoing, if within twenty-eight (28) days after our receipt of a Demand we receive a written notice from you or the Builder that your claim for the repayment of any sums referred to in the Demand has been disputed and that such dispute will be resolved in accordance with the Contract, the period of validity of this Guarantee shall be extended until thirty (30) days after the dispute has been finally determined in accordance with paragraph 5 below.

5. Notwithstanding the other terms of this Guarantee, if within twenty-eight (28) days after our receipt of a Demand we receive a written notice from you or from the Builder stating that your claim for repayment of any sums referred to in the Demand has been disputed and that such dispute will be resolved in accordance with the Contract (including, as

NEWBUILDCON - Standard Newbuilding Contract - PART II

may be, by Class, an Expert, a Mediator or in arbitration), then we shall not be obliged to make any payment to you under this Guarantee until thirty (30) days after the dispute has been finally determined or in the event of an appeal from an arbitration award, until thirty (30) days after delivery of the final unappealable judgment; or in the event that the court remits the matter to the arbitrator, until thirty (30) days after the publication of the revised final award or in the event of an appeal from the award, until thirty (30) days after delivery of the final unappealable judgment.

6. All payments to be made under this Guarantee shall be made without any set off or counterclaim and without deduction or withholding for or on account of any taxes, duties or charges whatsoever unless we are compelled by law to deduct or withhold the same in which case we shall make the minimum deduction or withholding permitted and will pay such additional amounts as may be necessary in order that the amount received by you after such deductions or withholdings shall be equal to the amount which would have been received had no such deduction or withholding been made.

7. All payments to be made under this Guarantee shall be made in [here insert currency].

8. Notwithstanding any provision in the Contract, this Guarantee shall be freely assignable by you and by any assignee. Upon assignment, all references in this Guarantee to "you" shall be read as references to the assignee or subsequent assignees.

9. This Guarantee is governed by the laws of [here state applicable law. In the absence of any statement the laws of England and Wales shall apply] and we hereby submit to the exclusive jurisdiction of [here state place of dispute resolution. In the absence of any statement the High Court of England and Wales shall apply]. [We hereby authorise and nominate the following agent to accept service of any court proceedings on our behalf: [here insert name and address.]]

10. Any notice, claim or Demand to be given or made by you under this Guarantee shall be in writing signed by one of your officers and may be served on us either by post or by tested telex/authorised SWIFT or equivalent, and if sent by post to [here insert address] (or such other address as we may notify to you in writing) and if by tested telex at [here insert number] or if by SWIFT or equivalent at [here insert number] via your bank and shall be effective only upon actual receipt.

11. To the extent that we may be or may hereafter become entitled, in any jurisdiction, to claim for ourselves or our property, assets or revenue immunity (whether by reason of sovereignty or otherwise) in respect of our obligations under this Guarantee from service of process, suit, jurisdiction, judgment, order, award, attachment (before or after judgment or award), set off, execution of a judgment or other legal process and to the extent that in any such jurisdiction there may be attributed to us or any of our property, assets or revenue such an immunity (whether or not claimed) we hereby irrevocably agree not to claim and hereby irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction.

12. We hereby warrant that we are permitted by any relevant law to which we are subject (including, where relevant, the laws of the place or places of each of our incorporation, establishment, regulation, registration and residence) to:
12.1 issue a guarantee in this form,
12.2 make payment under this Guarantee in a currency other than that of the place of (where relevant) each of our incorporation, establishment, regulation, registration and residence in case of a Demand for payment under this Guarantee, and
12.3 designate the place stated in paragraph 9 above as the forum and the place of jurisdiction to which we irrevocably submit.

13. We hereby warrant that this Guarantee has been, or will be, duly registered with the relevant State authority in any legal jurisdiction in which such registration is required for any reason.

14. We hereby warrant that we have obtained all necessary approvals and authorisations to issue this Guarantee.

Dated the day of 2

..... (signature)

for and on behalf of [here insert name of Guarantor]

NEWBUILDCON - Standard Newbuilding Contract - PART II

ANNEX A(iv)

IRREVOCABLE LETTER OF GUARANTEE FOR BUILDER'S OBLIGATIONS UNDER CLAUSE 27

To: [here insert name and address of the Buyer]

1. In this Guarantee, the following terms have the following meanings:

   'Award Interest' means any interest which may be awarded against the Builder in connection with the final determination of any dispute notified to us in accordance with paragraph 5 below.

   'Contract' means the contract dated [here insert date] made between the Builder and you for the construction of the Vessel, as the same may be amended at any time.

   'Demand' means a written demand for payment under this Guarantee.

   'Maximum Liability' means our maximum liability under this Guarantee, including Award Interest which shall be [here insert amount].

   'Builder' means [here insert name and address of shipbuilder]

   'Vessel' means [here insert technical description and/or name]

2. In consideration of you entering into the Contract, agreeing to take delivery of the Vessel, and agreeing to accept this Guarantee pursuant to the Contract, at the request of the Builder we irrevocably and unconditionally guarantee (but as primary obligor and not by way of secondary liability only) that if the Builder becomes liable to pay any sum to you in accordance with the terms of Clause 27(d)(iv) of the Contract in respect of Delivery Defects, as defined in the Contract, we shall, upon receipt by us from you of a Demand for the same (together with a copy of a demand made by you against the Builder for payment), pay to you or to your order upon the expiry of thirty (30) days from receipt of such Demand the sum demanded by you and Award Interest (if any) provided that our total liability shall not exceed the Maximum Liability.

3. This Guarantee shall not be affected by any indulgence or delay allowed to the Builder nor by any amendment to, or variation of, the Contract whether as to time or otherwise that may be agreed between you and the Builder nor by any circumstances that would otherwise discharge our liability as guarantor.

4. Subject to paragraph 5 below, this Guarantee shall remain in force until the first to occur of (a) the repair of the Delivery Defects and (b) the payment to you by the Builder or by us of all sums secured by this Guarantee.

5. Notwithstanding the other terms of this Guarantee, if within twenty-eight (28) days after our receipt of a Demand we receive written notice from you or from the Builder stating that your claim to payment of the sums referred to in the Demand has been disputed and that such dispute will be resolved in accordance with the Contract (including, as may be, by Class, an Expert, a Mediator or in arbitration), then we shall not be obliged to make any payment to you under this Guarantee until thirty (30) days after the dispute has been finally determined or in the event of an appeal from an arbitration award, until thirty (30) days after delivery of the final unappealable judgment; or in the event that the court remits the matter to the arbitrator, until thirty (30) days after the publication of the revised final award.

6. All payments to be made under this our Guarantee shall be made without any set off or counterclaim and without deduction or withholding for or on account of any taxes, duties or charges whatsoever unless we are compelled by law to deduct or withhold the same in which case we shall make the minimum deduction or withholding permitted and will pay such additional amounts as may be necessary in order that the amount received by you after such deductions or withholdings shall be equal to the amount which would have been received had no such deduction or withholding been made.

7. All payments to be made under this Guarantee shall be made in [here insert currency].

8. Notwithstanding any provision in the Contract, this Guarantee shall be freely assignable by you and by any assignee. Upon assignment, all references in this Guarantee to "you" shall be read as references to the assignee or subsequent assignees.

9. This Guarantee is governed by the laws of [here state applicable law. In the absence of any statement the laws of England and Wales shall apply] and we hereby submit to the exclusive jurisdiction of [here state place of dispute resolution. In the absence of any statement the High Court of England and Wales shall apply]. [We hereby authorise

NEWBUILDCON - Standard Newbuilding Contract - PART II

and nominate the following agent to accept service of any court proceedings on our behalf: [here insert name and address.]]

10. Any notice, claim or Demand to be given or made by you under this Guarantee shall be in writing signed by one of your officers and may be served on us either by post or by tested telex/authorised SWIFT or equivalent, and if sent by post to [here insert address] (or such other address as we may notify to you in writing) and if by tested telex at [here insert number] or if by SWIFT or equivalent at [here insert number] via your bank and shall be effective only upon actual receipt.

11. To the extent that we may be or may hereafter become entitled, in any jurisdiction, to claim for ourselves or our property, assets or revenue immunity (whether by reason of sovereignty or otherwise) in respect of our obligations under this Guarantee from service of process, suit, jurisdiction, judgment, order, award, attachment (before or after judgment or award), set off, execution of a judgment or other legal process and to the extent that in any such jurisdiction there may be attributed to us or any of our property, assets or revenue such an immunity (whether or not claimed) we hereby irrevocably agree not to claim and hereby irrevocably waive such immunity to the fullest extent permitted by the laws of such jurisdiction.

12. We hereby warrant that we are permitted by any relevant law to which we are subject (including, where relevant, the laws of the place or places of each of our incorporation, establishment, regulation, registration and residence) to:
12.1 issue a guarantee in this form,
12.2 make payment under this Guarantee in a currency other than that of the place of (where relevant) each of our incorporation, establishment, regulation, registration and residence in case of a Demand for payment under this Guarantee, and
12.3 designate the place stated in paragraph 9 above as the forum and the place of jurisdiction to which we irrevocably submit.

13. We hereby warrant that this Guarantee has been, or will be, duly registered with the relevant State authority in any legal jurisdiction in which such registration is required for any reason.

14. We hereby warrant that we have obtained all necessary approvals and authorisations to issue this Guarantee.

Dated the day of 2

..... (signature)

for and on behalf of [here insert name of Guarantor]

NEWBUILDCON - Standard Newbuilding Contract - PART II

ANNEX "B" - (SPECIFICATION)
BIMCO STANDARD NEWBUILDING CONTRACT
CODE NAME: NEWBUILDCON

NEWBUILDCON - Standard Newbuilding Contract - PART II

ANNEX "C" - (MAKER'S LIST)
BIMCO STANDARD NEWBUILDING CONTRACT
CODE NAME: NEWBUILDCON

APPENDIX B

CMAC Standard Newbuilding Contract (Shanghai Form)[1]

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CHINA MARITIME ARBITRATION COMMISSION (CMAC)

STANDARD NEWBUILDING CONTRACT

(HULL NO:_____)

This Charter Party, made and concluded in this day of Between THIS CONTRACT, is made this (date) day of (month), (year), by and between, (full name of the BUYER), a corporation organized and existing under laws of (country or area of the BUYER), having its principal office at (country or city), as one party (hereinafter called the "BUYER" or "Principal"), and (full name of the shipbuilding trading company) a corporation organised and existing under laws of P.R. China, having its principal office at P.R. China as well as (full name of the shipbuilder) a corporation organized and existing under laws of P.R. China, having its principal office at P.R. China, together as the other party (hereinafter called the "SELLER" or "BUILDER").

WITNESSTH:

In consideration of the mutual covenants contained herein, the SELLER agrees to design, build ,equip, launch and complete at the SELLER's shipyard and to sell to the BUYER after accomplishment and successful trial of (type, name and number of the vessels), The technical Specifications will be described in Article I of the Contract. The VESSEL will be registered under the flag of (name of flag country). The BUYER agrees to purchase and take delivery of the aforesaid VESSEL from the SELLER and to pay for the same in accordance with the terms and conditions hereinafter set forth.

SECTION 1 VESSEL

ARTICLE/DESCRIPTION

1. HULL NUMBER

The Vessel shall be constructed at SELLER's shipyard or the shipyard specified by the SELLERS and shall have the BUILDER's Hull No: _____

2. PRINCIPAL TECHNICAL DOCUMENTATION

The VESSEL shall be constructed, equipped and completed in accordance with the following principal technical documentation:

(1) Specification (Drawing No. _____)

(2) General Arrangement (Drawing No._____)

(3) Midship Section (Drawing No._____)

(4) Makers list (Drawing No._____)

3. PRINCIPAL TECHNICAL PARAMETERS OF THE VESSEL

The principal technical parameters of the VESSEL as per the Specifications are as below:

(1) Principal Paticulars and Dimensions of the VESSEL

Length overall abt. m

Length between perpendiculars m
Breadth, moulded m
Depth, moulded m
Designed Draft m
Speed knot
Deadweight t
Hold Capacity m3
(2) Propelling Machinery:
The VESSEL shall be equipped, in accordance with the Specifications, with_____ set (s) _____ of Main Engine of_____ type with MCR_____ kW and rated revolution_____ rpm.
The technical parameters of the VESSEL shall be defined, measured, and approved in accordance with the "Specifications":

4. GUARANTEES
(1) Speed
The Builder guarantees that the trial speed, after correction, is to be not less than_____ nautical miles per hour on the trial condition of the weather and clean hull as stipulated in the Specifications. The speed shall be corrected for wind speed and shallow water effect with the method as specified in the Specifications.
(2) Deadweight
The term, "Deadweight", as used in the Contract, shall be as defined in the Specifications.
The Builder guarantees that the VESSEL is to have a deadweight of not less than_____ metric tons at the designed loaded draft of_____ meters in sea water of 1.025t/ m3 specific gravity.
(3) Hold Capacity
The Builder guarantees that the VESSEL's actual hold capacity is to be not less than_____ m3 as specified in the Specifications.
(4) Fuel Oil Consumption
The Builder guarantees that the fuel oil consumption of the Main Engine at shop test is not to exceed_____ grams/brake horse power/hour at normal continuous output at shop trial based on diesel fuel oil having a lower calorific value of _____ kilocalories per kilogram.
(5) The actual speed, deadweight hold capacity and fuel oil consumption of the VESSEL shall be measured by the BUILDER in the presence of the BUYER's supervisor(s) or the Representative authorized by the BUYER for purpose of confirmation or approval.
Should there be any dispute between the BUILDER and the BUYER in such measurements, Classification Society shall be appointed to make remeasurements subject to the agreement by both parties. The result made by the Classification Society shall be final and binding to both parties.

ARTICLE II CLASSIFICATION,RULES AND REGULATIONS

1. The VESSEL, including its design construction inspection test and delivery shall conform to the rules ,regulations and the conventions of_____ (herein insert the "Classification Society"). and shall obtain the class notation of_____ and shall also meet the requirements of the regulations and the rules of the flag authorities as below:
(1) The regulations and the rules having becoming effective on the date of the signing date of signing of the Contract, or
(2) The regulations and the rules which have not been effective while have been officially approved and published on the date of signing of the Contract and are to come into force pirot to the delivery of the VESSEL.
All the regulations, the rules and requirements of the flag authorities and the Classification Society shall be unconditionally met.
2. All the laws rules and regulations of the authorities shall be final and binding upon the parties hereto.
3. All fees and charges incidental to Classification and to comply with the rules, regulations and requirements of the Contract as described in the Specifications as well as royalties, if any,

payable on account of the construction of the VESSEL shall be for the account of the BUILDER, except as otherwise provided and agreed herein.
The key plans, materials and workmanship entering into the construction of the VESSEL shall at all times be subject to inspections and tests in accordance with the rules and regulations of the Classification Society.

ARTICLE III DESIGN—LIABILITY IN THE DESIGN CONTRACT

The design of the VESSEL shall be carried out by a design company in accordance with the Design Specifications based on the requirements of the BUYER. The design shall determine the performance and technical parameters of the VESSEL (including navigation areas and shipping course, ship type, trading purpose, nationality and class, propelling equipment, speed and reserved power, endurance, deadweight, hold capacity and accommodation facilities), as well as compliance with the rules and regulations of CLASSIFICATION SOCIETY and relevant authorities. A design contract shall be executed by the PARTIES for quality assurance and clarification of the obligations.
If the BUYER assigns_____ design company from outside of China to design the VESSEL the BUYER shall enter into a design contract with this design company. Thereafter, the BUILDER enters into a subcontract with _____ (the design company) for the detailed design and workshop design. In such event, the BUILDER shall undertake responsibility neither for any defect of the VESSEL and mistake arising from the design, or any deficiency of speed, deadweight, fuel oil consumption and hold capacity due to non-compliance with the relevant regulations and rules, nor for any extension of the Delivery Time of the VESSEL due to the delay in the delivery of the drawings.
If the design company is assigned by the BUILDER, the design contract shall be signed between the BUILDER and this design company. In such event, the BUILDER shall undertake responsibility for any defect of the VESSEL and mistake arising from the design, or any deficiency of speed, deadweight, fuel oil consumption and hold capacity due to non-compliance with the relevant regulations and rules, and for any extension of the Delivery Time of the VESSEL due to the delay in the delivery of the drawings.

ARTICLE IV ENVIRONMENTAL PROTECTION

1. IMO HAZARDOUS MATERIALS INVENTORY
The BUILDER shall, in accordance with the IMO Guidelines on Ship Recycling, with amendments in force as of the date of the Contract:
(1) Endeavour to take due account of the Vessel's Recycling disposal when designing and constructing the Vessel;
(2) Maximizing the use of the materials of green, low carbon and being recycled safely and environmental friendly;
(3) Minimizing the use of the materials which have been known to be potentially hazardous to human health and the environment.
In consultation with equipment manufactures, the BUILDER will provide the Buyer with a Green Passport Statement of Compliance issued by the Classification Society containing information including the Vessel's hull number and main particulars and listing any and all equipment and systems having been known to be potentially hazardous utilized in the construction of the Vessel.

The list of the materials which are potentially hazardous shall contain the location and the approximate quantity/volume of each material on board of the Vessel.
2. Protective Coating Standard
The Vessel's double-side skin spaces and dedicated seawater ballast tanks shall be coated in accordance with the Specifications. The Protective Coating Standard should be in compliance with the applicable laws, regulations, rules and requirements of the Classification Society and the Regulatory Authorities.
3. Source of Origin
If so requested by the Buyer, the BUILDER shall identify the country of origin of the main components listed in the Maker's List and Specifications.

SECTION 2 FINANCIAL

ARTICLE V CONTRACT PRICE & TERMS OF PAYMENT

1. CONTRACT PRICE:

The purchase price of the Vessel is _____ (Amount and Currency, hereinafter called the "Contract Price"), net receivable by the BUILDER which is exclusive of the BUYER's Supplies as provided in Article XI hereof, and shall be adjusted subject to Article VI under the Contract.

2. CURRENCY:

Any and all payments by the BUYER to the BUILDER under the Contract shall be made in _____

_____ (Currency and Symbol).

3. TERMS OF PAYMENT:

The Contract Price shall be paid by the BUYER to the BUILDER in installments as follows:

(1) The 1st Installment:

The sum of United States Dollars_____ (USD_____), representing_____

_____ percent (_____ %) of the Contract Price, shall become due and payable and be paid by the BUYER concurrently within three (3) working days after the BUILDER issued the Letter of Refund Guarantee.

(2) The 2nd Installment:

The sun of United States Dollars_____ (USD_____), representing_____

_____ percent (_____ %) of the Contract Price, shall become due and payable and be paid within three (3) business days after the cutting of the first steel plate of the Vessel.

(3) The 3rd Installment:

The sun of United States Dollars_____ (USD_____), representing_____

_____ percent (_____ %) of the Contract Price, shall become due and payable and be paid within three (3) business days after keel-laying of the first section of the Vessel.

(4) The 4th Installment:

The sun of United States Dollars_____ (USD_____), representing_____

_____ percent (_____ %) of the Contract Price, shall become due and payable and be paid within three (3) business days after launching of the Vessel.

(5) The 5th Installment:

The sun of United States Dollars_____ (USD_____), representing_____

_____ percent (_____ %) of the Contract Price plus any increase or minus any decrease due to modifications and/or adjustments to the Contract Price in accordance with provisions of the relevant Article hereof, shall become due and payable and be paid by the BUYER to the BUILDER on date of delivery of the Vessel. The BUILDER shall send to the BUYER an email or facsimile demand for this installment ten (10) days prior to the scheduled date of delivery of the Vessel.

(6) The 6th Installment:

The sun of United States Dollars_____ (USD_____), representing_____

_____ percent (_____ %) of the Contract Price shall be paid within three (3) working days after the expiration of the guarantee period of the Vessel.

4. METHOD OF PAYMENT

(1) 1st Installment:

The BUYER shall remit the amount of this installment to the receiving bank nominated by the BUILDER (to name the bank here), for credit to the account of the BUILDER, within three (3) business days after receiving notice in writing from the BUILDER which should also be confirmed and signed by the BUYER's authorized representative (same as below)regarding effectiveness of the Contract.

(2) 2nd Installment:

The BUYER shall remit the amount of this installment to the receiving bank nominated by the BUILDER, for credit to the account of the BUILDER, within three (3) business days after receiving notice in writing from the BUILDER regarding cutting steel of the Vessel.

(3) 3rd Installment:

The BUYER shall remit the amount of this installment to the receiving bank nominated by the BUILDER, for credit to the account of the BUILDER, within three (3) business days after receiving notice in writing from the BUILDER regarding keel-laying of the Vessel.

(4) 4th Installment:

The BUYER shall remit the amount of this installment to the receiving bank nominated by the BUILDER, for credit to the account of the BUILDER, within three (3) business days after receiving notice in writing from the BUILDER regarding launching of the Vessel.

(5) 5th Installment (Payable upon delivery of the Vessel):

The BUYER shall, at least three (3) bank business days prior to the scheduled date of delivery of the Vessel, make a cash deposit with the bank nominated by the BUILDER, covering the amount of this installment as adjusted in accordance with the provisions of the Contract as agreed by the Parties hereto, with an irrevocable instruction that the said amount shall be released to the BUILDER against presentation by the BUILDER to the said Bank, of a copy of the Protocol of Delivery and Acceptance signed by the BUYER's authorized representative and the SELLER. Interest, if any, accrued from such deposit, shall be for the benefit on the BUYER.

Unless otherwise provided in the Contract, the BUYER shall not defer or refuse payment of any installment for the reason of any disputes or arguments of whatsoever nature between the Parties.

(6) The 6th Installment:

The BUYER shall remit the amount of this installment to the receiving bank nominated by the BUILDER, for credit to the account of the BUILDER within three (3) working days after receipt of the notice from the BUILDER stating the expiration of the guarantee period of the Vessel.

5. PREPAYMENT:

The BUYER shall have the obligation to make prepayment of any and all installments before delivery of the Vessel, by giving to the SELLER at least thirty (30) calendar days prior notice in writing, without any price adjustment of the Vessel for such prepayment.

6.SECURITY FOR PAYMENT OF INSTALLMENTS BEFORE DELIVERY:

The BUYER shall, concurrently when the Contract being signed, deliver to the BUILDER an irrevocable and unconditional Letter of Guarantee in the from annexed hereto as Exhibit "B" in favor of the BUILDER issued by a first class international bank (hereinafter called the " Guarantor") acceptable to BUILDER's bank and the BUILDER. This guarantee shall secure the BUYER's obligation for the payment of all 2nd, 3rd and 4th installments of the Contract Price.

7. REFUNDS

All payments made by the BUYER prior to delivery of the Vessel shall be in the nature of advance to the BUILDER, and in the event the Contract is rescinded or canceled by the BUILDER, all in accordance with the specific terms of the Contract permitting such rescission or cancellation, the BUILDER shall refund to the BUYER the full amount of all sums already paid by the BUYER to the BUILDER under the Contract, together with interest (at the rate set out in respective provision thereof) from the respective payment date(s) to the date of remittance by telegraphic transfer of such refund to the account specified by the BUYER.

As security to the BUYER, the BUILDER shall deliver to the BUYER, concurrently with the Contract being signed, a Refund Guarantee to be issued by (to name bank here) in the form as per ANNEX "A" annexed hereto.

ARTICLE VI ADJUSTMENT OF THE CONTRACT PRICE

The Contract Price of the VESSEL shall be adjusted subject to (1) the actual technical particulars different from the Specification and/or (2) the external changes in the market different from the situation when signing the Contract . It is mutually agreed by both parties that the said technical particulars refer to the speed, the deadweight, the hold capacity, the fuel consumption of the main engine, delivery time and other items, and the said external changes in the market refer to the price of major materials and exchange rate. It is understood by both parties that the adjustment of the Contract Price refer to the increase or reduction of the Contract Price and any adjustment of the Contract Price is by way of liquidated damages and not by way of penalty.

This Article specifies the amount of liquidated damages for the deficiency of abovementioned technical particulars and changes in the market as below.

1. SPEED

(1) If the reduction of the speed (as determined by the sea trial after correction according to the Specifications, same is to apply to below) is less than three-tenths (3/10) of one knot below the guaranteed speed as specified in Paragraph 4 (1) of Article I, there shall be no adjustment of the Contract Price.

(2) However, if the reduction of the speed is greater than or equal to three-tenths (3/10) of one knot below the guaranteed speed as specified in Paragraph 3 (1) of Article I, the Contract Price shall be reduced as follows:

In case of reduction of less than 0.3 knot USD 0

In case of reduction

at or above 0.30 but below 0.40 knot USD_____

at or above 0.40 but below 0.50 knot USD_____

at or above 0.50 but below 0.60 knot USD_____

at or above 0.60 but below 0.70 knot USD_____

at or above 0.70 but below 0.80 knot USD_____

at or above 0.90 but below 1.00 knot USD_____

(3) If the reduction in speed is greater than 1 knot below the guaranteed speed, the BUYER shall at his own discretion either reject the VESSEL or cancel the Contract in accordance with Article XXVII, or may accept the VESSEL at a reduction in the Contract Price as above provided, by United States Dollars_____ only (USD_____) being the maximum.

(4) The BUILDER shall be entitled to carry out further sea trials after correcting the defects which result in the speed reduction to achieve the guaranteed speed as specified in the Specification.

(5) If the actual speed is more than the guaranteed speed as specified in the Specification, the BUYER shall provide bonus to the BUILDER as below method:

If the increase of the speed is less than three-tenths (3/10) of one knot more than the guaranteed speed, there shall be no adjustment of the Contract Price.

Thereafter the Contract Price shall be increased by USD_____ for each one-tenths (1/10) of one knot more than the guaranteed speed, but the maximum amount shall not be more than United States Dollars_____ (USD_____).

2. DEADWEIGHT

(1) If the actual deadweight of the VESSEL at design draft determined in accordance with the Specifications is not less than 98% of the guaranteed deadweight (_____ metric ton), there shall be no adjustment of the Contract Price.

(2) The Contract Price shall be decreased by the sum of United States Dollars _____ (USD_____) for each full metric ton of such reduction being less than 98% of the guaranteed deadweight (_____) metric tons.

(3) If the reduction in the VESSEL'S actual deadweight is greater than _____ metric tons below the guaranteed deadweight, the BUYER may, at its option, reject the VESSEL or cancel the Contract in accordance with the provisions of Article XVII of the Contract, or may accept the VESSEL with reduction in the Contract Price up to the maximum amount of United States Dollars_____ (USD_____).

(4) If the increase of actual deadweight of the VESSEL at design draft determined in accordance with the Specifications is less than 102% of the guaranteed deadweight (_____ metric ton), there shall be no adjustment of the Contract Price, while the Contract Price shall be increased by the sum of United States Dollars _____ (USD_____) for each full metric ton of such increase being more than 102% of the guaranteed deadweight (_____) metric tons. But the maximum amount increased shall not be more than United States Dollars_____ (USD_____).

3. HOLD CAPACITY

(1) If the actual hold capacity of the VESSEL is not less than 98% of the guaranteed hold capacity as specified in the Specification, there shall be no adjustment of the Contract Price.

(2) If the actual hold capacity of the VESSEL is less than 98% of the hold capacity as specified in the Specification, then for each full cubic meter thereafter below the hold capacity, the Contract Price shall be reduced by the sum of USD _____ for each full cubic meter as liquidated damages up to a maximum amount United States Dollars _____ (USD_____) (fractions of one percent to be prorated).

(3) If the reduction of the VESSEL'S actual hold capacity is greater than_____ below the

hold capacity as specified in the Specification, the BUYER may reject the VESSEL or cancel the Contract.

(4) If the actual hold capacity of the VESSEL is more than 102% of the hold capacity as specified in the Specification, then for each full cubic meter thereafter above the hold capacity, the Contract Price shall be increased by the sum of United States Dollars _____ (USD_____) for each cubic meter. But the maximum amount increased shall not be more than United States Dollars _____ (USD_____) (proportionally the amount less than 1 cubic meter can be exempted).

4. EXCESSIVE FUEL CONSUMPTION OF THE MAIN ENGINE

(1) If the actual fuel consumption of the Main Engine, as determined on the test bed is equal to or less than five percent (5%) of the guaranteed fuel consumption as specified under the provision of the Contract and the Specifications, there shall be no adjustment of the Contract Price.

(2) However, if the actual fuel consumption as determined by the test bed is greater than five percent (5%) above the guaranteed fuel consumption then, the Contract Price shall be reduced by the sum of United States Dollars_____ (USD) for each whole percentage (1%) increase in fuel consumption in excess of the above said five (5%) (fractions of one percent to be prorated).

(3) If as determined by test bed such actual fuel consumption of the Main Engines is greater than ten percent (10%). i.e._____ gram/bhp/h in excess of the guaranteed fuel consumption, the BUYER may reject the main engine or reject the VESSEL or cancel the Contract or may accept the VESSEL at a reduction in the Contract Price but the maximum reduction shall not be more than United States Dollars_____ (USD_____).

5. DELIVERY

(1) There shall be no adjustment of the Contract Price for the first thirty (30) days of delay in delivery of the VESSEL beyond the Delivery Date as defined in Article XIV hereof ending as of twelve o'clock midnight of the thirtieth (30th) day of delay.

(2) If the delivery of the VESSEL is delayed more than thirty (30) days after the Delivery Date as defined in Article XIV hereof, then, in such event, beginning at twelve o'clock midnight of the thirtieth (30th) day after the date on which delivery is required under the Contract, the Contract Price of the VESSEL shall be reduced by deducting the sum of United States Dollars _____

(USD_____) per day.

Unless the parties hereto agree otherwise, the total reduction in the Contract Price shall be deducted from the fifth installment of the Contract Price and in any event (including the event that the BUYER consents to take the VESSEL at the later delivery date after the expiration of _____days delay of delivery shall not be more than _____days at the above specified rate of reduction, that is United States Dollars _____ (USD_____) being the maximum.

(3) If the delay in the delivery exceeds_____ (_____) days (being the total of permissible and non-permissible Delays) after the Delivery Date as defined in Article XIV, in such event, the BUYER may, at its option, terminate or cancel the Contract in accordance with the provisions of Article XIII. The BUILDER may at any time after the expiration of the aforementioned _____

(_____) days, if the BUYER has not served notice of cancellation pursuant to Article X, notify the BUYER of the date upon which the SELLER estimates the VESSEL will be ready for delivery and demand in writing that the BUYER make an election, in which case the BUYER shall, within thirty (30) days after such demand is received by the BUYER, either notify the SELLER of its decision to cancel the Contract, or consent to take delivery of the VESSEL at an agreed future date, it being understood and agreed by the parties hereto that, if the VESSEL is not delivered by such future date, the BUYER shall have the same right of cancellation upon the same terms, as herein provided.

(4) The delivery of the VESSEL shall not be deemed delayed and the Contract Price shall not be reduced for any period when the Delivery Date of the VESSEL is extended by reason of causes and provisions of Articles XI, XIII. The Contract Price shall not be adjusted or reduced if the delivery of the VESSEL is delayed by reason of permissible delays as defined in Article XV hereof.

(5) If the delivery of the VESSEL shall be made earlier than the Delivery Date as stipulated in

Article XIV, the BUILDER shall notify the BUYER and that such notification shall be given not less than_____ (_____) days prior to the newly planned delivery date. A certain amount of bonus shall be given by the BUYER to the BUILDER as follows:

In the event that the delivery shall be made within fifteen (15) days earlier than the Delivery Date, the Contract Price shall remain unchanged. In the event that the delivery shall be made more than fifteen (15) days earlier than the specified Delivery Date, then a bonus shall be added to the Contract Price at a rate of United States Dollars_____ Only (USD_____) per day for each full day earlier than the fifteenth (15th) day prior to the Delivery Date. The total increase of the Contract Price for the earlier delivery shall be added to the fifth instalment of the Contract Price. While the maximum amount increased shall not be more than United States Dollars_____ Only (USD_____)

If the actual delivery time is after the Delivery Date as specified in Article XIV and before the permissible extended delivery date, the BUILDER shall not be entitled to be given bonus as specified in above paragraph 5 (5).

(6) In the event that the BUILDER is unable to deliver the VESSEL on the newly planned delivery date as declared, the VESSEL can, nevertheless, be delivered by the BUILDER at a date after such declared newly planned date.

In such circumstances, and for the purpose of determining the liquidated damages to the BUYER (according to the provisions of Paragraph 1 (1) of this Article) and the BUYER's right to cancel the Contract (according to the provisions of Paragraph 1 (3) of this Article), the newly planned delivery date declared by the BUILDER shall not be in any way be treated or be taken as having substituted the original Delivery Date as defined in Article XIV. The BUYER's aforesaid right for liquidated damages and to cancel the Contract shall be exercised to the extent as described in Paragraph 4 (1), 4 (2) and/or 4 (3) of Article XIII.

In whatever circumstances, the Delivery Date as defined in Article VII (not the newly planned delivery date as declared by the BUILDER) shall be used to exercise the BUYER's right for liquidated damages and to rescind the Contract and the BUILDER's liability to pay the aforesaid liquidated damages resulting from the delay in delivery of the VESSEL as specified in paragraph 5 (1), 5 (2), and 5 (3).

If the actual delivery time is after the declared newly planned date and before the Delivery Date as specified in Article XIV, the BUILDER shall be entitled to be given bonus as specified in above paragraph 5 (5).

6. MAJOR MATERIALS AND EQUIPMENT

The major materials and equipment referred in this paragraph refer to steels and main propulsion equipment.

The Contract Price of this VESSEL is determined by the market price (basic price) of steels and main propulsion equipment when signing the Contract.

If the price difference between the actual purchase price contracted between the BUILDER and the suppliers is _____ % higher than the basic price, the price difference shall be shared by both parties with the BUILDER undertaking _____ % and the BUYER undertaking _____ %.

7.EXCHANGE RATE

As the construction will last for a long time and the fluctuation of the exchange rate between USD and RMB may cause relevant financial changes of the parties, it is agreed that the exchange rate published by Bank of China on the date when the Contract signed will be deemed as a reference, any price difference due to the fluctuation when paying each installment should be shared by 50% by each party. The maximum of the exchange rate fluctuation shall not exceed 2% of the Contract Price, the part more than 2% should be borne by the BUYER.

8. OTHERS (OPTIONAL CLAUSE)

The purpose of setting aside this clause is to allow the parties to insert special technical requirements for a particular type of vessel and adjustment of the Contract Price arising from the changes (failure to meet or exceeding) in the values of the said special technical requirements. Any adjustment of the Contract Price made as per Paragraph 1, 2, 3, 4, 5 and 6 of this article shall be specified in writing before the payment of the 5th installment.

9. EFFECTIVENESS OF CONTRACT RESCISSION

It is expressly understood and agreed by the parties hereto that in any case as stated above, if the BUYER rescinds or cancel the Contract pursuant to any provision under this Article, the

BUYER shall be entitled to have its rights and compensation as set out in Article XXVII hereof shall not be entitled to any liquidated damage or compensation whether described above or otherwise.

ARTICLE VII TAXES AND DUTIES

1. TAXES

All taxes, if any, including stamp duties, incurred in connection with this Contract in the People's Republic of China shall be borne by the BUILDER. The BUILDER shall bear all taxes and/or duties imposed upon the equipment and facilities procured by the BUILDER in the People's Republic of China for the construction of the VESSEL.

2. DUTIES

The BUILDER shall indemnify the BUYER for, and hold it harmless against, any duties imposed in the People's Republic of China upon material and equipment which under the terms of the Contract and/or the Specifications will, or may be, supplied by the BUYER from the abroad for installation in the VESSEL as well as any duties imposed in the People's Republic of China upon running stores, provisions and supplies furnished by the BUYER from abroad to be stocked on board the VESSEL and also the duties or taxed if any, to be imposed upon the export of the VESSEL as a whole or upon any of its parts or equipment.

Any tax of duty other than those described hereinabove, if any, shall be borne by the BUYER.

SECTION 3 PRODUCTION

ARTICLE VIII APPROVAL AND ACCEPTANCE OF PLANS AND DRAWINGS

1. APPROVAL OF PLANS AND DRAWINGS

The BUILDER shall send to the BUYER (or its representatives) three (3) copies of plans drawings and technical documents for the BUYER's approval as required in the Specification, Within fourteen (14) running days upon receipt by the BUYER or twenty-one (21) running days upon dispatch by the BUILDER, whichever is earlier, the BUYER shall return to the BUILDER one copy of such documentation with the BUYER's approval or approval with remarks. In the event that the BUYER fails to return such documentation to the BUILDER within the above-designated period of time the said documentation shall be deemed to have been completely approved by the BUYER, unless an extension is requested in writing by the BUYER with the written consent of the BUILDER.

If the BUYER returns such documentation with remarks to the BUILDER within the above – designated period of time and such remarks are of a nature or substance constitute necessary modifications, the BUILDER shall commence or continue construction of the VESSEL in accordance with the modified drawings and technical documents. In the event that the BUYER's remarks are unclear or unspecified, the BUILDER shall have the right to make construction in its own interpretation.

A Makers List is attached with the Specifications, which is a list of the suppliers recommended by the BUILDER and to be known by the BUYER. Within ten (10) running days upon receipt by the BUYER or fifteen (15) running days upon notification by the BUILDER, whichever is shorter, the BUYER shall give a prior written request for alternative suppliers with sufficient reasons.

The BUILDER may, at its sole discretion, choose any of the suppliers who are approved by the BUYER. In the event that the BUYER prefer to a supplier other than the one preferred by the BUILDER (whether recommended by the BUILDER or not) and such preference affects the cost, the BUILDER shall notify the BUIDER of the cost changed. Within ten (10) running days upon receipt by the BUYER or fifteen (15) running days upon notification by the BUILDER, whichever is shorter, the BUYER shall have the right to notify the BUILDER of its insistence on the decision. In such event, the cost to be adjusted shall be added into or deducted from the CONTRACT PRICE. Should the BUYER take no measure or give up its decision, the BUILDER shall, at its sole discretion and under its guarantee obligation, choose any one of the recommended suppliers.

It is agreed by the parties that all communications relating to the VESSEL with the BUILDER's suppliers shall be carried out by the BUILDER. The BUYER shall use its best efforts to approve

the documentation related soonest within the above-designated time Such approval shall not diminish the BUILDR's responsibility for the VESSEL.

A prior written consent by the BUYER shall be obtained if the BUILDER turns to other makers not included in the Maker List.

2. ACCEPTANCE OF PLANS AND DRAWINGS

The parties shall make a list of all the plans and drawings, which are to be sent to the BUYER for approval (hereinafter called "the LIST") within_____ running days after signing of the Contract. Before arrival of the Supervisor at the BUILDER's Shipyard, the plans and the drawings specified in the LIST shall be sent to the BUYER and the BUYER shall, within _____ ( ) days after receipt thereof (excluding mailing time), return such plans and drawings submitted by the BUILDER with approval or remarks.

Concurrently with the arrival of the Supervisor at the BUILDER's shipyard, the BUYER shall notify the BUILDER in writing, stating the authority which the said Supervisor shall have on behalf of the BUYER, to approve or disapprove those of the plans and drawings specified in the LIST which have not yet been sent to the BUYER. The Supervisor shall, within_____ ( ) days after receipt thereof, return those plans and drawings with approval or remarks.

Unless notification is given to the BUILDER by the Supervisor or the BUYER of approval or disapproval of any plans and drawings within the above-designated period of time for each case, the said plans and drawings shall be deemed to have been automatically approved.

The plans and drawings approved by the BUYER Supervisor shall be final, and any alteration thereof shall be regarded as modification specified in Article XII of the Contract.

3. NOTES

(1) The drawings and the Specifications have been signed by the parties on or before the effective date of the Contract and shall form an integral part of the Contract and have the same effect as the Contract.

(2) In the event of any inconsistency or conflict between the provisions of the Contract and the Drawings and the Specifications, the provisions of the Contract shall prevail, without prejudice to the full effect of the drawings and the Specifications under other circumstances. In the event of any inconsistency or conflict between the drawings and the Specifications, the Specifications shall prevail. Any work required by the Specifications but not shown in the drawings, or shown in the drawings but not required by the Specifications, shall be accomplished by the BUILDER as if is a part of the Contract. Once finding any inconsistency or conflict between the provisions of the Contract and the drawings and the Specifications or between the drawings and the Specifications, one party shall promptly give the other party a written notice.

(3) In the event of any modification or change on the Specifications agreed by the parties after the effective date of the Contract, which may lead to the inconsistency or conflict between the Specifications and the drawings, such modification or change shall prevail.

ARTICLE IX SUPERVISION AND INSPECTION

1. APPOINTMENT OF THE BUYER'S SUPERVISOR

The BUYER shall send in good time to and maintain at the BUILDER's Shipyard, at the BUYER's own cost and expense, one or more representative (s) (hereinafter called the "Supervisor"), who shall be duly appointed in writing by the BUYER to supervise and inspect the construction of the VESSEL, her engines and accessories. The BUILDER shall be liable for obtaining of the necessary visa for the Supervisor to enter China or the BUILDER's Shipyard. The Supervisor shall ensure his observance of the rules, regulations and laws of the People's Republic of China. The BUYER undertakes to give the SELLER an adequate notice for the application of the visa.

2. SUPERVISION AND INSPECTION BY SUPERVISOR

The necessary inspection of the VESSEL, her machinery, equipment and out fittings shall be carried out by the Classification Society and inspection team of the BUYER's throughout the entire period of construction in order to ensure that the construction of the VESSEL is duly performed in accordance with the Contract and the Specifications.

The Supervisor shall have, at all time until delivery of the VESSEL, the right to attend tests according to the mutually agreed test list and inspect the VESSEL, her engines, accessories and materials at the BUILDER's Shipyard, its subcontractors or any other place where work is done or materials stored in connection with the VESSEL. In the event that the Supervisor discovers that

any construction or material or workmanship does not or will not conform to the requirements of the Contract and the Specifications, the Supervisor shall promptly give the BUILDER a notice in writing as to such non-conformity, upon receipt of which the BUILDER shall correct such nonconformity if the BUILDER agrees with the Supervisor. Should the BUILDER disagree to the Supervisor's comments, the BUILDER shall provide with reasons and explanations or discuss with the Supervisor for solution. Should there be no agreement reached, such dispute shall be submitted to Classification Society for solution, such solution made by the Classification Society shall be final binding to both parties. In such event, the BUILDER may proceed with construction. The BUYER undertakes and ensures the BUILDER that the Supervisor shall carry and usual shipbuilding practice and in a way as to minimize any increase in building costs and delays in the construction of the VESSEL.

The BUILDER shall provide, free of charge, the Supervisor with office accommodation, and other necessary facilities at or near the BUILDER's Shipyard. At all times, during the construction of the VESSEL until delivery thereof, the Supervisor shall be given unimpeded access to the VESSEL, her engines and accessories, and anywhere else where the work on, or the materials are being processed or stored, in connection with the construction of the VESSEL, including the BUILDER's yards, workshops, warehouses and its subcontractor's premises for working or storing materials in connection with the VESSEL's construction. The travel expenses to the subcontractor's premises outside of the city shall be at the BUYER's account. The transportation for the Supervisor in the city shall be offered by the BUILDER.

3. LIABILITY OF THE BUILDER

The Supervisor engaged by the BUYER under the Contract shall at all times be deemed to be the employee of the BUYER. The BUILDER shall be under no liability to the BUYER, or to the Supervisor or to the BUYER's employees or agents for personal injuries (including death), which incur on the VESSEL or/and within the premises of the BUILDER or its subcontractors while they or one of them is engaging in the construction of the VESSEL, unless such personal injuries (including death) were caused by gross negligence of the BUILDER, or of any of the BUILDRS's employees or agents or subcontractors. Nor shall the BUILDER be under any liability for damage, loss or destruction on the properties in China of the Supervisor, the BUYER's employees or agents, unless such damage, loss or destruction was under gross negligence of the BUILDER, or of any of the BUILDER's employees or agents or subcontractros.

4. SALARIES AND EXPENSES

All salaries and daily expenses of the Supervisor or any other employees appointed by the BUYER shall be for the BUYER's account in accordance with this article.

5. REPORT OF PROGRESS

The BUYER has the right to request the BUILDER for a monthly report of the construction progress during the construction of the VESSEL.

6. REPLACEMENT OF SUPERVISOR

The BUILDER has the right to request the BUYER in writing to replace the Supervisor who is deemed to be unsuitable and unsatisfactory for inspection on the progress of the construction of the VESSEL. If necessary, the BUYER may send its representative to the BUILDER's yard for investigation. Once such request of the BUILDER is justified by the BUYER, the BUYER shall make the replacement as soon as practicable.

ARTICLE XSUBCONTRACTING

The BUILDER may, at its sole discretion and responsibility, subcontract any portion of the construction work of the VESSEL to qualified and experienced subcontractors as set out in the Specifications of the Maker's List, but delivery and final assembly into the VESSEL of any such work subcontracted shall be at the BUILDER's Shipyard. The BUILDER shall remain fully responsible for due performance of such subcontracted work...

ARTCLE XI BUYER'S SUPPLIES

1. ARTICLE X BUYER'S LIABILITY

(1) The BUYER shall, at its own risk, cost and expenses, supply to the BUILDER the items as specified in the Specifications (hereinafter called the "BUYER'S SUPPLIES") in appropriate time

during the construction of the VESSEL. Such items shall be delivered at a warehouse or other storage facilities at the Shipyard as set out in the Specifications in a proper condition ready for installation on the VESSEL.

(2) To assist installation, the BUYER shall provide the BUILDER with the necessary documentation including specifications, drawings, instruction books, manuals, test reports and others required to comply with all applicable rules and regulations. If so requested by the BUILDER, the BUYER shall, at no cost to the BUILDER, arrange for the representatives of the manufacturers of the BUYER'S SUPPLIES to assist the BUILDER in installation or to carry out the installation of the BUYER'S SUPPLIES by themselves, or to carry out commission at the Shipyard.

(3) The BUILDER may reject any and all of the BUYER'S SUPPLIES if found to be unsuitable or in improper condition for installation. But if required by the BUYER, the BUILDER may make repair of adjustment of the BUYER'S SUPPLIES, which shall neither affect any other rights of the BUILDER under the Contract, nor shall constitute any bearing by the BUILDER of the consequences raised thereafter. In such event, the BUYER shall pay to the BUILDER all costs arising from the repair or adjustment and the delivery of the VESSEL shall automatically be extended for a period of time taken for such repair or adjustment.

(4) Should the BUYER fail to deliver to the BUILDER the BUYER'S SUPPLIES within the specified time, the delivery of the VESSEL shall automatically be extended for a period of such delay, which the BUYER shall be liable for. In such event, the BUYER shall pay to the BUILDER all losses sustained by the BUILDER due to such delay and such payment shall be made upon delivery of the VESSEL.

If delay in delivery of the BUYER'S SUPPLIES exceeds thirty (30) days, the BUILDER shall have the right to proceed with the construction of the VESSEL without the installation of such delayed items. The BUYER shall accept and take delivery of the VESSEL so constructed, without prejudice to any other rights of the BUILDER.

2. BUILDER's LIABILITY

The BUILDER shall store and properly handle the BUYER'S SUPPLIES after delivery to the Shipyard and install them on the VESSEL. Unless otherwise provided in the Contract, the BUILDER shall not be responsible for the quality and performance of the BUYER's SUPPLIES.

ATRICLE XII MODIFICATIONS, CHANGES AND EXTRAS

1. HOW EFFECTED

The Specification and/or drawings to which the VESSEL is built can be modified or changed at any time provided that the parties reach agreement and if in the BUILDER's reasonable judgement, such modifications or changes or accumulated modifications will not adversely affect the BUILDER's other commitments, and the BUYER shall agree as below provided to the adjustment of the Contract Price, extension of the Delivery Time and other terms of the Contract (if any). Subject to above conditions, the BUILDER shall use the best efforts to accommodate the BUYER's reasonable request so that the said changes and/or modifications shall be made at reasonable costs and within the period of time as short as possible.

Such agreements on the modifications or changes shall refer to an agreement on the increase or decrease, if any, in the Contract Price of the VESSEL and an agreement as to any extension or reduction in the time for delivery, and furthermore to provide an additional guarantee to the BUILDER to the BUILDER's satisfaction, or an agreement as to any other alternations in the Contract or an agreement on the modification of the Specification arising from the changes. The agreements as to the changes and modifications to the Specifications pursuant to the foregoing shall be effective by exchanges of such documents or other written documents and shall constitute an amendment to Specification and shall be deemed to be a part of the Contract and Specification. Upon agreements as to the changes and/or modifications to the Specifications have been reached, the BUILDER shall alter the construction of the VESSEL in accordance therewith, including any additions to, or reductions from the work to be performed in connection with such construction. If the parties fail to agree on the adjustment to the Contract Price, or extension of the delivery time or providing additional guarantee to the BUILDER or modifications to the Contract, the BUILDER is not obliged to undertake any request from the BUYER for modifications.

2. CHANGES IN RULES AND REGULATIONS

(1) If, after the date of signing the Contract, any requirements as to the rules and regulations as specified in the Contract and the Specifications to which the construction of the VESSEL is required to conform, are modified or changed by the Classification Society or the other regulatory authorities to make such modifications or changes, the BUYER or the BUILDER, upon receipt of the notice thereof, shall transmit such information in full to each other in writing, whereupon within ( ) days after receipt of the said notice by the BUYER form the BUILDER or vice versa, the BUYER shall instruct the BUILDER in writing as to the modifications or changes, if any, to be made in the VESSEL which the BUYER, in its sole discretion, shall decide. The SELLER shall promptly comply with such modifications or changes, if any in the construction of the VESSEL, provided that the BUYER shall first agree:

(a) to any increase or decrease in the Contract Price of the VESSEL occasioned by the cost for such modifications and changes; and/or

(b) to any extension in the delivery time of the VESSEL due to such modifications and changes; and/or

(c) to any increase or decrease in the guaranteed deadweight and speed of the VESSEL, if modifications and changes results in increased or reduced deadweight and speed; and/or

(d) to any other modifications in the terms of the Contract or of Specifications or both

(e) to the additional guarantee provided by the BUYER to the BUILDER's satisfaction due to the increase of the Contract Price.

Agreement as to such modifications or changes under this Paragraph shall be made in the same manner as provided above for modifications and/or changes of the Specifications and/or Plans.

(2) If, due to whatever reasons, the parties shall fail to agree on the adjustment of the Contract Price or extension of the delivery time or increase or decrease of the guaranteed speed, deadweight, or providing additional security to the BUILDER or any modifications of the terms of the Contract, the BUILDER shall be entitled to proceed with the construction of the VESSEL in accordance with the terms of the Contract and Specifications without making any such modifications or changes and the BUYER shall abide by the Contract and the Specifications without such modifications or changes.

(3) Even if the BUILDER and the BUYER fail to agree on the adjustment of the Contract Price or extension of the delivery time due to the modifications to meet the compulsory rules and regulations, the BUILDER shall proceed with such modifications as required by the said rules and regulations while the BUILDER is entitled to reserve the right by stating in writing the adjustment of the Contract Price or extension of the delivery time. Such dispute shall be settled as per Article XXVI of the Contract.

3. SUBSTITUTION OF MATERIALS AND/OR EQUIPMENT

In the event that any of the materials and/or equipment required by the Specifications and the Contract for the construction of the VESSEL cannot be procured in time to meet the delivery time of the VESSEL, the BUILDER may, with providing adequate evidence and subject to the approval by the BUYER in writing, supply other materials and/or equipment of the equivalent quality, and meeting the requirements of the Classification Society and of the rules and the regulations with which the construction of the VESSEL must comply.

ARTICLE XIII SEA TRIALS

1. NOTICE

The BUILDER shall, after obtaining the certificate for sea trails, give the BUYER and the supervisors at least thirty (30) calendar days prior notice of the estimated date and seven (7) definite days prior notice in writing of the time and place of the sea trial to be carried out as per the specification and the BUYER and the supervisors shall promptly acknowledge the receipt of such notice. The representative of the BUYER and/or the supervisor shall be present to witness such trials and approve the performance thereof during the sea trials. Failure of the BUYER's representative to be present in time at the trials after such notice to the BUYER, the Delivery Date of the VESSEL shall be extended by the period of delay caused by such failure of the BUYER's representative delays to attend such trails. If the absence of the BUYER's representative causes the delay in the sea trials more than seven (7) days, the BUYER shall be deemed to have waived the right to be present at the trials, and the BUILDER may conduct the

sea trials without the BUYER's representative being onboard, and in such circumstances, the BUYER shall be obliged to accept the VESSEL on the basis of a certificate jointly signed by the BUILDER and the Classification alter the sea trails and minor corrections and remedies as mentioned in this Article certifying that the VESSEL conforms to the requirements of the Contract and the Specification with satisfaction in all respects. The BUILDER shall make all necessary arrangements for the visa of the BUYER's representative, otherwise the sea trials shall be postponed until the BUYER's representative arrives in the shipyard, and any resulting delay in delivery of the VESSEL shall not be deemed as a Permissible Delay. But in case the nationality and the personal particulars of the BUYER's representative are not acceptable to the BUILDER as per current regulation and/or law of the People's Republic of China, the BUYER shall immediately replace this representative or other representative as per the BUILDER's request. The parties understand that the weather conditions of the area where the sea trials are to be carried out is momentarily changeable without advance warning, therefore if the sea trials are interrupted or prevented by the sudden unfavorable weather conditions, the parties shall agree to stop the sea trials and postpone the sea trials until the first favorable day thereafter when weather conditions permit. Unless otherwise the parties agree in writing that the BUYER accepts the VESSEL on the basis of the results achieved in the sea trials prior to sudden change in the weather conditions. The resulting delay due to the bad weather conditions shall be deemed as Permissible Delay as described by the Contract.

2. CONDUCT OF THE SEA TRIALS

(a) All expenses in connection with the sea trials be for the BUILDER's costs and expenses. The BUILDER shall arrange necessary crews onboard to meet safety requirements during sea trials. The sea trials shall be conducted as per the requirements of the Specification and comply with the requirements of the Specification.

The course of the sea trials shall be determined by the BUILDER and the sea trials shall be conducted in the area equipped with speed measuring facilities.

(b) To meet the conditions for sea trial as stipulated in the Specification, the BUILDER shall furnish water and fuel oil with exception of lubricating oil and hydraulic oil which shall be supplied by the BUYER. The said provision by the parties shall comply with the requirements of the applicable engine Specification. All the costs of the water, bunkers, lubricating oil, hydraulic oil and grease consumed during the sea trials shall be for the BUILDER's account.

3. SEA TRIALS AT LOAD DRAFT

In addition to the provisions as required by this Article, the BUILDER shall for the BUILDER's account provide fresh water and the stores for the sea trials to have the VESSEL achieve the ballast conditions (with fresh water, sea water of other stores as may be required) as specified by the Specifications for reaching the load draft.

4. METHOD OF ACCEPTANCE OR REJECTION

(a) The BUYER or the BUYER's representative, within six (6) working days after receiving the notice from the BUILDER of the completion of the sea trials, shall notify the BUILER in writing of its acceptance for delivery or rejection of the VESSEL together with reasons therefore.

(b) However, should the results of the sea trials demonstrate that the VESSEL or any part or equipment therefore does not conform to the requirements of the Specification, the BUILDER shall together with the BUYER's representative inspect the cause of such non-conformity and the BUILDER shall take all necessary steps to rectify such non-conformity. If necessary the BUILDER shall for its own cost and expense carry out further sea trial. If the BUILDER notifies the BUYER of the completion of the deficiencies and the new sea trial, the BUYER, within six (6) working days after receiving the said notice from the BUILDER, shall notify the BUILDER in writing of its acceptance for delivery or rejection of the VESSEL together with reasons therefor.

(c) If the BUYER fails to notify the BUILDER in writing of its acceptance or rejection of the VESSEL together with reasons therefor with reasons within six (6) working days as stipulated in above item (a) and (b), the BUYER shall be deemed to have accepted the VESSEL.

(d) If the parties disputes any results of the sea trials and tests, the disputes shall be resolved in accordance with Article XXVI for arbitration.

(e) The BUYER shall not reject to take delivery of the VESSEL due to its remarks made after the sea trials and/or further sea trial. While the BUILDER shall remove the remarks (if such remarks are acceptable to the BUILDER) before effecting delivery of the VESSEL to the BUYER under the Contract.

5. DISPOSITION LF SURPLUS CONSUMABLE STORES

Upon taking delivery of the VESSEL, the BUYER shall reimburse the BUILDER in the manner as stipulated in 3 (5) and 4 (5) under Article V at current price same as the one in the delivery port for any quantities of the bunkers, fresh water and other consumable stores remaining onboard after sea trial.

The BUILDER shall reimburse the BUYER in the manner as stipulated in 3 (5) and 4 (5) under Article V for any quantities of lubricating oil and hydraulic oil actually consumed during sea trials at same price as the BUYER purchased.

6. EFFECT OF THE ACCEPTANCE

The BUYER's written notification of acceptance of the VESSEL delivered to the BUILDER as above stipulated, shall be final and binding provided the VESSEL conforms to the Specifications, and the BUYER is not entitled to refuse the BUILDER's request to deliver the VESSEL provided that the BUILDER complies with all other conditions for delivery as above set forth.

SECTION 4 DELIVERY

ARTICLE XIV DELIVERY AND DELIVERY DOCUMENTS

1. TIME AND PLACE

Subject to Article XIII after the sea trials (or possible new sea trials) and the acceptance by the BUYER, the VESSEL shall be delivered on or before _____ safely afloat by the BUILDER to the BUYER at the BUILDER's shipyard in accordance with the Specifications and with all Classification and Statutory Certificates provided that. In the even of delays in the construction of the VESSEL or any performance required under the Contract due to causes which under the terms of the Contract permit extension of the delivery time, the aforementioned delivery time of the VESSEL shall be extended accordingly.

Abovementioned date or such later date to which delivery is extended pursuant to the terms of the Contract is hereinafter called the "Delivery Date".

2. WHEN AND HOW EFFECT

Provided that the BUYER and the BUILDER have fulfilled all of their respective obligations as stipulated in the Contract, delivery of the VESSEL shall be effected forthwith by the concurrent delivery by each of the parties hereto, one to the other, of the Protocol of Delivery and Acceptance, acknowledging delivery of the VESSEL by the BUILDER and acceptance thereof by the BUYER, and the said Protocol of Delivery and Acceptance shall be prepared in quadruplicate and executed by each of the parties hereto after signing.

3. DOCUMENTS TO BE DELIVERED TO THE BUYER

Upon delivery and acceptance of the VESSEL by the BUYER, the BUILDER shall provide to the BUYER the following documents together with the aforementioned Protocol of Delivery and Acceptance:

(1) Protocol of Trials made by the BUILDER pursuant to the Specifications.

(2) Protocol of Inventory and Equipment of the VESSEL including spare parts and the like, all as specified in the Specifications, made by the BUILDER.

(3) Protocol of Surplus Consumable Stores made by the BUILDER.

(4) Finished Drawings and Plans pertaining to the VESSEL as stipulated in the Specifications, made by the BUILDER.

(5) Protocol of Deadweight and Inclining Experiment, made by the BUILDER.

(6) All below certificates required to be furnished upon delivery of the VESSEL pursuant to the Contract and as provided in the Specifications.

..

Certificates shall be issued by relevant Authorities or Classification Society. The VESSEL shall comply with the above rules and regulations which are in force at the time of signing the Contract. All the certificates shall be delivered in one (1) original to the VESSEL and two (2) copies to the BUYER.

If the complete certificate or certificates are unable to be issued at the time of delivery by the Classification Society or any third party other than the BUILDER, then the BUYER shall accept the interim certificate or certificates as issued by the Classification Society or the third party other than the BUILDER, provided that the full final certificates shall be furnished by the BUILDER before the expiry of the interim certificate or certificates.

(7) Declaration of Warranty issued by the BUILDER that the VESSEL is delivered to the BUYER free and clear of any liens, charges, claims, mortgages, or other encumbrances upon the BUYES's title thereto, and in particular, that the VESSEL is absolutely free of all burdens in the nature If imposts, duties, taxes or charges imposed by the province or country of the port of delivery, as well as of all liabilities of the BUILDER to its sub-contractors, employees and crews and/or all liabilities arising from the operation of the VESSEL in trial run or trial runs, or otherwise, prior to delivery.
(8) Commercial Invoice made by the BUILDER.
(9) Bill of Sale made by the BUILDER.

4. OUTSTANDING ITEMS WHEN DELIVERY OF THE VESSEL
If there are few outstanding items which don't affect the safety and navigation of the VESSEL when delivery of the VESSEL, the parties shall list the quantity of the outstanding items and date to complete these items. All outstanding items shall be completed within four (4) days after delivery of the VESSEL, which shall be recorded in the delivery documents. Such outstanding items shall not affect the delivery of the VESSEL and the BUYER shall take delivery of the VESSEL.

ARTICLE XV DELAYS EXTENSION OF TIME FOR DELIVERY(FORCE MAJEURE)

1.CAUSE OF DELAY
If, at any time before actual delivery, either the construction of the VESSEL, or any performance required hereunder as a prerequisite of delivery of the VESSEL, is delayed due to war. blockade, revolution, insurrection, mobilization, civil commotions, riots, strikes, sabotage, lock-outs, epidemics, epidemics, abnormal weather conditions, typhoon, or other causes beyond the control of the BUILDER or of its sub-contractors for instance the long restriction of electric current from an outside source and the defects of casting and forging components, as the case may be. And other or by force majeure of any description, whether of the nature indicated by the forgoing or not, or by destruction of the BUILDER or works of the BUILDER or its sub-contractors, or of the VESSEL or any part thereof ,by fire, flood, or other causes beyond the control of the SELLER or its sub-con-tractors as the case may be, or due to the bankruptcy of the equipment and/or material supplier or suppliers, then, in the event of delay due to the happening of any of the aforementioned contingencies, the Seller shall not be liable for such delay and the time for delivery of the VESSEL under this Contract shall be extended without any reduction in the Contract Price for a period of time which shall not exceed the total accumulated time of all such delays, subject nevertheless to the BUYER,s right of cancellation and subject however to all relevant provisions of this Contract which authorize and permit extension of the time of delivery of the VESSEL.

2.NOTICE OF DELAY
Within seven (7)days from the date of commencement of any delay on account of which the SELLER claims that it is entitled under this Contract to an extension of the time for delivery of the VESSEL, the SELLER shall advise the BUYER by telex confirmed in writing, of the date such delay commenced, and the reasons therefor.
Likewise within seven(7)days after such delay ends, the SELLER shall advise the BUYER in writing or by telex confirmed in writing of the date such delay ended, and also shall specify the maximum period of the time by which the date for delivery of the VESSEL is extended by reason of such delay. Failure of the BUYER to acknowledge of SELLER,s notification of any claim for extension of the Delivery Date within thirty (30)days after receipt by the BUYER of such notification, shall be deemed to be a waiver by the BUYER of its right to object to such extension,.
3.RIGHT TO CANCEL FOR EXCESSIVE DELAY
If the total accumulated time of all permissible delays and non-permissible delays aggregate to _____ days or more, excluding delays due to arbitration as provided for in Article XVI here of due to default in performance by the BUYER, of due to delays in delivery of the BUYER,s supplied items, and excluding delays due to cause which, under Article V, VI, XI, and XII hereof,

permit extension or postponement of the time for delivery of the VESSEL, then in such event, the BUYER may in accordance with the provisions set out herein cancel this Contract by serving upon the SELLER telexed notice of cancellation which shall be confirmed in writing and the provisions of Article X of this Contract shall apply. The SELLER may, at any time, after the accumulated time of the aforementioned delays justifying cancellation by the BUYER as above provided for, demand in writing that the BUYER shall make an election, in which case the BUYER shall, within thirty(30)days after such demand is received by the BUYER either notify the SELLER of its. Intention to cancel, or consent to an extension of the time of delivery to an agreed future date, it being understood and agreed by the parties hereto that if any further delay occurs on account of causes justifying cancellation as specified in this Contract, the BUYER shall have the same right of cancellation upon the same terms as hereinabove provided.

4.DEFINITON OF PERMISSIBLE DELAY

Delays on account of such causes as provided for in Paragraph 1 of this Article, but excluding any other extensions of a nature which under the terms of this Contract permit postponement of the Delivery Date, shall be understood to be (and are herein referred to as)permissible delays, and are to be distinguished from non-permissible delays on account of which the Contract Price of the VESSEL is subject to adjustment provided for in Article III hereof.

ARTICLE XVI TITLE AND RISK

Title to and risk of the VESSEL shall rest with the BUILDER before delivery and pass to the BUYER immediately upon delivery and acceptance thereof.

At the time of delivery, the VESSEL shall be free of all liens, mortgages, claims, charges, and other encumbrances.

ARTICLE XVII POSSESSION AND REMOVAL OF VESSEL

1. THE POSSESSION OF THE VESSEL

The BUYER shall take physical possession of the VESSEL immediately upon delivery and acceptance thereof.

2. THE REMOVAL OF THE VESSEL

The BUYER shall remove the VESSEL from the port of the BUILDER or delivery place within five (5) calendar days after delivery and acceptance as above. If the BUYER does not remove the VESSEL within the aforesaid five (5) calendar days, in such event, the BUYER shall pay to the BUILDER the reasonable mooring charge of the VESSEL and the BUILDER is entitled to remove the VESSEL at any time thereafter from the delivery place to another safe premise with prior notice to the BUYER.

ARTICLE XVIII VESSEL REGISTRATION

The BUYER shall register the VESSEL at its own cost and expense in accordance with (here to fill in the name of the country where the VESSEL is to be registered) law after delivery and acceptance.

ARTICLE XIX BUILDER'S GURANTEE OF QUALITY

1. GURANTEE OF MATERIAL AND WORKMANSHIP

Within a period of twelve (12) months following the Vessel delivery to the BUYER, the BUILDER shall guarantee the Vessel, her hull and machinery and all parts and equipments thereof that are manufactured or furnished or supplied by the BUILDER and/or its sub-contractors under the Contract including material, equipment (however excluding any parts for the Vessel which have been supplied by or on behalf of the BUYER) against all defects which are due to defective materials, and/or poor workmanship.

2. NOTICE OF DEFECTS

The BUYER shall give the notice to the BUILDER in writing as promptly as possible, after the discovery of any defect or deviation for which a claim may be made under this guarantee. The BUYER's written notice shall describe the nature of the defect and the extent of the damage caused thereby. The BUILDER shall have no obligation under this guarantee for any defects

discovered prior to the expiry date of the guarantee period, unless such notice is received by the BUILDER not later than thirty (30) days after the expiry date. The written notice of defects received within thirty (30) days after the expiry date of guarantee period shall explain the nature of such defect and extent of damage, so that the forthcoming claim will be sufficient compliance with the requirements as to time.

3. REMEDY OF DEFECTS

The BUILDER shall remedy any defects against which the Vessel or any parts of the equipment thereof is guaranteed under this Article by making all necessary repairs and/replacement. Such repairs and/or replacement shall be made at the BUILDER's cost and expense.

However, if it is impractical to make the repair by the BUILDER, as if the BUILDER's supply of replacement parts, and materials can not be accomplished without impairing or delaying the operation or working of the Vessel, then in such event that the BUYER makes the necessary repairs or replacements elsewhere at the discretion of the BUYER, the BUYER shall first and in all events, will, as soon as possible, give the BUILDER the notice in writing or orally of the time and place such repairs will be made. Without impairing or delaying the operation or working of the Vessel, the BUILDER shall have the right to inspect through its own representative or that of Classification Society the nature and extent of the Guarantee Defects to be replaced or repaired claimed by the BUYER. The BUILDER shall, in such case, promptly advise the BUYER in writing, after such examination has been completed, of its acceptance or rejection of such Guarantee Defects as ones that covered by the guarantee. In most cases, the Guarantee Engineer, as hereinafter provided for the Vessel, will act for and on behalf of the BUILDER.

In any circumstances as set out below, the BUILDER shall immediately pay to the BUYER in the currency of United States Dollars by telegraphic transfer the actual costs for such repairs or replacements including transportation costs, or at the average lever for making similar repairs or replacements including transportation costs as quoted by the leading shipyards, whichever is lower:

(1) Upon the BUILDER's acceptance of the defects as justifying remedy under this Article, or

(2) If the BUILDER neither accepts nor rejects the notice of defects as above provided, nor refer to the arbitration within thirty (30) days after the receipt of the BUYER's notice of defects.

Any dispute shall be referred to arbitration in accordance with the provisions of Article XXVI hereof.

4. EXTENT OF THE BUILDER'S LIABILITY

The BUILDER shall have no obligation and/or liabilities with respect to any defects discovered after the expiration of the Guarantee Period specified as above.

The BUILDER shall be liable to the BUYER for defects and damages caused by any of the defects specified in Paragraph 1 of this Article provided that such liability of the BUILDER shall be limited to the defects discovered within the Guarantee Period specified in Paragraph 1. The BUILDER shall not be obligated to repair, or be liable for, damages to the Vessel, or to any part of the equipment thereof, due to ordinary wear and tear or caused by the defects other than those specified in Paragraph 1 as above, nor shall there be any BUILDER's liability hereunder for defects in the Vessel, or any part of the equipment thereof, caused by fire or accidents at sea or elsewhere, or management mistake, accidents, negligence, or willful neglect, on the part of the BUYER, its employees or agents including the Vessel's officers, crew and passengers, or any persons on or doing work on the Vessel other than the BUILDER, its employees, agents or sub-contractors. Likewise, the BUILDER shall not be liable for defects in the Vessel, or the equipment or any part thereof, due to repairs or replacement which made by those than the BUILDER and/or their sub-contractors.

Upon the delivery of the Vessel to the BUYER, in accordance with the terms of the Contract, the BUILDER shall thereby and thereupon be released of all responsibility and liability whatsoever and howsoever arising under or by virtue of the Contract (save in respect of those obligations to the BUYER expressly provided for in this Article IX), including but not limit to any responsibility or liability for defective workmanship, materials, or equipment, design or in respect of any other defects whatsoever and any loss or damage resulting from any act, omission or default of the BUILDER. The BUILDER shall, in any circumstances, be liable for any consequential loss or special loss, or expense arising from any cause whatsoever including not limit to, loss of time, profit or earning or demurrage directly from any commitments of the BUYER in connection with the Vessel.

The Guarantee provided in this Article and the obligations and the liabilities of the BUILDER hereunder are exclusive and in lieu of and the BUYER hereby waives all other remedies, warranties, guarantees or liabilities, express or implied, arising by Law or otherwise (including but not limit to any obligations of the BUILDER with respect to fitness, merchantability and consequential damage) or whether or not occasioned by the BUILDER's negligence, The Guarantee shall not be extended, altered or varied except by a written instrument signed by the duly authorized representatives of the BUILDER, and the BUYER.

ARTICLE XX GUARANTEE PERIOD AND GUARANTEE ENGINEER

1. GUARANTEE PERIOD

The SELLER shall guarantee the VESSEL for a period of twelve (12) months from the month of delivery to the last day of the twelfth month.

2. GUARANTEE ENGINEER

The BUILDER shall appoint one or two Guarantee Engineer (s) to serve the VESSEL as the BUILDER's representative (s) for a period of three (3) months from the delivery of the VESSEL. The BUYER, and his employees, shall give such Guarantee Engineer (s) full co-operation in carrying out his/their duties as the representative (s) of the SELLER on board the VESSEL. The BUYER shall accord the Guarantee Engineer (s) the treatment comparable to the VESSEL's Chief Engineer, and shall provide him with accommodation and subsistence at no cost to the SELLER and/or the Guarantee Engineer (s).

The BUYER shall pay to the Guarantee Engineer (s) the sum of United States Dollars_____ per month per person to cover his/their miscellaneous expenses including wages and also the BUYER shall pay the expense of repatriation to the location of the BUILDER by air upon termination of his/their service, the expense of his/their communications with the BUILDER when made in performance of his/their duties as the Guarantee Engineer (s) and the expenses, if any, of his/their medical and hospital care. The BUYER, its successor (s) and/or assign (s), shall be liable to and indemnify the SELLER and/or the Guarantee Engineer (s) and /or the SELLER for personal injuries, including death and damages to, or loss or destruction of property of the Guarantee Engineer (s), if such death, injuries, damages, loss and/or destruction were caused by gross negligence or willful misconduct of the BUYER and/or, its successor (s) and/or assign (s) or its employees and/or agents.

Pertaining to the detailed particulars of this Paragraph, a written agreement shall be made according to this effect between the parties hereto upon delivery of the VESSEL...

SECTION 5 LEGAL

ARTICL XXI LAW APPLICABLE

The parties hereto agree that the Contract should be governed by and interpreted in accordance with the Laws of People's Republic of China or the laws of other state agreed by the two parties.

ARTICLE XXII BUYER'S DEFAULT

1. DEFINITION OF DEFAULT

The BUYER shall be deemed in default of its obligation under the Contract if any of the following events occurs:

(1) The BUYER fails to pay the Second or Third or Fourth installment to the BUILDER when any such installment becomes due and payable under the provisions of Article V hereof and provided the BUYER shall have received the BUILDER's demand for payment in accordance with Article IV hereof, or

(2) The BUYER fails to pay the fifth installment to the BUILDER in accordance with Paragraph 3 (5) and 4 (5) of Article XIII hereof provided the BUYER shall have received the BUILDER's demand for payment in accordance with Article IV hereof; or

(3) The BUYER fails to take delivery of the Vessel, when the Vessel is duly tended for delivery by the BUILDER under the provisions of Article XIII hereof.

2. NOTICE OF DEFAULT

If the BUYER is in default of payment or in performance of its obligations as provided hereinabove, the BUILDER shall notify the BUYER in writing on the date of occurrence of the

default as per Paragraph 1 of this Article and the BUYER shall forthwith acknowledge in writing to the BUILDER that such notification has been received. In case the BUYER does not give the aforesaid acknowledgement in writing to the BUILDER within three (3) calendar days it shall be deemed that such notification has been duly received by the BUYER.

3. INTEREST AND CHARGE

(1) If the BUYER is in default of payment as to any installment as provided in Paragraph 1 (1) and/or 1 (1) of this Article, the BUYER shall pay interest on such installment at the rate of _____ percent (_____%) per annum for a period of 15 days from the due date thereof and thereafter at the rate of _____ percent (_____%) per annum until the date of the payment of the full amount, including all aforesaid interest.

In case the BUYER shall fail to take delivery of the Vessel as provided in Paragraph 1 (3) of this Article, the BUYER shall be deemed in default of payment of the fifth installment and shall pay interest thereon at the same rate as aforesaid form (and including) the day on which the Vessel is tendered for delivery, as provided in Article XIII Paragraph 6 hereof.

(2) In any event of default by the BUYER under 1 (1) or 1 (2) or 1 (3) above, the BUYER shall not costs, charges and expenses incurred by the BUILDER in consequence of such default unless provided by relevant.

4. DEFAULT BEFORE DELIVERY OF THE VESSEL

(1) If any default by the BUYER occurs as defined in Paragraph 1 (1) or 1 (2) or 1 (3) of this Article, the Delivery Date shall at the BUILDER's option, be postponed for a period of continuance of such default by the BUYER.

(2) If any such default as defined in Paragraph 1 (1) or 1 (2) or 1 (3) of this Article committed by the BUYER continues for a period of fifteen (15) days, then, the BUILDER shall have all following rights and remedies:

(i) The BUILDER may, at its option, cancel or rescind the Contract, provided the BUILDER has notified the BUYER of such default pursuant to Paragraph 2 of this Article, by giving notice of such effect to the BUYER by telex confirmed in writing. Upon receipt by the BUYER of such telex notice of cancellation or rescission, all of the BUYER's Supplies shall forthwith become the sole property of the BUILDER, and the Vessel and all its equipment and machinery shall be at the sole disposal of the BUILDER for sale or otherwise; and

(ii) (Applicable to any BUYER's default defined in 1 (1) of this Article) The BUILDER shall, without prejudice to the BUILDER's right to recover from the BUYER the 5th installment, interest, costs and/or expenses by applying the proceeds to be obtained by sale of the Vessel in accordance with the provisions set out in the Contract, have the right to declare all unpaid 2nd, 3rd and 4th installments to be forthwith due and payable, and upon such declaration, the BUILDER shall have the right to immediately demand the payment of the aggregate amount of all unpaid 2nd, 3rd and 4th installments from the Guarantor in accordance with the terms and conditions of the guarantee issued by the guarantor.

5. SALE OF THE VESSEL

(1) In the event of cancellation or rescission of the Contract as above provided, the BUILDER shall have full right and power either to complete or not to complete the Vessel at it deems fit, and to sell the VESSEL at a public or private sale on such terms and conditions as the BUILDER thinks fit without being answerable for any loss or damage occasioned to the BUYER thereby. In the case of sale VESSEL, the BUILDER shall give telex or written notice to the BUYER.

(2) In the event of the sale of the VESSEL in its completed state, the proceeds of sale received by the BUYER shall be applied firstly to payment of all expenses attending such sale and otherwise incurred by the BUILDER as a result of the BUYER's default, and then to payment of all unpaid installments and/or unpaid balance of the Contract Price and interest on such installment at the interest rate as specified if the relevant provisions set out above from the respective due dates thereof to the date of application.

(3) In the event of the sale of the VESSEL in its incomplete state, the proceeds of sale received by the BUILDER shall be applied firstly to all expenses attending such sale and otherwise incurred by the BUILDER as a result of the BUYER's default, and then to payment of all costs of construction of the VESSEL (such costs of construction, as herein mentioned, shall include but are not limited to all costs of labor and/or the costs paid by the BUILDER for the equipment and/or materials to be installed on the VESSEL) and/or any fees, charges, expenses and/or

royalties incurred and/or to be incurred for the VESSEL less the installments so retained by the BUILDER, and compensation to the BUILDER for a reasonable sum of loss of profit due to the cancellation or rescission of the Contract.

(4) In either of the above events of sale, if the proceed of sale exceeds the total of the amounts to which such proceeds are to be applied as aforesaid, the BUILDER shall promptly pay the excesses to the BUYER without interest, provided, however that the amount of each payment to the BUYER shall in no event exceed the total amount of installments already paid by the BUYER and the cost of the BUYER's supplies, if any.

(5) If the proceed of sale are insufficient to pay such total amounts payable as aforesaid, the BUYER shall promptly pay the deficiency to the BUILDER upon request.

ARTICLE XXIII BUILDER'S DEFAULT

Failure to accomplish the following obligations by the BUILDER shall constitute events of default:

1. The failure of the BUILDER to prosecute the Contract work with such diligence and in such manner as will disable it to complete the VESSEL construction by the Delivery Date stipulated in the Contract, except and to the extent that such failure is due to the causes stated in Article XI of the Contract for which the BUILDER would be entitled to an extension of the Delivery Date, such as the delay of the VESSEL delivery caused by force majeure; provided that the BUYER shall have given the BUILDER notice of such failure and that the BUILDER shall not, within fifteen (15) days of the date of receipt of such notice, have shown to the satisfaction of the BUYER that it has taken steps sufficient to remedy the failure in a manner satisfactory to the BUYER.

2. The failure of the BUILDER in any other respect to use due diligence in the performance of the Contract work or its failure to perform any of the covenants, agreements or undertakings on its part to be performed under the Contract, including but not limited to, the BUILDER's agreement to make prompt payment for all labor, material, services and other charges which are to be paid by the BUILDER; provided that the BUYER shall give notice to the BUILDER as to such failure, and the BUILDER shall not, within fifteen (15) days after being so notified, correct any failure to use due diligence or undertake the performance of said covenants, undertakings or agreements required to cure such failure, and thereafter prosecute in good faith to completion all such work or performance required to cure such failure.

3. The BUILDER being dissolved or adjudicated a bankrupt or making a general assignment for the benefit of its creditors, or the appointment of a receiver or receivers of any kind whatsoever, whether or not appointed in bankruptcy, common law or equity proceedings, whether temporary or permanent for the property of the BUILDER, or the filing by the BUILDER of a petition for reorganization or other proceedings under any of the provisions of the Bankruptcy Code, or the filing of such petition by creditors, stakeholders or any other person whatsoever and approval thereof by the Court.

4. Where there is a cause of delay in the Contract beyond prior expectation (except such causes stated in Article XI of the Contract for which the BUILDER would be entitled to extent the completion), and such delay would disable the BUILDER to accomplish the obligations under the Contract as determine by the BUYER.

ARTICLE XXIV ASSIGNMENT OF THE CONTRACT

1. ASSIGNMENT OF THE BUILDER

To prevent the committed financing from suffering any loss, the BUILDER shall have the right to assign the benefit arising under or by virtue of the Contract to the financing party.

2. ASSIGNMENT OF THE BUYER

(1) To prevent the committed financing from suffering any loss, the BUYER shall have the right to assign the benefit arising under or by virtue of the Contract to the financing party.

(2) After obtaining consent from the BUILDER (such consent not to be unreasonably withheld), the BUYER shall assign or transfer the right and obligation under the Contract or assign the Contract to the third party.

(3) Assigner and assignee shall jointly undertake and responsible for the execution of the provisions set forth under the Contract between the assignee and the BUILDER.

ARTICLE XXV LIEN AND MORTGAGE OF THE VESSEL

1. LIEN OF THE VESSEL

If the BUILDER is under no default, the BUILDER shall have the right to lien the possessing constructing VESSEL to insure the repayment of the construction cost when the contractual payment obligation has not been performed by the BUYER.

2. MORTGAGE OF THE VESSEL

The VESSEL which is under construction shall be eligible for shipping mortgage. The BUILDER shall have the right to be the Pledger by pledging the VESSEL for the shipping mortgage and should sign a contract with the Pledgee in writing.

The mortgage registration shall be done jointly by the Pledger and the Pledgee in the VESSEL Registry for the shipping mortgage; the third party shall not be confronted for those without registration.

Registration of the shipping mortgage shall include the following main items:

(1) The name, title and address of the Pledgee and Pledger

(2) The name, nationality, the VESSEL ownership certificate issuing authority and the certificate number of the VESSEL to be mortgaged

(3) The loan amount, interest rate and the tenor to be guaranteed

The Pledger shall procure insurance for the mortgaged VESSEL unless the Contract agreed otherwise. The Pledgee shall have the right to procure insurance for the mortgaged VESSEL should it not be insured and the premium shall be borne by the Pledger.

ARTICLE XXVI DISPUTE RESOLUTION AND ARBITRAITON

Any contract dispute between both parties could be settled by friendly consultation or conciliation by relative authorities. Should friendly consultation or conciliation fail, both parties agree to submit relative disputes to Classification Society or other Regulatory Authority, or apply to CMAC for arbitration. If the arbitration clause or agreement is ruled to be null and void, the parties could bring a suit before the maritime court with jurisdiction.

The effective arbitration award, judgment, ruling, settlement agreement or other legal documents should be performed by both parties comprehensively. When one party fails to execute the above legal documents, the other party may apply to the maritime court with jurisdiction for enforcement.

1. CLASSIFICATION SOCIETY OR OTHER REGULATORY AUTHORITY

Disputes about whether or not the VESSEL is in accordance with the rules, regulations, and requirements of the Classification Society or other Regulatory Authority may submit to the Classification Commission of the Classification Society, or other Regulatory Authority. The determination of the authority is final and binding upon both parties. Any other disputes under the contract should be submitted to conciliation or arbitration for resolution, which is stipulated in below paragraph 2, and 3.

2. CONCILIATION

Before the dispute be submitted to arbitration, both parties agree to submit any of their disputes arising form the Contract or relating to the Contract to Shanghai Maritime Conciliation Center of CMAC for conciliation, which apply to the Center's Conciliation Rules and Panel of conciliators. Both parties agree to submit their settlement agreement by conciliation to CMAC and jointly appoint or entrust the chairman of CMAC shall appoint one sole arbitrator to render an arbitration award according to the law and the content of conciliation settlement between the parties. The arbitration procedure and time limit shall not be confine by the Arbitration Rules of CMAC. Unless either party opposes, the conciliator appointed in the conciliation procedure may continue to act as the sole arbitrator to render an arbitration award, if the conciliator is also listed among the Panel of Arbitrators of CMAC.

If both parties don't agree to conciliate according to above regulations, _____ Conciliation Rules should be adopted by the parties.

3. ARBITRATION

Any dispute under or in connect with the Contract shall be submit to CMAC for arbitration which shall be conducted in accordance with the Arbitration Rules of CMAC in effect at the time of applying for arbitration. The arbitration award is final and binding upon both parties.

If both parties don't agree to submit the dispute to the above-mentioned arbitration institute, the both parties agree to submit to ___(location or institute) and apply to ___Arbitration Rules.

ARTICLE XXVII SUSPENSING AND TERMINATION

1. BUYER'S TERMINATION

During the period of performing the contract, the BUYER shall have the right to terminate the Contract upon giving notice in the event that:

(1) The Guarantor providing the refund guarantee on behalf of the BUILDER is deemed insolvent, unless the BUILDER provides a replacement and acceptable refund guarantee to the BUYER within 30 days of the BUYER's notice requiring a replacement refund guarantee to be provided, or

(2) Excluding permissible delays, the BUILDER fails to perform any work relating to the shipbuilding for a running period of at least_____ days, provided that thereafter the BUYER gives the BUILDER at least_____ days' notice in writing of his intention to terminate the Contract under this clause and within that period the BUILDER fails to remedy its breach, or,

(3) In the event that:

(a) The delivery date is delayed by more than 180 days by fore majeure events,

(b) The delivery of the VESSEL is delayed by more than 180 days, excluding permissible delays,

(c) The aggregate of delays in the delivery of the VESSEL in (a) and (b) above is more than 270 days.

The BUILDER may at any time after the BUYER is entitled to terminates the Contract give notice to the BUYER requesting that the BUYER either agrees to a new delivery date or terminate the Contract. Such new delivery date shall be a reasonable estimated date by the BUILDER, when the VESSEL will be ready for delivery. Within 15 days of the request by the BUILDER, the BUYER shall notify the BUILDER of his determination. If the BUYER doesn't terminate the Contract, then the new delivery date shall be deemed to be the delivery date provided it doesn't occur later than 30 days prior to the expiry of the refund guarantee. If the VESSEL is not delivered by that date, the BUYER shall have the right to terminate this Contract.

(4) The reduction in speed, deadweight, hold capacity and the excessive fuel consumption of the main engine entitles the BUYER to reduce the Contract Price, terminate or cancel the Contract as per clause 1, 2, 3 and 4 in Article VI greater than the reduction amount stated in contract;

(5) There are deficiencies of the VESSEL as stated in the Contract to entitle the BUYER to suspend the performance of the Contract;

(6) The BUILDER's guarantee is in breach of relevant regulations of this Contract.

2. BUILDER'S TERMINATION

During the period of performing the contract, the BUILDER shall have the right to terminate the Contract upon giving notice to the BUYER in the event that:

(1) The Guarantor providing the installment or performance guarantee on behalf of the BUYER is deemed insolvent, unless the BUYER provides a replacement and acceptable refund guarantee to the BUILDER within 30 days; or

(2) The BUYER fails to pay any sums due under the contract for a period of 21 banking days, provided that the BUILDER thereafter gave the BUYER at least 5 banking days notice of his intention to terminate the Contract under this Article and within that period the BUYER failed to remedy the breach;

(3) The BUYER fails to take delivery of the VESSEL tendered in accordance with the Contract;

(4) The BUYER fails to provide installment or performance guarantee according to this Contract.

3. Suspension of BUILDER'S Construction Work

Without prejudice to BUILDER's right of termination, the BUILDER has the right to suspend the construction work if the BUYER fails to pay any installment due according to the contract for 15 banking days until payment of such outstanding sums.

4. DEEMED INSOLVENCY

A party or the Guarantor providing the refund guarantee shall be deemed insolvent if the proceedings are commenced against the insolvent party or the Guarantor for winding up, dissolution or reorganization (otherwise than for the purpose of amalgamation or reconstruction), liquidation, the appointment of a receiver, trustee or similar officer, bankruptcy, suspension of payments or similar events. A party shall have the right to terminate the Contract forthwith upon giving notice if the other party or Guarantor is deemed insolvent.

5. EFFECTIVENESS of BUYER'S TERMINATION

If the Contract is terminated by the BUYER, the BUILDER shall refund all sums paid by the

BUYER to the BUILDER according to the contract here of plus interest thereon at the rate stated in contract per annum from the date of payment to the date of refund. The BUILDER shall also return the BUYER's SUPPLIERS, or if they cannot be returned, the BUILDER shall pay to the BUYER an amount equal to the BUYER's cost for such BUYER's SUPPLIERS.

6. EFFECTIVENESS OF THE BUILDER'S TERMINATION

If this Contract is terminated by the BUILDER, the BUILDER shall have the right to retain the BUYER's SUPPLIERS together with any installments paid by the BUYER and shall have the right and power either to complete or not to complete the shipbuilding; but in any event shall sell the VESSEL (either in its complete or incomplete form), including those BUYER's supplies which are installed or have been utilized on board the VESSEL, at the best price reasonably obtainable at a public or private sale on reasonable terms and conditions.

(1) In the event of the sales of the VESSEL in its complete form, the proceeds of the sale received by the BUILDER shall be applied in the following order:

(a) to pay all expenses incurred by the BUILDER in respect of the sale and otherwise incurred by the BUILDER as a result of the BUYER's breach of the contract;

(b) to pay unpaid installments of the contract price including any which would have been payable after the date of termination and interest on such installments at the rate of interest stated in contract from the respective due dates thereof to the date of application.

(2) In the event of the sale of the VESSEL in its incomplete form the proceeds of sale received by BUILDER shall be applied in the following order:

(a) To pay all expenses incurred by the BUILDER in respect of the sale and otherwise incurred by the BUILDER as a result of the BUYER's default;

(b) To pay all unpaid installments of the Contract Price to the extent due but not yet paid at the date of termination and interest on such installments at the rate of interest stated in the Contract from the respective due date thereof to the date of application;

(c) To pay all costs of part shipbuilding less any paid installments and less any sums credited in paragraph (b) as above;

(d) To compensate the loss of the BUILDER's reasonable net profits caused by the BUYER's breach of the Contract.

(3) In any of the above events, if the proceeds of sale exceed the sums to which such proceeds are to be applied as aforesaid, the BUILDER shall promptly pay any such excess to the BUYER without interest thereon, provided that the amount of such payment to the BUYER shall in no event exceed the total amount of installments paid by the BUYER. The BUILDER shall at the same time either permit the BUYER to remove the BUYER's supplies which are not installed or utilized onboard the VESSEL (if any) from the shipyard for the cost and expense of the BUYER, or give credit to the BUYER for the value thereof.

(4) If the proceeds of sale are insufficient to pay the BUILDER the total amounts due from the BUYER as aforesaid, the BUILDER may sell the BUYER's SUPPLIES which are not installed or utilized onboard the VESSEL (if any) at the best price reasonable obtainable at a public auction or private sale on reasonable terms and conditions, applying the proceeds of such sale toward the unsatisfied amounts due from the BUYER, and giving credit to the BUYER for any excess.

(5) If the proceeds of sale are still insufficient to pay the BUILDER the total amounts due from the BUYER as aforesaid, the BUYER shall pay the BUILDER the amount of such deficiency, plus interest at the rate stated in the Contract calculated from the date when the payments become due.

ARTICLE XXVIII INSURANCE

1. EXTENT OF INSURANCE COVERAGE

From the time of steel cutting of the VESSEL until the same is completed and delivered to the BUYER, the BUILDER shall keep the VESSEL insured with a qualified Chinese insurance company for shipbuilder's insurance. Such insurance shall cover the damages or losses of the VESSEL's materials, hull and equipments which incurred by various marine perils, inland perils or the BUILDER's errors and omissions during the period of construction and trail, as well as any additional costs and liability to a third party including the BUYER's SUPPLIES.

The amount of such insurance coverage shall be in an amount equal to the amount of the Contract Price, and not less than, the aggregate of the payments made by the BUYER to the

BUILDER and the value of the BUYER's SUPPLIES. Before the delivery of the VESSEL, if the BUILDER and the BUYER adjust the Contract Price in accordance with the Article VI of the Contract, it is the BUILDER's obligation to adjust the insurance amount accordingly.
All losses under such insurance policy shall be payable to the BUILDER.
The BUYER shall inform the BUILDER of any subsequent changes of the value of the BUYER's SUPPLIES upon receipt of the notice of such changes of value, the BUILDER is obliged to accordingly change the insured value of the materials and equipment which supplied by the BUYER.
The BUYER is obliged to assist the BUILDER in arranging the aforesaid insurance and providing relevant documents required by the insurance company. The BUILDER is obliged provide the BUYER with the copy of the insurance policy as backup.
2. APPLICATION OF RECOVERED AMOUNT
(1) Partial Loss
In the event the VESSEL shall be damaged by any insured cause whatsoever prior to acceptance and delivery thereof by the BUYER and in the further event that such damage shall not constitute an actual or a constructive total loss of the VESSEL, the BUILDER shall apply the amount recovered under the insurance policy referred to in Paragraph 1 of this Article to the repair of such damage satisfactory to the Classification Society and the Administrative Authority as described in the Specifications. No additional expenses should be collected by the BUILDER and the BUYER shall accept the VESSEL in accordance with this Contract.
(2) Total Loss
In the event that the VESSEL is determined to be an actual or constructive total loss:
(a) By the mutual agreement between the PARTIES hereto, proceed in accordance with terms of the Contract, in which case the amount recovered under said insurance policy shall be applied to the reconstruction and/or repair of the VESSEL's damages and/or reinstallation of BUYER's supplies without additional expenses to BUYER, provided the PARTIES hereto shall have first agreed in writing as to such reasonable extension of the delivery date and adjustment of other terms of other terms of this Contract including the Contract Price as may be necessary for the completion of such reconstruction; or
(b) If due to whatever reasons the parties fail to agree on the above, then refund immediately to the BUYER the amount of all installments paid to the BUILDER under this Contract without interest together with recovered amount for BUYER's SUPPLIES onboard, whereupon this Contract shall be deemed to be canceled and all rights, duties, liabilities and obligations of each of the parties to the other shall terminate forthwith.
Within thirty (30) days after receiving notice of any damage to the VESSEL constituting an actual or a constructive total loss, the BUYER shall notify the BUILDER in writing of its agreement or disagreement under this sub-paragraph. In the event the BUYER fails to so notify the BUILDER, then such failure shall deemed as rescinded and canceled and the BUYER receive the refund as hereinabove provided and this paragraph (b) shall apply.
Concurrently with the refundment to be made by the BUILDER to the BUYER as per the paragraph (b), the Contract is deemed to be terminated, all the right and obligation of one party to another party under the Contract shall be null and invalid, and the guarantees under the Contract shall be returned.
3. TERMINATION OF INSURANCE
The BUILDR's interest under the insurance policy shall cease and terminate forthwith upon delivery of the VESSSEL.

ARTICLE XXIX PATENTS, TRADEMARKS AND COPYRIGHTS

The machinery and equipment of the VESSEL may bear the patent number, trademarks or trade names of the manufacturers. The BUILDER shall defend and save harmless the BUYER from patent liability of claims of patent infringement of any nature or kind, including costs and expenses for, or on account of any patented or patentable invention made or used in the performance of the Contract and also including cost and expense of litigation, if an. If the BUYER involved into a patent infringement because of the BUILDER, it may lodge claims against the BUILDER for its losses arising therefrom.
Nothing contained herein shall be construed a transferring any patent or trademark rights or

copyright in equipment covered by the Contract, and all such rights are hereby expressly reserved to the true and lawful owners thereof. Notwithstanding any provisions contained herein to the contrary, the BUILDER's obligation under this Article should not be terminated by the passage of any specified period of time.

The BUILDER's indemnity hereunder does not extend to equipment or parts supplied by the BUYER to the BUILDER if any.

SECTION 6 SUNDRY

ARTICLE XXX NOTICE AND LANGUAGE

1. NOTICE

Any and all notices and communications in connection with the Contract shall be addressed as follows:

P.C.

To the BUYER (the full name of the BUYER)

Address: (the legal address of the BUYER)

Tel No:

Fax No:

Email:

To the SELLER (the full name of the SELLER)

Address: (the legal address of the SELLER)

P.C.

Tel No:

Fax No:

Email:

To the BUILDER: (the full name of the BUILDER)

Address: (the legal address of the BUILDER)

P.C.

Tel No:

Fax No:

Email:

Any notice or communication sent to the BUYER singly from the SELLER or the BUILDER shall be deemed as from the SELLER and the BUILDER together.

Any change in the address shall be communicated in writing by the party adding such change to the other party and in the event of failure to give such notice of change, communications addressed to the other party at their last known address shall be deemed sufficient.

Any and all notices, demands, requests, instructions, advices and communications in connection with the Contract shall be deemed to be given at the time when the same is delivered to the address of the party to be served however, that email and fax shall be deemed to be delivered upon dispatch and receipt.

2. LANGUAGE

Any and all documents as well as notices, communications, specifications and drawings and any other written materials in connection with the Contract shall be written in the Chinese or the English language subject to the situation, each language is legally of equal effect while in case there is any disagreement between the English version and Chinese version, the Chinese one shall prevail. Each party hereto shall have no obligation to translate them into any other language.

ARTICLE XXXI OPTION

The BUYER shall have the right to build the optional vessels, the optional VESSEL should be executed at the same contract price and construction time as the VESSEL. Such option must be declared by the BUYER to the BUILDER within the number of months that has been confirmed by the parties following the effective date of the Contract.

The BUILDER also has the right to negotiate with the BUYER on issues of the contract price of the optional vessel the construction time can be properly shortened and the delivery date can be properly put forward.

ARTICLE XXXII EFFECTIVE CONDITIONS AND DATE OF CONTRACT

The Contract shall become effective upon fulfillment of all the following and other mutually agreed conditions:

(1) The Contract and the Specifications have been signed and sealed; and

(2) Receipt by the BUILDER of the first installment in accordance with Article V of this Contract; and

(3) Receipt by the BUILDER of a Letter of Guarantee in the annexed hereto as Annex B issued by a first class international bank of the BUYER acceptable to the SELLER in accordance with Article V hereof; and

(4) Receipt by the BUYER of a Refund Guarantee in the form annexed hereto as Annex A issued by a first class international bank of the SELLER acceptable to the BUYER in accordance with Article V hereof; and

(5) Approval of the boards of the two parties.

(6) In case the export license and the construction license have not been issued within (_____) days by the Chinese government, this Contract shall become ineffective automatically.

Unless other written agreements exist in the Contract, the parties shall be expressly released from their obligations to each other in accordance with this Contract, an instruction should be made to indicate the ineffectiveness of the Contract. Meanwhile, the BUILDER should return the BUYER all its payments which has been paid before plus an interest of the BUYER's payment at the rate of_____ percent (_____ %) per annum.

ARTICLE XXXIII ENTIRE AGREEMENT

The Contract constitutes the entire agreement between the parties and no promise, warranty or statement prior to the date of the Contract shall affect the Contract. Any modification of the Contract shall not be of any effect unless in writing negotiated and signed by or on behalf of the parties.

ANNEXES

CMAC Standard Newbuilding Contract (Shanghai Form)

ANNEX A

BUILDER'S IRREVOCABLE LETTER OF REFUND GUARANTEE

To: [insert the full name of the beneficiary]

Date:

To whom it may concern

IRREVOCABLE LETTLE OF GUARANTEE FOR PAYMENT

At the request of a [here insert the name of shipping trade company] and [here insert the name of shipyard or the shipbuilding company] (hereinafter called as "the Seller"), in consideration of you agreeing to pay the Seller the installments before the delivery of the vessel under the building contract concluded by you and Seller dated [ ] (hereinafter called as "the Contract") for a vessel with construction number [ ] and deadweight [metric ton] (hereinafter called as "the Vessel"), we hereby guarantee that the Seller will repay to you an amount up to a total of United States Dollars [ ] representing the aggregate amount paid by you to the Seller under the Contract before the delivery of the Vessel, of the first installment of the Contract Price amounted USD [ ], the second installment amounted USD [ ], the third installment amounted USD [ ] and the fourth installment amounted USD [ ]. Should the Seller fails to repay to you such any or all installments due as provided by the articles under the Contract, and you suspend to terminate the Contract due to the extension of the delivery date, we will make such payment to you without interest. In the event that the delivery date is delayed for [ ] days and you terminate the Contract in accordance with the clause 3 of Article 8 or clause 1 (3), 2 (3), 3 (3), or 4 (3) of Article 3 of the Contract, we shall pay to you the aforesaid amount of installments together with interest at the rate of [ ] percent (%) per annum, or [ ] percent (%) per annum in other circumstances. Within thirty (30) running days

upon receipt by us from you of a Repayment Demand, we shall pay to you the sun as follows. However, in the event that is disagreement between you and the Seller on the following issues:
(1) Whether the Seller is liable for the repayment of any or all installments to you, and
(2) Whether you have the right to require us for payment Should the Seller or you submit such dispute before the arbitration in accordance with Article 26 of the Contract or raise an appeal in accordance with the laws of other country, we is entitled to terminate the contract and postpone any payment until the arbitration award between the Seller and the Buyer is published. We shall not be obligated to make such payment unless repayment of the Seller is ordered in the arbitration award and the Seller waives or disclaims appeal in accordance with the laws of other country. Should the Seller fails to enforce the arbitration award, we will pay off the amount ordered by the award (or the judgment), which shall not exceed the amount to be secured by the Letter of Guarantee, plus the interest mentioned above.
All payments under the Letter of Guarantee shall be made in United States Dollars. The Letter of Guarantee comes to effect upon the receipt of the first installment by the Seller from you prior to the delivery under the Contract. The sum available under the Letter of Guarantee shall be in line with the amount which has paid by you prior to the delivery. The amount to be paid under the Letter of Guarantee shall not exceed the aggregate amount of the installments paid by you to the Seller before the delivery of the Vessel, plus the interest at the rate of [ ] percent (%) per annum calculated on the amount of each installment from the date of receipt of the same by the Seller until the date on which the same is repaid under the Letter of Guarantee.
The Letter of Guarantee shall remain in force until (a) due delivery of the Vessel to, and acceptance of the Vessel by, the Buyer, or (b) the payment to you by the Buyer or by us of all sums guaranteed by the Letter of Guarantee, or (c) the [ ] day (the thirtieth day after the delivery date under the Article 14 of the Contract), whichever is earlier. Hereafter, you shall return the Letter of Guarantee to us by airmail for the purpose of revocation, unless:
(1) In the event that the Vessel is under construction, the period of validity of the Letter of Guarantee shall be extended until [ ] day (the [ ] day after the delivery date under the Article 13 of the Contract), or the date of due delivery of the Vessel to and acceptance of the Vessel by the Buyer, if first incurs. Or
(2) In the event that you or the Seller submit before the arbitration authority or the court the matter under the Contract, the period of validity of the Letter of Guarantee will be automatically extended until the thirtieth day after the publication of the arbitration award of the judgment.
The Letter of Guarantee is governed by the laws of the Peoples' Republic of China.
Yours truly,
[ ] Bank

CMAC Standard Newbuilding Contract (Shanghai Form)

ANNEX B

BUYER'S IRREVOCABLE LETTER OF GUARANTEE ON THE SECOND, THIRD AND FOURTH INSTALLMENTS

BANK

To: [insert the full name of the beneficiary]
[ ] Shipyard (or Shipbuilding Company)
Date:
To whom it may concern

(1) In consideration of you and [ ] (hereinafter called as "the BUYER") entering into a sales contract (building contract) dated [ ] for the construction of a VESSEL with hull number [ ] and deadweight ton of [metric ton] (hereinafter called as "the VESSEL") we, as the primary obligor and not a guarantor only, hereby irrevocably, absolutely and unconditionally guarantee that the BUYER will punctually pay to you the sum of United States Dollars [ ] representing the aggregate amount of the second, third and fourth installments of the Contract Price as provided by the Section (2) herein.

(2)In accordance with the Contract, the sum to be secured in the Letter of Guarantee includes the second installment of USD [ ], for which the BUYER is liable within three (3) New York Banking Day after the commencement of the construction of the VESSEL, the third installment of USD [ ], for which the BUYER is liable when the first paragraph of the VESSEL is put on the slipway, and the fourth installment of USD [ ], for which the BUYER is liable within three (3) New York Banking Day after launching of the VESSEL.

(3) As the primary obligor and not a guarantor only, we hereby irrevocably, absolutely and unconditionally guarantee that we will punctually pay the interest calculated on the amount of each installment, which the BUYER is obliged to pay, at the rate of [ ] percent (%) per annum from the expiry date of such installment as provided by the Contract until the date on which the same is fully paid.

(4) Should the BUYER fails to punctually pay any installment or interest and such failure is last for fifteen (15) days, we will, upon receipt by us from you of the first written demand for the same, pay to you or to your order the amount of the second, third and fourth installments and relevant interest as provided by Section (3) above, without request to you for a further action, measure or steps on the mortgages holding by you or the SELLER.

(5) The Letter of Guarantee and obligations hereunder shall be freely assignable by you at your own discretion. If assigned, it is guaranteed that any third party consigned by you or the Business Department of the Head Office of Bank of China is your agent. Such third party or Business Department of Head Office of Bank of China is deemed to be authorized as the agent herein.

(6) Any payment under the Letter of Guarantee shall be made in United States Dollars to [here insert the name of bank] and transfer to your account in the Business Department of the Head Office of Bank of China, with you or your agent as the beneficiary and the receiving bank appointed or temporarily appointed by the SELLER.

(7) Our obligations under the letter of guarantee shall not be affected or impaired by the following factors: any dispute between the BUYER and you, as the SELLER, under the Contract, or delay on delivery or construction of the VESSEL for any reason, change or extension of the period of construction or delivery of the VESSEL, any mortgage or compensations incurs or to incur, any absolution from you or other relevant parties, non-performance or invalidity of the relevant provisions or other factor which may diminish the obligations under the Letter of Guarantee such as any action, omission, facts or conditions.

(8) Any representation or demand in writing made by you shall be signed by one of your duly authorized officers and may be served on us by hand or by post to [ ] (or such other address as we may notify to you in writing), or by authorized communication number with written confirm of Bank of China.

(9) The Letter of Guarantee come to effect upon your receipt and remain in force until (a) due delivery of the VESSEL to, and acceptance of the VESSEL with full performance of his obligation, by the BUYER,or (b) the payment to you by the BUYER or by us of all amount of the second, third and fourth installments and interest, whichever is earlier.

(10) Our liability under the Letter of Obligation shall not exceed the maximum sum of USD [ ], which includes:

(a) The aggregate amount of the second, third and fourth installments to be secured in the Letter of Guarantee, which is USD [ ], and

(b) Interest on the installment for sixty (60) days at the rate of [ ] percent (%) per annum, which is USD [ ].

(11) All payments to be made under the Letter of Guarantee shall be made without any set off or counterclaim and without deduction or withholding for or on account of any taxes, duties or charges whatsoever unless we are compelled by law to deduct or withhold the same in which case we shall make the minimum deduction or withholding permitted and will pay such additional amounts as may be necessary in order that amount received by you after such deduction or withholding shall be equal to the amount which would have been received had no such deduction or withholding been made.

(12) The Letter of Guarantee is to be construed in accordance with the laws of [here insert the name of country]. We hereby submit it to the courts without judicial privileges for any legal action or litigation in the [here insert the name of country].

(13) The Letter of Guarantee will be ended as of the date above. After that, you shall return the Letter of Guarantee without any condition.

(14) In witness whereof, the Letter of Guarantee is effective and submitted by our duly authorized representatives on the date above.

CMAC Standard Newbuilding Contract (Shanghai Form)

ANNEX C

SPECIFICATION

CMAC Standard Newbuilding Contract (Shanghai Form)

ANNEX D

GENERAL ARRANGMENT AND MIDSHIP DRAWING

CMAC Standard Newbuilding Contract (Shanghai Form)

ANNEX E

MAKER'S LIST

CMAC Standard Newbuilding Contract (Shanghai Form)

ANNEX F

Comprehensive Table for the Contract's Element

(B-C Standard Shipbuilding Contract Facility Edition)

<table>
<tr><td colspan="3">1.Place and Date of the Contract</td></tr>
<tr><td>2. BUILDER's name, full style address, and
contract details
ship trading company (if any)
Name:
Address:
Country:
Tel:
Fax:
Email:

BUILDER
Name:
Address:
Country:
Tel:
Fax:
Email:</td><td colspan="2">3. BUYER's name, full style address, and contract details
Name:
Address:
Country:
Tel:
Fax:
Email:</td></tr>
<tr><td>4. VESSEL description/type</td><td colspan="2"></td></tr>
<tr><td>A. Main Dimensions
(i) LOA (m)
(ii) Length between perpendiculars (m)
(iii) Deadweight capacity (DWT) (mts)
(iv) Design draft (m)</td><td>B. cargo capacity
(i) Cubic capacity
(ii)Rold capacity</td><td>B2. TEU carrying capacity(state number of containers)
(i) Total on deck
a. 20'/40'/45'TEU
b. No. of reefers
(ii) Total under deck
a. 20'/40'/45'TEU
b. No. of reefers</td></tr>
<tr><td>Main engine
(i) Maker/Type
(ii) Max. continuous rating (kilowatts at MCR)
(iii) RPM at MCR</td><td colspan="2">D. Average speed
(i) Service speed (knot)at design draft

E. Other matters (optional)</td></tr>
</table>

(iv) Specific Fuel Oil Consumption at MCR	
5. BUILDER's Hull Number	6. Flag State
7. Classification Society/Class character	8. Contract Price and Currency (a) Price (b) Currency
9. Contractual Date of Delivery	10. Payments
11. BUILDER's Bank Account Data Name: Address: Country: Phone/Fax: Email: Sort code: Account number: Account name:	1st installment 2nd installment 3rd installment 4th installment Final installment
12. Adjustment of Contract Price A. Speed (a) Contract Price reduction amount (b) Maximum reduction amount (c) Contract Price addition amount (d) Maximum addition amount	B. Deadweight: (a) Contract Price reduction amount (b) Maximum reduction amount (c) Contract Price addition amount (d) Maximum addition amount
C. Cubic (a) Contract Price reduction amount (b) Maximum reduction amount (c) Contract Price addition amount (d) Maximum addition amount	D. Fuel Consumption (a) Contract Price reduction amount (b) Maximum reduction amount (c) Contract Price addition amount (d) Maximum addition amount
E. Late or Advanced Delivery compensation (a) Amount per day for delay (b) Maximum reduction amount (c) Amount per day for advanced delivery (d) Maximum addition amount	F. Others (optional)
13.Guarantees (a) BUYER's guarantees (i) Number of days after signing contract (ii) BUYER's installment/Performance Guarantee (b) BUILDER's guarantees (i) Numbers of days after signing contract	14. Guarantee Period(state number of months, if left blank 12 months shall apply)
15. Additional Guarantee Period (state number of months)	16. Suspension and Termination (a) Running period (state number of days) (b) Notice period (state number of days)
17. Applicable Law and Dispute Resolution (a) Governing law (b) Place of dispute resolution	18. Guarantee Engineer (state total number of months)
19. Effective Date of Contract (state conditions to be satisfied)	20. State number of days within which conditions have to be satisfied
21. Optional additional vessels (state number)	22. Optional additional vessels contract price and delivery dates
23. Declaration of options (state number of months after Effective Date)	24. Interest (state rate of interest)
25. BUYER's Guarantor (state name of bank or party as appropriate, full style address, and contract details) Name:	26. BUILDER's Guarantor (state name of bank or party as appropriate, full style address, and contract details) Name:

Address: Country: Phone: Fax: Email:	Address: Country: Phone: Fax: Email:
27. Number of Annexes	28. Number of Additional Clauses
Signature (BUILDER)	Signature (BUYER)

Remark: There are two functions to set the above annex F. One is to show the Contract comprehensively and clearly to the both of the PARTIES. The other is to form a simple contract by such independent table avoiding the complicated statement.

APPENDIX C

Institute Clauses for Builders' Risks[1]

INSTITUTE CLAUSES FOR BUILDERS' RISKS (1/6/88)

(This insurance is subject to English law and practice)

VESSEL ..... Contract or Yard No .....
BUILDERS .....
.....
BUILDERS' YARDS .....
.....

SUBJECT OF INSURANCE

(Where more than one part of the subject matter insured is described in Section I(A), Section I(B), or Section II below, then the respective wording of Section I(A), Section I(B) or Section II shall be applied to each part separately.)

SECTION I

Provisional Period ..... from .....
but this insurance to terminate upon delivery to Owners, if prior to expiry of Provisional Period.

(A) HULL and MACHINERY etc., under construction at the yard or other premises of the BUILDERS.

Description	Contract or Yard No.	Provisionally valued at	To be built at/by

The subject matter of this sub-section (A) is covered whilst at Builders' Yard and at Builders' premises elsewhere within the port or place of construction at which the Builders' Yard is situated, and whilst in transit between such locations. The Underwriters' liability in respect of each item of this sub-section (A) which is at such locations shall attach from the time:—

(i) of inception of this Section I if such item has already been allocated to the Vessel;
(ii) of delivery to Builders of such item (if allocated) when delivered after inception of this Section I;

1 Institute of London Underwriters (CL351, CL349, CL350, CL352, CL115). Reproduced by kind permission of the International Underwriting Association of London (IUA).

(iii) of allocation by Builders if allocated after inception of this Section I;

(B) MACHINERY etc., insured hereon whilst under construction by Subcontractors.

Description	Contract or Yard No.	Provisionally valued at	To be built at/by

The subject-matter of this sub-section (B) is covered whilst at Subcontractors' works and at Subcontractors' premises elsewhere within the port or place of construction at which the Subcontractors' works are situated and whilst in transit between such locations.

The Underwriters' liability in respect of each item of this sub-section (B) which is at such locations shall attach from the time:

(i) of inception of this Section I if such item has already been allocated to the Vessel;
(ii) of delivery to the Subcontractors of such item (if allocated) when delivered after inception of this Section I;
(iii) of allocation by the Subcontractors if allocated after inception of this Section I.

The subject-matter of this sub-section (B) is also covered whilst:

(a) in transit to Builders if the transit is within the port or place of construction at which the Builders' Yard is situated;
(b) at Builders' Yard and at Builders' premises elsewhere within the port or place of construction at which the Builders' Yard is situated and whilst in transit between such locations.

SECTION II

Provisional Period from .....
but this insurance to terminate upon delivery to Owners if prior to expiry of Provisional Period.

MACHINERY etc. insured hereon from delivery to BUILDERS

Description	Contract or Yard No.	Provisionally valued at	To be built at/by

The subject matter of this Section II is covered whilst at Builders' Yard and at Builders' premises elsewhere within the port or place of construction at which the Builders' Yard is situated and whilst in transit between such locations. The Underwriters' liability in respect of each item of this Section II shall attach from the time of delivery to Builders.

---

1. Insured value

1.1 Whereas the value stated herein is provisional, it is agreed that the final contract price, or the total building cost plus .....% whichever is the greater, of the subject matter of this insurance shall be the insured value.
1.2 Should the insured value, determined as above,

1.2.1 exceed the provisional value stated herein, the Assured agree to declare to the Underwriters hereon the amount of such excess and to pay premium thereon at the full policy rates, and the Underwriters agree to accept their proportionate shares of the increase, or

1.2.2 be less than the provisional value stated herein, the sum insured by this insurance shall be reduced proportionately and the Underwriters agree to return premium at the full policy rates on the amounts by which their respective lines are reduced.

1.3 Nevertheless, should the insured value exceed 125% of the provisional value, then the limits of indemnity under this insurance shall be 125% of the provisional value, any one accident or series of accidents arising out of the same event.

1.4 Notwithstanding the above it is understood and agreed that any variation of the value for insurance on account of a material alteration in the plans or fittings of the Vessel or a change in type from that originally contemplated does not come within the scope of this clause and such a variation requires the specific agreement of the Underwriters.

2. Transit

Held covered at a premium to be arranged for transit not provided for in Section I or II above.

3. Delayed delivery

Held covered at a premium to be arranged in the event of delivery to Owners being delayed beyond the provisional period(s) mentioned above, but in no case shall any additional period of cover extend beyond 30 days from completion of Builders' Trials.

4. Deviation or change of voyage

Held covered in case of deviation or change of voyage, provided notice be given to the Underwriters immediately after receipt of advices and any amended terms of cover and any additional premium required by them be agreed.

5. Perils

5.1 SUBJECT ALWAYS TO ITS TERMS, CONDITIONS AND EXCLUSIONS this insurance is against all risks of loss of or damage to the subject-matter insured caused and discovered during the period of this insurance including the cost of repairing replacing or renewing any defective part condemned solely in consequence of the discovery therein during the period of this insurance of a latent defect. In no case shall this insurance cover the cost of renewing faulty welds.

5.2 In case of failure of launch, the Underwriters to bear all subsequent expenses incurred in completing launch.

6. Earthquake and volcanic eruption exclusion

In no case shall this insurance cover loss damage liability or expense caused by earthquake or volcanic eruption. This exclusion applies to all claims including claims under Clauses 13, 17, 19 and 20.

7. Pollution hazard

This insurance covers loss of or damage to the Vessel caused by any governmental authority acting under the powers vested in it to prevent or mitigate a pollution hazard, or threat thereof, resulting directly from damage to the Vessel for which the Underwriters are liable under this insurance, provided such act of governmental authority has not resulted from want of due diligence by the Assured, the Owners, or Managers of the Vessel or any of them to prevent or mitigate such hazard or threat. Master, Officers, Crew or Pilots not to be considered Owners within the meaning of this Clause 7 should they hold shares in the vessel.

8. Faulty design

Notwithstanding anything to the contrary which may be contained in the Policy or the clauses attached thereto, this insurance includes loss of or damage to the subject matter insured caused and discovered during the period of this insurance arising from faulty design of any part or parts thereof but in no case shall this insurance extend to cover the cost or expense of repairing, modifying, replacing or renewing such part or parts, nor any cost or expense incurred by reason of betterment or alteration in design.

9. Navigation

9.1 With leave to proceed to and from any wet or dry docks, harbours, ways, cradles and pontoons within the port or place of construction and to proceed under own power, loaded or in ballast, as often as required, for fitting out, docking, trials or delivery, within a distance by water of 250 nautical miles of the port or place of construction, or held covered at a premium to be arranged in the event of such distance being exceeded.

9.2 Any movement of the Vessel in tow outside the port or place of construction held covered at a premium to be arranged, provided previous notice be given to the Underwriters.

10. Deductible

10.1 No claim arising from a peril insured against shall be payable under this insurance unless the aggregate of all such claims arising out of each separate accident or occurrence (including claims under Clauses 13, 17, 19 and 20) exceeds ..... in which case this sum shall be deducted. Nevertheless the expense of sighting the bottom after stranding, if reasonably incurred specially for that purpose, shall be paid even if no damage be found. This Clause 10.1 shall not apply to a claim for total or constructive total loss of the Vessel or, in the event of such a claim, to any associated claim under Clause 20 arising from the same accident or occurrence.

10.2 Claims for damage by heavy weather occurring during a single sea passage between two successive ports shall be treated as being due to one accident. In the case of such heavy weather extending over a period not wholly covered by this insurance the deductible to be applied to the claim recoverable hereunder shall be the proportion of the above deductible that the number of days of such heavy weather falling within the period of this insurance bears to the number of days of heavy weather during the single sea passage.

The expression "heavy weather" in this Clause 10.2 shall be deemed to include contact with floating ice.

10.3 Excluding any interest comprised therein, recoveries against any claim which is subject to the above deductible shall be credited to the Underwriters in full to the extent of the sum by which the aggregate of the claim unreduced by any recoveries exceeds the above deductible.

10.4 Interest comprised in recoveries shall be apportioned between the Assured and the Underwriters, taking into account the sums paid by the Underwriters and the dates when such payments were made, notwithstanding that by the addition of interest the Underwriters may receive a larger sum than they have paid.

11. Unrepaired damage

11.1 The measure of indemnity in respect of claims for unrepaired damage shall be the reasonable depreciation in the market value of the Vessel at the time this insurance terminates arising from such unrepaired damage, but not exceeding the reasonable costs of repairs.

11.2 In no case shall the Underwriters be liable for unrepaired damage in the event of a subsequent total loss (whether or not covered under this insurance) sustained during the period covered by this insurance or any extension thereof.

11.3 The Underwriters shall not be liable in respect of unrepaired damage for more than the insured value at the time this insurance terminates.

12. Constructive total loss

12.1 In ascertaining whether the subject matter insured is a constructive total loss, the insured value shall be taken as the repaired value and nothing in respect of the damaged or break-up value shall be taken into account.

12.2 No claim for constructive total loss based upon the cost of recovery and/or repair shall be recoverable hereunder unless such cost would exceed the insured value. In making this determination, only the cost relating to a single accident or sequence of damages arising from the same accident shall be taken into account.

13. General average and salvage

13.1 This insurance covers the Vessel's proportion of salvage, salvage charges and/or general average, reduced in respect of any under-insurance, but in case of general average sacrifice of the Vessel the Assured may recover in respect of the whole loss without first enforcing their right of contribution from other parties.

13.2 Adjustment to be according to the law and practice obtaining at the place where the adventure ends, as if the contract of affreightment contained no special terms upon the subject but where the contract of affreightment so provides the adjustment shall be according to the York-Antwerp Rules.

13.3 When the Vessel sails in ballast, not under charter, the provisions of the York-Antwerp Rules, 1974 (excluding Rules XX and XXI) shall be applicable, and the voyage for this purpose shall be deemed to continue from the port or place of departure until the arrival of the Vessel at the first port or place thereafter other than a port or place of refuge or a port or place of call for bunkering only. If at any such intermediate port or place there is an abandonment of the adventure originally contemplated the voyage shall thereupon be deemed to be terminated.

13.4 No claim under this Clause 13 shall in any case be allowed, where the loss was not incurred to avoid or in connection with the avoidance of a peril insured against.

14. Notice of claim

In the event of loss damage liability or expense which may result in a claim under this insurance, prompt notice shall be given to the Underwriters prior to repair and, if the subject matter is under construction abroad, to the nearest Lloyd's Agent so that a surveyor may be appointed to represent the Underwriters should they so desire.

15. Change of interest

Any change of interest in the subject matter insured shall not affect the validity of this insurance.

16. Assignment

No assignment of or interest in this insurance or in any moneys which may be or become payable thereunder is to be binding on or recognised by the Underwriters unless a dated notice of such assignment or interest signed by the Assured, and by the assignor in the case of subsequent assignment, is endorsed on the Policy and the Policy with such endorsement is produced before payment of any claim or return of premium thereunder.

17. Collision liability

17.1 The Underwriters agree to indemnify the Assured for any sum or sums paid by the Assured to any other person or persons by reason of the Assured becoming legally liable by way of damages for:

17.1.1 loss of or damage to any other vessel or property on any other vessel;

17.1.2 delay to or loss of use of any such other vessel or property thereon;

17.1.3 general average of, salvage of, or salvage under contract of, any such other vessel or property thereon;

17.1.4 where such payment by the Assured is in consequence of the Vessel hereby insured coming into collision with any other vessel.

17.2 The indemnity provided by this Clause 17 shall be in addition to the indemnity provided by the other terms and conditions of this insurance and shall be subject to the following provisions:

17.2.1 Where the insured Vessel is in collision with another vessel and both vessels are to blame then, unless the liability of one or both vessels becomes limited by law, the indemnity under this Clause 17 shall be calculated on the principle of cross-liabilities as if the respective Owners had been compelled to pay to each other such proportion of each other's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured in consequence of the collision.

17.2.2 In no case shall the Underwriters' total liability under Clause 17.1 and 17.2 exceed their proportionate part of the insured value of the Vessel hereby insured in respect of any one such collision.

17.3 The Underwriters will also pay the legal costs incurred by the Assured or which the Assured may be compelled to pay in contesting liability or taking proceedings to limit liability, with the prior written consent of the Underwriters.

Exclusions

17.4 Provided always that this Clause 17 shall in no case extend to any sum which the Assured shall pay for or in respect of:

17.4.1 removal or disposal of obstructions, wrecks, cargoes or any other thing whatsoever;

17.4.2 any real or personal property or thing whatsoever except other vessels or property on other vessels;

17.4.3 the cargo or other property on, or the engagements of, the insured Vessel;

17.4.4 loss of life, personal injury or illness;

17.4.5 pollution or contamination of any real or personal property or thing whatsoever (except other vessels with which the insured Vessel is in collision or property on such other vessels).

18. Sistership

Should the Vessel hereby insured come into collision with or receive salvage services from another vessel belonging wholly or in part to the same Owners or under the same management, the Assured shall have the same rights under this insurance as they would have were the other vessel entirely the property of Owners not interested in the Vessel hereby insured but in such cases the liability for the collision or the amount payable for the services rendered shall be referred to a sole arbitrator to be agreed upon between the Underwriters and the Assured.

19. Protection and indemnity

19.1 The Underwriters agree to indemnify the Assured for any sum or sums paid by the Assured to any other person or persons by reason of the Assured becoming legally liable, as Owner of the Vessel, for any claim, demand, damages and/or expenses, where such liability is in consequence of any of the following matters or things and arises from an accident or occurrence during the period of this insurance:

19.1.1 loss of or damage to any fixed or movable object or property or other thing or interest whatsoever, other than the Vessel, arising from any cause whatsoever in so far as such loss or damage is not covered by Clause 17;

19.1.2 any attempted or actual raising, removal or destruction of any fixed or movable object or property or other thing, including the wreck of the Vessel, or any neglect or failure to raise, remove, or destroy the same; 19.1.3 liability assumed

by the Assured under contracts of customary towage for the purpose of entering or leaving port or manoeuvering within the port;

19.1.3 loss of life, personal injury, illness or payments made for life salvage.

19.2 The Underwriters agree to indemnify the Assured for any of the following arising from an accident or occurrence during the period of this insurance:

19.2.1 the additional cost of fuel, insurance, wages, stores, provisions and port charges reasonably incurred solely for the purpose of landing from the Vessel sick or injured persons or stowaways, refugees, or persons saved at sea;

19.2.2 additional expenses brought about by the outbreak of infectious disease on board the Vessel or ashore;

19.2.3 fines imposed on the Vessel, on the Assured, or on any Master Officer crew member or agent of the Vessel who is reimbursed by the Assured, for any act or neglect or breach of any statute or regulation relating to the operation of the Vessel, provided that the Underwriters shall not be liable to indemnify the Assured for any fines which result from any act neglect failure or default of the Assured their agents or servants other than Master Officer or crew member;

19.2.4 the expenses of the removal of the wreck of the Vessel from any place owned, leased or occupied by the Assured;

19.2.5 legal costs incurred by the Assured, or which the Assured may be compelled to pay, in avoiding, minimising or contesting liability with the prior written consent of the Underwriters.

Exclusions

19.3 Notwithstanding the provisions of Clauses 19.1 and 19.2 this Clause 19 does not cover any liability cost or expense arising in respect of:

19.3.1 any direct or indirect payment of the Assured under workmen's compensation or employers' liability acts and any other statutory or common law, general maritime law or other liability whatsoever in respect of accidents to or illness of workmen or any other persons employed in any capacity whatsoever by the Assured or others in on or about or in connection with the Vessel or her cargo materials or repairs;

19.3.2 liability assumed by the Assured under agreement expressed or implied in respect of death or illness of or injury to any person employed under contract of service or apprenticeship by the other party to such an agreement;

19.3.3 punitive or exemplary damages, however described;

19.3.4 cargo or other property carried, to be carried or which has been carried on board the Vessel but this Clause 19.3.4 shall not exclude any claim in respect of the extra cost of removing cargo from the wreck of the Vessel;

19.3.5 loss of or damage to property, owned by builders or repairers or for which they are responsible, which is on board the Vessel;

19.3.6 liability arising under a contract or indemnity in respect of containers, equipment, fuel or other property, on board the Vessel and which is owned or leased by the Assured;

19.3.7 cash, negotiable instruments, precious metals or stones, valuables or objects of a rare or precious nature, belonging to persons on board the Vessel, or non-essential personal effects of any Master, Officer or crew member;

19.3.8 fuel, insurance, wages, stores, provisions and port charges arising from delay to the Vessel while awaiting a substitute for any Master, Officer or crew member;

19.3.9 fines or penalties arising from overloading or illegal fishing;

19.3.10 pollution or contamination of any real or personal property of thing whatsoever.

19.4 The indemnity provided by this Clause 19 shall be in addition to the indemnity provided by the other terms and conditions of this insurance.

19.5 Where the Assured or the Underwriters may or could have limited their liability the indemnity under this Clause 19 in respect of such liability shall not exceed Underwriters' proportionate part of the amount of such limitation.

19.6 In no case shall the Underwriters' liability under this Clause 19 in respect of each separate accident or occurrence or series of accidents arising out of the same event, exceed their proportionate part of the insured value of the Vessel.

19.7 PROVIDED ALWAYS THAT:

19.7.1 prompt notice must be given to the Underwriters of every casualty event or claim upon the Assured which may give rise to a claim under this Clause 19 and of every event or matter which may cause the Assured to incur liability costs or expense for which he may be insured under this Clause 19;

19.7.2 the Assured shall not admit liability for or settle any claim for which he may be insured under this Clause 19 without the prior written consent of the Underwriters.

20. Duty of assured (sue and labour)

20.1 In case of any loss or misfortune it is the duty of the Assured and their servants and agents to take such measures as may be reasonable for the purpose of averting or minimising a loss which would be recoverable under this insurance.

20.2 Subject to the provisions below and to Clause 10 the Underwriters will contribute to charges properly and reasonably incurred by the Assured their servants or agents for such measures. General average, salvage charges (except as provided for in Clause 20.4) collision defence or attack costs and costs incurred by the Assured in avoiding, minimising or contesting liability covered by Clause 19 are not recoverable under this Clause 20.

20.3 Measures taken by the Assured or the Underwriters with the object of saving, protecting or recovering the subject matter insured shall not be considered as a waiver or acceptance of abandonment or otherwise prejudice the rights of either party.

20.4 When a claim for total loss of the subject matter insured is admitted under this insurance and expenses have been reasonably incurred in saving or attempting to save the subject-matter insured and other property and there are no proceeds, or the expenses exceed the proceeds, then this insurance shall bear its pro rata share of such proportion of the expenses, or of the expenses in excess of the proceeds, as the case may be, as may reasonably be regarded as having been incurred in respect of the subject matter insured.

20.5 The sum recoverable under this Clause 20 shall be in addition to the loss otherwise recoverable under this insurance but shall in no circumstances exceed the amount insured under this insurance in respect of the Vessel.

The following clauses shall be paramount and shall override anything contained in this insurance inconsistent therewith.

21. War exclusion

In no case shall this insurance cover loss damage liability or expense caused by:

21.1 war civil war revolution rebellion insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power;

21.2 capture seizure arrest restraint or detainment (barratry and piracy excepted), and the consequences thereof or any attempt thereat;

21.3 derelict mines torpedoes bombs or other derelict weapons of war.

22. Strikes exclusion

In no case shall this insurance cover loss damage liability or expense caused by:

22.1 strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions;

22.2 any terrorist or any person acting from a political motive.

23. Malicious acts exclusion

In no case shall this insurance cover loss damage liability or expense arising from:

23.1 the detonation of an explosive;
23.2 any weapon of war;

and caused by any person acting maliciously or from a political motive.

24. Nuclear exclusion

In no case shall this insurance cover loss damage liability or expense directly or indirectly caused by or contributed to by or arising from:

24.1 ionising radiations from or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel
24.2 the radioactive, toxic, explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof
24.3 any weapon of war employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.

INSTITUTE WAR CLAUSES FOR BUILDERS' RISKS (1/6/88)

(This insurance is subject to English law and practice)

1. Attachment

This insurance shall not attach to the subject matter insured until the Vessel is launched and then shall attach only to such part of the subject matter as is built into or is in or on the Vessel at the time of the launch. The insurance against the said risks shall attach to the remainder of the subject matter insured only as it is placed in or on the Vessel subsequent to the launch.

2. Perils

Subject always to the exclusions hereinafter referred to, this insurance covers loss of or damage to the subject-matter insured caused by:

2.1 war civil war revolution rebellion insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power;
2.2 capture seizure arrest restraint or detainment, arising from perils covered under 2.1 above, and the consequences thereof or any attempt thereat;
2.3 derelict mines torpedoes bombs or other derelict weapons of war.

3. Protection and indemnity

This insurance also covers, subject to the limitation of liability provided for in Clauses 19.5 and 19.6 of the Institute Clauses for Builders' Risks 1/6/88, the liability under Clause 19 of the Institute Clauses for Builders' Risks 1/6/88 which is excluded by Clauses 21, 22.2 and 23.

Provided however that such cover shall not attach until the vessel is launched.

4. Incorporation

The Institute Clauses for Builders' Risks 1/6/88 except Clauses 4, 5.1 and 5.2, 7, 8, 21, 22, 23 and 24 are deemed to be incorporated in this insurance, in so far as they do not conflict with the provisions of these clauses.

5. Detainment

In the event that the Vessel shall have been the subject of capture seizure arrest restraint or detainment, and the Assured shall thereby have lost the free use and disposal of the Vessel for a continuous period of 12 months then for the purpose of ascertaining whether the Vessel is a constructive total loss the Assured shall be deemed to have been deprived of the possession of the Vessel without any likelihood of recovery.

6. Exclusions

This insurance excludes:

6.1 loss damage liability or expense arising from:
- 6.1.1 any detonation of any weapon of war employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter, hereinafter called a nuclear weapon of war;
- 6.1.2 the outbreak of war (whether there be a declaration of war or not) between any of the following countries:
  United Kingdom, United States of America, France, the Union of Soviet Socialist Republics, the People's Republic of China;
- 6.1.3 confiscation expropriation requisition or pre-emption;
- 6.1.4 capture seizure arrest restraint or detainment by or under the order of the government or any public or local authority of the country in which the Vessel is owned or registered;
- 6.1.5 arrest restraint or detainment under quarantine regulations or by reason of infringement of any customs or trading regulations;
- 6.1.6 the operation of ordinary judicial process, failure to provide security or to pay any fine or penalty or any financial cause;
- 6.1.7 any claims based upon loss of or frustration of any voyage or contract for sale or other adventure;

6.2 loss damage liability or expense covered by the Institute Clauses for Builders' Risks 1/6/88 or which would be recoverable thereunder but for Clause 10 thereof;

6.3 any claim for any sum recoverable under any other insurance on the property hereby insured or which would be recoverable under such insurance but for the existence of this insurance;

6.4 any claim for expenses arising from delay except such expenses as would be recoverable in principle in English law and practice under the York-Antwerp Rules 1974.

7. Termination

7.1 This insurance may be cancelled by either the Underwriters or the Assured giving 7 days notice (such cancellation becoming effective on the expiry of 7 days from midnight of the day on which notice of cancellation is issued by or to the Underwriter(s). The Underwriters agree however to reinstate this insurance subject to agreement between the Underwriters and the Assured prior to the expiry of such notice of cancellation as to new rate of premium and/or conditions and/or warranties.

7.2 Whether or not such notice of cancellation has been given this insurance shall TERMINATE AUTOMATICALLY:
- 7.2.1 upon the occurrence of any hostile detonation of any nuclear weapon of war as defined in Clause 6.1.1 wheresoever or whensoever such detonation may occur and whether or not the Vessel may be involved;
- 7.2.2 upon the outbreak of war (whether there be a declaration of war or not) between any of the following countries:
  United Kingdom, United States of America, France, the Union of Soviet Socialist Republics, the People's Republic of China:
- 7.2.3 in the event of the Vessel being requisitioned, either for title or use.

7.3 In the event either of cancellation by notice or of automatic termination of this insurance by reason of the operation of this Clause 7 pro rata net return of premium shall be payable to the Assured.

This insurance shall not become effective if, subsequent to its acceptance by the Underwriters and prior to the intended time of its attachment, there has occurred any event which would have automatically terminated this insurance under the provisions of Clause 7 above.

INSTITUTE STRIKES CLAUSES FOR BUILDERS' RISKS (1/6/88)

(This insurance is subject to English law and practice)

1. Perils

Subject always to the exclusions hereinafter referred to, this insurance covers loss of and damage to the subject-matter insured, caused by:

1.1 strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions;
1.2 any terrorist or any person acting maliciously or from a political motive.

2. Protection and indemnity

This insurance also covers, subject to the limitation of liability provided for in Clauses 19.5 and 19.6 of the Institute Clauses for Builders' Risks 1/6/88, the liability under Clause 19 of the Institute Clauses for Builders' Risks 1/6/88 which is excluded by Clause 22.1.

3. Incorporation

The Institute Clauses for Builders' Risks 1/6/88 are deemed to be incorporated in this insurance, in so far as they do not conflict with the provisions of these clauses, but this insurance excludes any claim which would be recoverable under the said clauses.

4. Returns of premium

No return of premium hereunder unless specially agreed.

5. Exclusions

This insurance excludes:

5.1 any loss of or damage to the subject-matter insured covered by the Institute War Clauses Builders' Risks 1/6/88;
5.2 any claim for expenses arising from delay except such expenses as would be recoverable in principle in English law and practice under the York-Antwerp Rules 1974;
5.3 piracy (but this exclusion shall not affect cover under Clause 1.1);
5.4 any claim based upon loss of or frustration of any voyage or contract for sale or other adventure.

The following clauses shall be paramount and shall override anything contained in this insurance inconsistent therewith.

6. War exclusion

In no case shall this insurance cover loss damage or expense caused by war civil war revolution rebellion insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power.

7. Nuclear exclusion

In no case shall this insurance cover loss damage liability or expense directly or indirectly caused by or contributed to by or arising from:

7.1 ionising radiations from or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel;
7.2 the radioactive, toxic, explosive or other hazardous properties of any explosive nuclear assembly or nuclear component thereof;
7.3 any weapon of war employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.

BUILDERS' RISKS: INSTITUTE CLAUSE FOR LIMITATION OF LIABILITY IN RESPECT OF FAULTY DESIGN & P. & I. RISKS (INST. F.D. & P. & I. CLAUSE) (1/6/88)

Notwithstanding anything to the contrary which may be contained in the Policy or the clauses attached thereto:

(1) This insurance includes loss of or damage to the subject matter insured caused and discovered during the period of this insurance arising from faulty design of any part or parts thereof but in no case shall this insurance extend to cover the cost or expense of repairing, modifying, replacing or renewing such part or parts, nor any cost or expense incurred by reason of betterment or alteration in design.
(2) The amount recoverable under the Protection and Indemnity Clause in respect of any one accident or series of accidents arising out of the same event shall in no case exceed the sum hereby insured.

INSTITUTE DEDUCTIBLE CLAUSE BUILDERS' RISKS (1/12/72)

Notwithstanding anything to the contrary which may be contained in the Policy or the clauses attached thereto, no claim arising from a peril insured against shall be payable under this insurance unless the aggregate of all such claims arising out of each separate accident or occurrence (including claims under the Collision Protection and Indemnity, Removal of Wreck, and Suing and Labouring Clauses) exceeds ..... in which case this sum shall be deducted.

Nevertheless the expense of sighting the bottom after stranding, if reasonably incurred specially for that purpose, shall be paid even if no damage be found. This paragraph shall not apply to a claim for total or constructive total loss of the subject matter insured.

Claims for damage by heavy weather occurring during a single sea passage between two successive ports shall be treated as being due to one accident. In the case of such heavy weather extending over a period not wholly covered by this insurance the deductible to be applied to the claim recoverable hereunder shall be the proportion of the above deductible that the number of days of such heavy weather falling within the period of this insurance bears to the number of days of heavy weather during the single sea passage.

The expression "heavy weather" in the preceding paragraph shall be deemed to include contact with floating ice.

Excluding any interest comprised therein, recoveries against any claim which is subject to the above deductible shall be credited to the Underwriters in full to the extent of the sum by which the aggregate of the claim unreduced by any recoveries exceeds the above deductible.

Interest comprised in recoveries shall be apportioned between the Assured and the Underwriters, taking into account the sums paid by Underwriters and the dates when such payments were made, notwithstanding that by the addition of interest the Underwriters may receive a larger sum than they have paid.

APPENDIX D

London Marine Construction All Risks Wording (01/09/07)[1]

SCHEDULE

Note: For items marked * the default provision in the relevant clause shall apply in the absence of any other figure agreed in this Schedule.		Clause number [Default provision*]
Assured: Name and address of Builder:		Clause 56.5
Name and address of Yard:		Clause 56.23
Name and address of Buyer:		Clause 56.6
Vessel: Hull number/project name:		Clause 56.21
Period: Commencement date:		Clause 43.2.2 or 56.16.1 as applicable
Termination date:		Clause 43.2.2 or 56.16.2 as applicable
Estimated Launch Date:		Clause 56.13
Sum Insured (insured value):		Clause 43.2.5 or 56.20 as applicable
Escalation percentage*:		Clause 44.2 [110% of the Sum Insured]
Going-in Value (Pre-existing Vessel)—where applicable:		Clause 43.2.1

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Limit of liability: Collision liability legal costs*:		Clauses 6.3 and 45.1.3 [25% of the Sum Insured]
Material (not forming part of the Works Value—Actual total loss, Abandonment)*:		Clauses 29.2, 31.4 and 45.1.6 [10% of the Sum Insured]
Trials*:		Clause 45.1.7 [10% of the Sum Insured]
Failure to launch*:		Clause 45.1.8 [10% of the Sum Insured]
Allocated Series Costs*:		Clause 56.3 [None]
Deductibles: Section A—Construction		Clause 5
Section B—Liability		Clause 8
Section C—War		Clause 14
Section D—Strikes etc.		Clause 19
Profit percentage*:		Clause 56.17 [10% of the costs]
Navigation distance*:		Clause 49.1.2 [250 nautical miles]
Optional buybacks: Defects:	Insured/Not insured (delete as applicable)	Clause 57 [Not insured]
Profit on partial loss:	Insured/Not insured (delete as applicable)	Clause 58 [Not insured]
Expediting Expenses: Limit of liability*:	Insured/Not insured (delete as applicable)	Clauses 45.1.9 and 59 [Not insured] [10% of the Sum Insured]
Trials amendment	Insured/Not insured (delete as applicable)	Clause 60 [Not insured]
Extended cover for Items*:		Clauses 50.1 and 50.3 [None]

Premium: Section C Section D			Clause 15.3 Clause 20.2
Premium payments: First instalment*: Subsequent instalments:	Amount	Due date	Clause 47.1 [within 45 days] [on due date]
Additional premiums to be paid within*:			Clause 47.2 [60 days]

1. General

Application

1.1 This Clause 1 and Parts I to IV shall apply to this insurance. Clauses 57 to 60 of Part V shall only apply where and to the extent that the Underwriters have expressly so agreed in the Schedule.

1.2 Clause 43 (Pre-existing Vessel) shall apply where the Vessel is a Pre-existing Vessel that is to undergo conversion, repair, lengthening or any other work, as more particularly described in Clause 43.

1.3 This insurance is not evidence of financial responsibility under the Oil Pollution Act 1990 or any similar Federal or State laws and may not be shown or tendered to the United States Coast Guard or any Federal or State agency as evidence of financial responsibility or evidence of insurance. The Underwriters do not agree to be guarantors.

Law and Jurisdiction

1.4 This insurance is subject to English law and practice and to the exclusive jurisdiction of the English High Court of Justice

1.4.1 except as provided in Clause 37 (Arbitration); and

1.4.2 except as may be expressly provided herein to the contrary.

1.5 Subject to the overriding provisions of Clause 1.4, disputes between the Assured and the Underwriters may, if not settled amicably by negotiation, be referred by agreement of the Assured and the Underwriters to mediation or other form of alternative dispute resolution.

Invalidity/Unenforceability

1.6 If any provision of this insurance is held to be invalid or unenforceable, such invalidity or unenforceability shall not affect the other provisions of this insurance which shall remain in full force and effect.

Miscellaneous

1.7 Headings or references to headings are for information only and shall not be used in construing these provisions.

1.8 Words commencing with capital letters (save in headings or references to headings) shall have the meanings assigned to them in Clause 56 (Definitions).

PART I—STANDARD COVER

SECTION A—CONSTRUCTION

2. Perils

2.1 Subject always to Clause 3 (Section A exclusions), the insurance under Section A is against all risks of physical loss or physical damage to the Subject Matter Insured caused and discovered during the Period of the Insurance.

2.2 For the avoidance of doubt, the Subject Matter Insured shall not be regarded as physically lost or physically damaged solely by virtue of the existence therein of any defect in design, plan or specification, defect in workmanship, defect in material or latent defect.

3. Section A Exclusions

In no case shall the insurance under Section A cover the cost of replacing, repairing or rectifying any:

3.1 defect in design, plan or specification;
3.2 defect in workmanship;
3.3 defect in material;
3.4 latent defect.

However, these exclusions shall not extend to the cost of repairing physical loss or physical damage caused by such defect and discovered during the Period of the Insurance, to the extent that the cost of repairing such physical loss or physical damage exceeds the cost that would have been incurred to replace, repair or rectify the said defect had it been discovered immediately prior to the occurrence of the physical loss or physical damage caused thereby.

4. General average and salvage

4.1 The insurance under Section A covers the Vessel's proportion of salvage, salvage charges and/or general average, without reduction in respect of any under-insurance, but in the case of general average sacrifice of the Vessel, the Assured may recover in respect of the whole loss without first enforcing their right of contribution from other parties.

4.2 General average shall be adjusted according to the law and practice obtaining at the place where the adventure ends, as if the contract of affreightment contained no special terms upon the subject; but where the contract of affreightment so provides, the adjustment shall be according to the York-Antwerp Rules.

4.3 When the Vessel sails in ballast, not under charter, the provisions of the York-Antwerp Rules 2004 (excluding Rules XX and XXI) shall be applicable, and the voyage for this purpose shall be deemed to continue from the port or place of departure until the arrival of the Vessel at the first port or place thereafter other than a port or place of refuge or a port or place of call for bunkering only. If at any such intermediate port or place there is an abandonment of the adventure originally contemplated, the voyage shall thereupon be deemed to be terminated.

4.4 The Underwriters shall in no case be liable under this Clause 4 where the loss was not incurred to avoid or in connection with the avoidance of a peril insured under this insurance.

4.5 The Underwriters shall in no case be liable under this Clause 4 for or in respect of:

4.5.1 special compensation payable to a salvor under Article 14 of the International Convention on Salvage 1989 or under any other provision in any statute, rule, law or contract which is similar in substance;

4.5.2 expenses or liabilities incurred in respect of damage to the environment, or the threat of such damage, or as a consequence of the escape or release of any pollutant substance from the Vessel, or the threat of such escape or release.

4.6 Clause 4.5 shall not however exclude any sum which the Assured shall pay:

4.6.1 to salvors for or in respect of salvage remuneration in which the skill and efforts of the salvors in preventing or minimising damage to the environment as is referred to in Article 13 paragraph 1(b) of the International Convention on Salvage 1989 have been taken into account

4.6.2 as general average expenditure allowable under Rule XI(d) of the York-Antwerp Rules 2004, but only where the contract of affreightment provides for adjustment according to the York-Antwerp Rules 2004.

4.7 Should the Vessel receive salvage services from another vessel belonging wholly or in part to the Assured or under the same management, the Assured shall have the same rights under this insurance as they would have were the other vessel entirely the property of owners not interested in the Vessel; but in such cases the amount payable for the services rendered shall be referred to a sole arbitrator in accordance with Clauses 37.5 to 37.8 (Arbitration).

5. Section A Deductible

5.1 No claim arising from a peril insured under Section A shall be payable under Section A unless the aggregate of all such claims arising out of each separate Occurrence (including claims under Clauses 4 (General average and salvage) and 25 (Duty of the Assured (sue and labour))) exceeds the Section A deductible agreed in the Schedule in which case this sum shall be deducted. Nevertheless the expense of sighting the bottom after stranding, if reasonably incurred specially for that purpose, shall be paid even if no physical damage be found.

5.2 This Clause 5 shall not apply to Abandonment or a claim for total or constructive total loss of the Vessel or, in the event of such a claim, to any associated claim under Clause 25 (Duty of the Assured (sue and labour)) arising from the same Occurrence.

SECTION B—LIABILITY

6. Collision

6.1 The Underwriters shall indemnify the Assured for any sum or sums paid by the Assured to any other person or persons by reason of the Assured's interest in the Vessel and by reason of the Assured becoming legally liable by way of damages:

6.1.1 for loss of or damage to any other vessel or property on any other vessel;

6.1.2 for delay to or loss of use of any such other vessel or property thereon;

6.1.3 for general average of, salvage of, or salvage under contract of, any such other vessel or property thereon;

6.1.4 in respect of the liability of any such other vessel arising out of the escape or release of any pollutant substance from any such other vessel,

where such payment by the Assured is in consequence of the Vessel coming into collision with any other vessel during the Period of the Insurance.

6.2 The indemnity provided by this Clause 6 shall be subject to the following provisions:

6.2.1 Where the Vessel is in collision with another vessel and both vessels are to blame then, unless the liability of one or both vessels becomes limited by law, the indemnity under this Clause 6 shall be calculated on the principle of cross-liabilities as if the respective owners had been compelled to pay to each other such proportion of each other's damages as may have been properly allowed in ascertaining the balance or sum payable by or to the Assured in consequence of the collision.

6.2.2 In no case shall the Underwriters' total liability under Clauses 6.1 and 6.2 exceed their proportionate shares of the Sum Insured in respect of any one collision.

6.3 The Underwriters shall also indemnify the Assured for legal costs incurred by the Assured or which the Assured may be compelled to pay in contesting liability or taking proceedings to limit liability, provided always that their prior written agreement to the

incurring of such legal costs shall have been obtained and that the total liability of the Underwriters under this Clause 6.3 shall in no case (unless the Underwriters' specific written agreement shall have been obtained) exceed 25% of the Sum Insured.

6.4 The Underwriters shall in no case be liable under this Clause 6 for any sum which the Assured shall pay for or in respect of:

6.4.1 removal or disposal of any obstruction, wreck, cargo or any other thing whatsoever;

6.4.2 any real or personal property or thing whatsoever except any other vessel or property on any other vessel;

6.4.3 the cargo or other property on, or the engagements of, the Vessel;

6.4.4 loss of life, personal injury or illness;

6.4.5 pollution or contamination, or threats thereof, of any real or personal property or thing whatsoever (except any other vessel with which the Vessel is in collision or property on such other vessel or the liability arising out of the escape or release of any pollutant substance from such other vessel) or damage to the environment, or threat thereof, save that this exclusion shall not exclude any sum which the Assured shall pay for or in respect of salvage remuneration in which the skill and efforts of the salvors in preventing or minimising damage to the environment as referred to in Article 13 paragraph 1(b) of the International Convention on Salvage 1989 have been taken into account;

6.4.6 loss of or damage to property (not being a vessel) owned, leased or occupied by any Assured or any Additional Assured.

6.5 Should the Vessel come into collision with another vessel belonging wholly or in part to the Assured or under the same management, the Assured shall have the same rights under this insurance as they would have were the other vessel entirely the property of owners not interested in the Vessel; but in such cases the liability for the collision shall be referred to a sole arbitrator in accordance with Clauses 37.5 to 37.8 (Arbitration).

7. Protection and indemnity

7.1 The Underwriters shall indemnify the Assured for any sum or sums paid by the Assured to any other person or persons by reason of the Assured becoming legally liable, by reason of the Assured's interest in the Vessel, for any claim, demand, damages and/or expenses, where such liability is in consequence of any of the matters or things described in Clauses 7.1.1 to 7.1.5 and arises from an Occurrence during the Period of the Insurance:

7.1.1 loss of or damage to any fixed or moveable object or property or other thing or interest whatsoever, other than the Vessel, arising from any cause whatsoever in so far as such loss or damage is not covered by Clause 6 (Collision);

7.1.2 any attempted or actual raising, removal or destruction of any fixed or moveable object or property or other thing, including the wreck of the Vessel, or any neglect or failure to raise, remove, or destroy the same;

7.1.3 liability assumed by the Assured under contracts of customary towage for the purpose of entering or leaving port or manoeuvring within the port;

7.1.4 loss of life, personal injury, illness or payments made for life salvage:

7.1.5 the escape or release from the Vessel of any pollutant substance or the threat of such escape or release (subject always to Clause 7.5).

7.2 The Underwriters shall indemnify the Assured for any of the following arising from an Occurrence during the Period of the Insurance:

7.2.1 the additional cost of fuel, insurance, wages, stores, provisions and port charges reasonably incurred solely for the purpose of landing from the Vessel sick or injured persons or stowaways, refugees, or persons saved at sea;

7.2.2 additional expenses brought about by the outbreak of infectious disease on the Vessel or ashore;

7.2.3 fines imposed on the Vessel, on the Assured, or on any master, officer, crew member or agent of the Vessel who is reimbursed by the Assured, for any act

or neglect or breach of any statute or regulation relating to the operation of the Vessel, provided that the Underwriters shall in no case be liable to indemnify the Assured for any fines which result from any act, neglect, failure or default of the Assured, their agents or servants other than any master, officer or crew member;

7.2.4 the expenses of the removal of the wreck of the Vessel from any place owned, leased or occupied by the Assured;

7.2.5 legal costs incurred by the Assured, or which the Assured may be compelled to pay, in avoiding, minimising or contesting liability or taking proceedings to limit liability with the prior written agreement of the Underwriters in respect of a liability covered by this Clause 7.

7.3 The Underwriters shall in no case be liable under this Clause 7 for any liability, cost or expense arising in respect of:

7.3.1 any direct or indirect payment by the Assured or any Additional Assured under workmen's compensation or employers' liability acts and any other statutory or common law, general maritime law or other liability whatsoever in respect of accidents to or illness of workmen or any other persons employed in any capacity whatsoever by the Assured or any Additional Assured or others in, on or about or in connection with the Vessel or its cargo, materials or repairs;

7.3.2 liability assumed by the Assured or any Additional Assured under agreement expressed or implied in respect of death or illness of or injury to any person employed under a contract of service or apprenticeship by the other party to such agreement;

7.3.3 punitive or exemplary damages, however described;

7.3.4 cargo or other property carried, to be carried or which has been carried on the Vessel, but this Clause 7.3.4 shall not exclude any claim in respect of the extra cost of removing cargo from the wreck of the Vessel;

7.3.5 loss of or damage to property owned by the Assured or any Additional Assureds or others employed in connection with the Vessel or property for which any of them is responsible, which is on the Vessel;

7.3.6 loss of or damage to the Subject Matter Insured, but this exclusion shall not extend to claims under Clauses 7.1.2 or 7.2.4;

7.3.7 liability arising under a contract or indemnity in respect of containers, equipment, fuel or other property on the Vessel and which is owned or leased by the Assured or any Additional Assured;

7.3.8 loss of or damage to cash, negotiable instruments, precious metals or stones, valuables or objects of a rare or precious nature, belonging to persons on the Vessel, or non-essential personal effects of any master, officer or crew member;

7.3.9 fuel, insurance, wages, stores, provisions and port charges arising from delay to the Vessel while awaiting a substitute for any master, officer or crew member;

7.3.10 fines or penalties arising from overloading or illegal fishing.

7.4 The Underwriters shall indemnify the Assured for any of the following in the event of a claim recoverable under Clause 7.1.5 (subject always to Clause 7.5):

7.4.1 the costs of any measures reasonably taken to prevent the escape or release from the Vessel of any pollutant substance;

7.4.2 the costs of any measures reasonably taken for the purpose of preventing or minimising pollution or any resulting loss or damage together with any liability for loss of or damage to property caused by measures so taken;

7.4.3 the costs or liabilities incurred as a result of compliance with any order or direction given by any government or authority, for the purpose of preventing or minimising pollution, provided always that such compliance is not a requirement for the normal operation or salvage or repair of the Vessel.

7.5 It is a condition precedent to the liability of the Underwriters under Clause 7.1.5 and Clause 7.4 that all of the following conditions are met and are shown by the Assured to have been met:

7.5.1 the escape or release of any pollutant substance or the threat of such escape or release was caused by an Occurrence; and

7.5.2 the Occurrence commenced on an identified specific date during the Period of the Insurance; and

7.5.3 the Occurrence was discovered by the Assured within 72 hours of commencement; and

7.5.4 the Occurrence did not result from the Assured's intentional violation of any statute, rule, ordinance or regulation.

7.6 Where the Assured or any Additional Assured or the Underwriters can or could have limited their liability, the indemnity under this Clause 7 in respect of such liability shall in no case exceed the Underwriters' proportionate shares of the amount of such limitation.

7.7 In no case shall the Underwriters' liability under this Clause 7 arising out of each separate Occurrence exceed their proportionate shares of the Sum Insured.

8. Section B Deductible

No claim arising from a peril insured under Section B shall be payable under Section B unless the aggregate of all such claims arising out of each separate Occurrence (including claims under Clause 25 (Duty of the Assured (sue and labour))) exceeds the Section B deductible agreed in the Schedule, in which case this sum shall be deducted.

SECTION C—WAR

9. Attachment

9.1 Subject always to Clause 9.2, the insurance under Section C shall attach on the Launch Date (and not before) and then only to the Vessel as at the Launch Date. The insurance under Section C shall only apply to Items as they are placed on the Vessel on or after the Launch Date.

9.2 The insurance under Section C shall not attach if, between the commencement of the Period of the Insurance and the Launch Date, there has occurred any event which would have automatically terminated the insurance under Section C in accordance with Clause 15 (Termination).

10. Perils

Subject always to Clause 13 (Section C exclusions), the insurance under Section C covers:

10.1 physical loss of or physical damage to the Subject Matter Insured caused by war, civil war, revolution, rebellion, insurrection or civil strife arising therefrom, or any hostile act by or against a belligerent power;

10.2 loss of or physical damage to the Subject Matter Insured caused by capture, seizure, arrest, restraint or detainment, arising from perils covered under Clause 10.1, and the consequences thereof or any attempt thereat;

10.3 physical loss of or physical damage to the Subject Matter Insured caused by derelict mines, torpedoes, bombs or other derelict weapons of war.

11. General average and salvage, protection and indemnity/collision liability

Subject always to Clause 13 (Section C exclusions), the insurance under Section C also covers:

11.1 general average and salvage under Clause 4 (General average and salvage) which is excluded by Clause 22 (War exclusion);

11.2 the liability under Section B which is excluded by Clause 22 (War exclusion).

12. Detainment

12.1 In the event that the Vessel shall have been the subject of capture, seizure, arrest, restraint or detainment covered under Clause 10.2 (Perils), and the Assured shall thereby have lost the free use and disposal of the Vessel for a continuous period of 12 months, then for the purpose of ascertaining whether the Vessel is a constructive total loss, the Assured shall be deemed to have been deprived of possession of the Vessel without any likelihood of recovery.

12.2 The inability of the Vessel to sail from any port, canal, waterway or other place to the high seas for a continuous period of 12 months as a result of the closure of the connecting channel to all vessels of such size or draft shall amount to "restraint" in accordance with Clause 10.2 (Perils), provided that such closure has arisen through the blockage of the port, canal, waterway or other place by a warlike act or act of national defence.

13. Section C Exclusions

In no case shall the insurance under Section C cover:

13.1 loss, damage, liability or expense arising from:

13.1.1 the outbreak of war (whether there be a declaration of war or not) between any of the following countries:
United Kingdom, United States of America, France, the Russian Federation, the Peoples' Republic of China;

13.1.2 confiscation, expropriation, requisition or pre-emption;

13.1.3 capture, seizure, arrest, restraint or detainment by or under the order of the government or any public or local authority of the country in which the Vessel is owned or registered;

13.1.4 arrest, restraint or detainment under quarantine regulations or by reason of infringement of any customs or trading regulations;

13.1.5 the operation of ordinary judicial process, failure to provide security or to pay any fine or penalty or any financial cause;

13.1.6 the loss of or frustration of any voyage or contract for sale or other adventure;

13.2 loss, damage, liability or expense covered under Section A, Section B or Section D or which would be recoverable thereunder but for the deductible clauses therein.

14. Section C Deductible

14.1 No claim arising from a peril insured under Section C shall be payable under Section C unless the aggregate of all such claims arising out of each separate Occurrence (including claims under Clauses 11 (General average and salvage, P&I and collision liability) and 25 (Duty of the Assured (sue and labour))) exceeds the Section C deductible, if any, agreed in the Schedule in which case this sum shall be deducted.

14.2 This Clause 14 shall not apply to Abandonment or a claim for total or constructive total loss of the Vessel or, in the event of such a claim, to any associated claim under Clause 25 (Duty of the Assured (sue and labour)) arising from the same Occurrence.

15. Termination

15.1 The insurance under Section C may be cancelled by either the Underwriters or the Assured giving 7 days' notice (such cancellation becoming effective on the expiry of 7 days from midnight of the day on which notice of cancellation is issued by or to the Underwriters). The Underwriters shall however reinstate the insurance under Section C subject to agreement between the Underwriters and the Assured prior to the expiry of such notice of cancellation as to any new rate of premium and/or conditions and/or warranties.

15.2 Whether or not such notice of cancellation has been given the insurance under Section C shall TERMINATE AUTOMATICALLY:

15.2.1 upon the outbreak of war (whether there be a declaration of war or not) between any of the following countries:
United Kingdom, United States of America, France, the Russian Federation, the People's Republic of China;

15.2.2 in the event of the Vessel being requisitioned, either for title or use.

15.3 In the event either of cancellation by notice or of automatic termination of the insurance under Section C by reason of the operation of this Clause 15, pro rata net return of premium under Section C shall be payable to the Assured, provided always that the premium under this Section C was separately identified from the premium under Section A, Section B and Section D of this insurance, prior to such cancellation by notice or such automatic termination.

SECTION D—STRIKES, TERRORIST, POLITICAL MOTIVE AND MALICIOUS ACTS

16. Perils

Subject always to Clause 18 (Section D exclusions), the insurance under Section D covers physical loss of or physical damage to the Subject Matter Insured caused by the perils listed in Clause 23 (Strikes, terrorist, political motive and malicious acts exclusion).

17. General average and salvage, protection and indemnity/collision liability

Subject always to Clause 18 (Section D exclusions), the insurance under Section D also covers:

17.1 general average and salvage under Clause 4 (General average and salvage) which is excluded by Clause 23 (Strikes, terrorist, political motive and malicious acts exclusion);

17.2 the liability under Section B which is excluded by Clause 23 (Strikes, terrorist, political motive and malicious acts exclusion).

18. Section D Exclusions

In no case shall the insurance under Section D cover:

18.1 loss, damage, liability or expense covered under Section A, Section B or Section C or which would be recoverable thereunder but for the deductible clauses therein;

18.2 loss, damage, liability or expense arising from the loss of or frustration of any voyage or contract for sale or other adventure.

19. Section D Deductible

19.1 No claim arising from a peril insured under Section D shall be payable under Section D unless the aggregate of all such claims arising out of each separate Occurrence (including claims under Clauses 17 (General average and salvage, P&I/collision liability) and 25 (Duty of the Assured (sue and labour)) exceeds the Section D deductible, if any, agreed in the Schedule in which case this sum shall be deducted.

19.2 This Clause 19 shall not apply to Abandonment or a claim for total or constructive total loss of the Vessel or, in the event of such a claim, to any associated claim under Clause 25 (Duty of the Assured (sue and labour)) arising from the same Occurrence.

20. Termination

20.1 The insurance under Section D may be cancelled by either the Underwriters or the Assured giving 7 days' notice (such cancellation becoming effective on the expiry of 7

days from midnight of the day on which notice of cancellation is issued by or to the Underwriters). The Underwriters shall however reinstate the insurance under Section D subject to agreement between the Underwriters and the Assured prior to the expiry of such notice of cancellation as to any new rate of premium and/or conditions and/or warranties.

20.2 In the event of such cancellation of the insurance under Section D, pro rata net return of premium under Section D shall be payable to the Assured, provided always that the premium under this Section D was separately identified from the premium under Section A, Section B and Section C of this insurance, prior to such cancellation.

PART II—GENERAL EXCLUSIONS

21. General Exclusions

In no case shall this insurance cover loss, damage, liability or expense caused:

21.1 by wilful misconduct of the Assured;
21.2 by insolvency;
21.3 solely by ordinary wear and tear;
21.4 by delay, except such expenses as would be recoverable in principle in English law and practice under the York-Antwerp Rules 2004.

22. War Exclusion

In no case shall the insurance under Section A, Section B or Section D cover loss, damage, liability or expense caused by:

22.1 war, civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or any hostile act by or against a belligerent power;
22.2 capture, seizure, arrest, restraint or detainment (violent theft, barratry and piracy excepted), and the consequences thereof or any attempt thereat;
22.3 derelict mines, torpedoes, bombs or other derelict weapons of war.

23. Strikes, terrorist, political motive and malicious acts exclusion

In no case shall the insurance under Section A, Section B or Section C cover loss, damage, liability or expense caused by:

23.1 strikers, locked-out workmen, or persons taking part in labour disturbances, riots or civil commotions;
23.2 violent theft by persons from outside the Vessel;
23.3 piracy;
23.4 barratry of master, officers or crew;
23.5 any terrorist;
23.6 any person acting maliciously or from a political motive;
23.7 the use of any weapon or the detonation of an explosive by any person acting maliciously or from a political motive.

However, the exclusion in Clause 23.7 shall not extend to physical loss of or physical damage to the Vessel caused by any governmental authority acting under the powers vested in it to prevent or mitigate a pollution hazard or damage to the environment or the threat thereof, resulting directly from physical loss or physical damage to the Vessel for which the Underwriters are liable under Section A, Section C or Section D of this insurance, provided such act of governmental authority has not resulted from want of due diligence by the Assured or any of them to prevent or mitigate such hazard or damage or threat thereof. Master, officers, crew or pilots shall not be considered as the Assured within the meaning of this Clause should they hold shares in the Vessel.

24. Radioactive contamination, chemical, biological, bio-chemical and electromagnetic weapons exclusion

In no case shall the insurance under Section A, Section B, Section C or Section D cover loss, damage, liability or expense directly or indirectly caused by or contributed to by or arising from:

24.1 ionising radiations from or contamination by radioactivity from any nuclear fuel or from any nuclear waste or from the combustion of nuclear fuel;

24.2 the radioactive, toxic, explosive or other hazardous or contaminating properties of any nuclear installation, reactor or other nuclear assembly or nuclear component thereof;

24.3 any weapon or device employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter;

24.4 the radioactive, toxic, explosive or other hazardous or contaminating properties of any radioactive matter. The exclusion in this Clause 24.4 shall not extend to radioactive isotopes, other than nuclear fuel, when such isotopes are being prepared, carried, stored, or used for commercial, agricultural, medical, scientific or other similar peaceful purposes;

24.5 any chemical, biological, bio-chemical or electromagnetic weapon.

PART III—CLAIMS

25. Duty of the Assured (sue and labour)

25.1 In case of any loss or misfortune it is the duty of the Assured and their servants and agents to take such measures as may be reasonable for the purpose of averting or minimising a loss which would be recoverable under this insurance.

25.2 Subject to the provisions of this Clause 25 and to Clauses 5 (Section A deductible), 8 (Section B deductible), 14 (Section C deductible) and 19 (Section D deductible), the Underwriters shall contribute to charges properly and reasonably incurred by the Assured, their servants or agents for such measures. General average, salvage charges (except as provided for in Clause 25.4), special compensation and expenses as referred to in Clause 4.5 (General average and salvage), collision defence or attack costs and costs as referred to in Clause 7.4 (Protection and indemnity) are not recoverable under this Clause 25. For the avoidance of doubt, Expediting Expenses are not recoverable under this Clause 25.

25.3 Measures taken by the Assured or the Underwriters with the object of saving, protecting or recovering the Subject Matter Insured shall not be considered as a waiver or acceptance of abandonment or otherwise prejudice the rights of either party.

25.4 When the Underwriters have admitted a claim for total loss of the Vessel or there has been an Abandonment under this insurance and expenses have been reasonably incurred in saving or attempting to save the Vessel and other property and there are no proceeds, or the expenses exceed the proceeds, then this insurance shall bear its pro rata share of such proportion of the expenses, or of the expenses in excess of the proceeds, as the case may be, as may reasonably be regarded as having been incurred in respect of the Vessel, excluding all special compensation and expenses as referred to in Clause 4.5 (General average and salvage).

25.5 The sum recoverable under this Clause 25 shall be in addition to the loss otherwise recoverable under this insurance but shall in no case exceed the Sum Insured.

26. Notice of claim

26.1 In the event of an Occurrence whereby loss, damage, liability or expense may result in a claim under this insurance, notice shall be given to the Underwriters:

26.1.1 as soon as possible after the date on which the Assured or the Assured's project management become aware of such loss, damage, liability or expense; and

26.1.2 in case of physical loss of or physical damage to the Subject Matter Insured, prior to the commencement of any repair work.

26.2 If notice is not given to the Underwriters within 180 days of the Assured or the Assured's project management becoming aware of such loss, damage, liability or expense, no claim shall be recoverable under this insurance in respect of such loss, damage, liability or expense, unless the Underwriters agree to the contrary in writing.

26.3 Subject always to Clause 26.2, if notice is not given to the Underwriters prior to the commencement of repair work to physical loss of or physical damage to the Subject Matter Insured, no claim shall be recoverable under this insurance in respect of such physical loss or physical damage, save to the extent that the Assured can establish that the Underwriters have not suffered any prejudice as a result of not having been so notified.

26.4 It is a condition precedent to the liability of the Underwriters under Section B, Clause 11.2 (Section C, P&I and collision liability) and Clause 17.2 (Section D, P&I and collision liability) that:

26.4.1 prompt notice must be given to the Underwriters of every casualty, event or claim upon the Assured which may give rise to a claim under Section B, Clause 11.2 or clause 17.2 and of every event or matter which may cause the Assured to incur liability, costs or expense for which they may be insured under Section B, Clause 11.2 or Clause 17.2;

26.4.2 the Assured shall not admit liability for or settle any claim for which they may be insured under Section B, Clause 11.2 or Clause 17.2 without the prior written agreement of the Underwriters.

26.5 It is a condition precedent to the liability of the Underwriters under Clauses 7.1.5 and 7.4 (Protection and indemnity) that written notice of the Occurrence is given to the Underwriters within 30 days of the Assured's or the Assured's project management's discovery of the Occurrence.

27. Partial loss

27.1 The measure of indemnity in respect of partial loss shall, where the Subject Matter Insured has been repaired, be the reasonable cost of the repairs, but shall in no case exceed the Sum Insured in respect of any one Occurrence.

27.2 For the avoidance of doubt, the reasonable cost of the repairs shall not include:

27.2.1 the Assured's profit on such cost;

27.2.2 Expediting Expenses.

28. Constructive total loss

28.1 The measure of indemnity in respect of a constructive total loss shall be the Sum Insured.

28.2 In ascertaining whether the Subject Matter Insured is a constructive total loss, the Sum Insured less the Profit Percentage thereon shall be taken as the repaired value and nothing in respect of the damaged or break-up value shall be taken into account.

28.3 No claim for a constructive total loss based upon the cost of recovery and/or the reasonable cost of the repairs (calculated in accordance with Clause 27 (Partial loss)), shall be recoverable under this insurance unless such cost(s) would exceed the Sum Insured less the Profit Percentage thereon.

28.4 In making the determination under Clause 28.3:

28.4.1 only the cost(s) relating to physical loss or physical damage arising from the same Occurrence shall be taken into account; and

28.4.2 no account shall be taken of:

28.4.2.1 Expediting Expenses; or

28.4.2.2 the Assured's profit on the cost of recovery of and/or the reasonable cost of the repairs to the Subject Matter Insured.

29. Actual total loss

29.1 The measure of indemnity in respect of an actual total loss shall be the Works Value plus the Profit Percentage thereon at the time of loss.

29.2 In the event of an actual total loss, the Underwriters shall also indemnify the Assured for the cost of material (not forming part of the Works Value) where the Assured is under a legal obligation to purchase the material, notwithstanding the actual total loss. The liability of the Underwriters shall not exceed the lesser of the contractual liability of the Assured in respect of such material or the cost of such material. In no case shall the Underwriters' liability under this Clause 29.2 exceed 10% of the Sum Insured or such other percentage agreed in the Schedule.

30. Unrepaired damage

30.1 The measure of indemnity in respect of a claim for unrepaired damage shall be the reasonable cost of the repairs calculated in accordance with Clause 27 (Partial loss), but shall in no case exceed the Contract Deduction in respect of such damage.

30.2 In no case shall the Underwriters be liable for unrepaired damage in the event of a subsequent Abandonment or of a subsequent total loss (whether or not covered under this insurance) sustained during the Period of the Insurance or any extension thereof.

30.3 The Underwriters shall in no case be liable for unrepaired damage for more than the Sum Insured at the time this insurance terminates or is cancelled.

30.4 Any dispute between the Assured and the Underwriters as to whether the Underwriters' agreement is or is not reasonably withheld to the amount by which the sum payable by the Buyer to the Builder is reduced by reason of physical damage to the Vessel not repaired by the Builder at the time this insurance terminates or is cancelled shall be referred to arbitration in accordance with Clauses 37.1 to 37.4 (Arbitration).

31. Abandonment

31.1 In the event of physical loss of or physical damage to the Vessel and in the event that:

31.1.1 the cost of recovery and/or the reasonable cost of the repairs (calculated in accordance with Clause 27 (Partial loss)) of the Vessel required to recover and/or repair the Vessel to a stage equivalent to that at the time of loss exceed(s) the Works Value at the time of loss, but do(es) not exceed the Sum Insured; and

31.1.2 there is an Abandonment,

the measure of indemnity shall be the Works Value plus the Profit Percentage thereon at the time of loss.

31.2 Any dispute between the Assured and the Underwriters as to whether the Underwriters' agreement is or is not reasonably withheld to an agreement between the Builder and the Buyer that the Builder is relieved of the obligation to build or deliver the Vessel to the Buyer, by reason of physical loss of or physical damage to the Vessel, shall be referred to arbitration in accordance with Clauses 37.1 to 37.4 (Arbitration).

31.3 In making the determination under Clause 31.1.1:

31.3.1 only the cost(s) relating to physical loss or physical damage arising from the same Occurrence shall be taken into account; and

31.3.2 no account shall be taken of:

31.3.2.1 Expediting Expenses; or

31.3.2.2 the Assured's profit on the cost of recovery and/or the reasonable cost of the repairs to the Vessel.

31.4 In the event of an Abandonment, the Underwriters shall also indemnify the Assured for the cost of material (not forming part of the Works Value) where the Assured is under a legal obligation to purchase the material, notwithstanding the Abandonment. The liability of the Underwriters shall not exceed the lesser of the contractual liability of the Assured in respect of such material or the cost of such material. In no case shall the

Underwriters' liability under this Clause 31.4 exceed 10% of the Sum Insured or such other percentage agreed in the Schedule.

32. Trials

In case of failure of trials resulting from physical loss or physical damage to the Vessel due to a peril insured under this insurance, the Underwriters shall pay the expenses reasonably incurred in re-running trials to the extent that such expenses are necessary to effect the repairs, but in no case shall the Underwriters be liable for expenses incurred in re-running trials undertaken solely by reason of contractual provisions between the Builder and the Buyer.

33. Failure of launch

In case of failure of launch of the Vessel, the Underwriters shall pay the expenses reasonably incurred solely in connection with completion of the launch of the Vessel.

34. Deductibles

In the event of a claim under more than one section of this insurance arising out of the same Occurrence, then only the highest applicable deductible shall be deducted.

35. Claims under more than one section exclusion

The insurance under Section B, Section C and Section D excludes any sum recoverable under Section A of this insurance.

36. Payment of claims

Unless otherwise agreed in writing, claims shall be paid to the broker which placed this insurance and such payment, whether in account or otherwise, shall be a complete discharge of the Underwriters' obligations under this insurance in respect of the amount so paid (and whether or not more than one Assured or Additional Assured may have an interest in such payment).

37. Arbitration

Abandonment/unrepaired damage

37.1 Any dispute between the Assured and the Underwriters concerning whether the Underwriters' agreement is or is not reasonably withheld for the purposes of Clause 30.4 (Unrepaired damage) or Clause 31.2 (Abandonment) shall be referred to arbitration in London in accordance with the Arbitration Act 1996 or any statutory modification or re-enactment thereof for the time being in force and in accordance with Clauses 37.2 to 37.4.

37.2 The arbitration shall be conducted in accordance with the London Maritime Arbitrators Association (LMAA) Terms current at the time when the arbitration proceedings are commenced.

37.3 The reference shall be to three arbitrators. A party wishing to refer a dispute to arbitration shall appoint its arbitrator and send notice of such appointment in writing to the other party requiring the other party to appoint its own arbitrator within 14 days of that notice and stating that it will appoint its arbitrator as sole arbitrator unless the other party appoints its own arbitrator and give notice in writing that it has done so within the 14 days specified. If the other party does not appoint its own arbitrator and give notice in writing that it has done so within the 14 days specified, the party referring a dispute to arbitration may, without the requirement of any further prior notice to the other party, appoint its arbitrator as sole arbitrator and shall advise the other party accordingly. The award of a sole arbitrator shall be binding on both parties as if he or she had been appointed by the agreement of both parties.

37.4 Nothing in this Clause 37 shall prevent the parties agreeing in writing to vary these provisions to provide for the appointment of a sole arbitrator.

Sister ship salvage/collision

37.5 The amount payable in respect of salvage services as described in Clause 4.7 (General average and salvage) or the liability for any collision as described in Clause 6.5 (Collision) shall be referred to arbitration in London in accordance with the Arbitration Act 1996 or any statutory modification or re-enactment thereof for the time being in force and in accordance with Clauses 37.6 to 37.8.

37.6 the matters described in Clause 37.5 shall be referred to a sole arbitrator to be selected either by the Assured or the Underwriters from the persons currently on the panel of Lloyd's Salvage Arbitrators with a right to appeal from an award made by the arbitrator to either party by notice in writing to the other party within 28 days of the date of publication of the arbitrator's award.

37.7 The arbitrator on appeal shall be the person currently acting as the Lloyd's Appeal Arbitrator.

37.8 Both the arbitrator and the arbitrator on appeal shall have the same powers as an arbitrator and an arbitrator on appeal under LOF 2000 or any standard revision thereof.

38. Subrogation

38.1 In the event of loss, damage, liability or expense covered under this insurance, the Underwriters shall be subrogated to all rights and remedies of the Assured and any Additional Assureds:

38.1.1 save against the Builder (subject to Clause 38.2) and the Buyer, against whom such rights and remedies are waived by the Underwriters; and

38.1.2 save against any Additional Assured (subject to Clause 38.2) whose written contract with the Assured provides that the Underwriters shall waive such rights and remedies, but only to the extent of the waiver (if any) provided by such written contract.

38.2 Where an Assured or any Additional Assured is, under a separate insurance, insured against liability for loss of or damage to the Subject Matter Insured, such Assured or Additional Assured agrees on its own behalf and on behalf of the insurers of such liability insurance:

38.2.1 that the Underwriters shall not waive any rights of subrogation against such Assured or Additional Assured; and

38.2.2 to provide a copy of the policy or other document evidencing such liability insurance to the Underwriters upon their written request; and

38.2.3 that the Underwriters may bring proceedings against such Assured or Additional Assured in respect of loss of or damage to the Subject Matter Insured.

However, the Underwriters shall not seek to recover more from such Assured or Additional Assured than the applicable limit or limits of such liability insurance.

39. Recoveries

39.1 The Assured shall, whether or not the Underwriters have paid a claim or agreed to pay a claim or potential claim under this insurance, take reasonable steps to:

39.1.1 assess as soon as possible whether there are any prospects of a recovery from third parties in respect of matters giving rise to a claim or to a potential claim under this insurance;

39.1.2 protect any claims against such third parties if necessary by the commencement of proceedings and the taking of appropriate steps to obtain security for the claim from third parties;

39.1.3 keep the Underwriters and the appointed average adjuster (if any) advised of the recovery prospects and any action taken against third parties;

39.1.4 co-operate with the Underwriters in the taking of such steps as may be reasonably required to pursue any claims against third parties.

39.2 The Underwriters shall pay the reasonable costs incurred by the Assured pursuant to this Clause 39 in the same proportion as the insured losses bear to the total of the insured and uninsured losses (as defined in Clause 39.4.2).

39.3 Where the Assured have incurred reasonable costs pursuant to Clause 39.1.2 and where no claim is recoverable under this insurance, provided always that the Underwriters' written agreement to the reimbursement of such costs shall have been obtained prior to the incurring of such costs, the Underwriters shall reimburse such costs to the extent agreed, notwithstanding that no claim is recoverable under this insurance.

39.4 In the event of recoveries from third parties in respect of claims which have been paid in whole or in part under this insurance, such recoveries shall be distributed between the Underwriters and the Assured as follows:

39.4.1 the reasonable costs and expenses incurred in making such recoveries from the third party shall be deducted first and returned to the paying party;

39.4.2 the balance shall be apportioned between the Underwriters and the Assured in the same proportion that the insured losses and uninsured losses bear to the total of the insured and uninsured losses. For the purposes of Clause 39.2 and this Clause 39.4.2, "uninsured losses" shall mean loss of or damage to the Subject Matter Insured and any liability or expense which would have been recoverable under this insurance, but for the application of deductible(s) and the limits of this insurance.

39.5 For the purposes of this Clause 39, "third parties" shall not include the Builder or the Buyer or any Additional Assured against whom the Underwriters have waived rights of subrogation in accordance with Clause 38 (Subrogation).

40. Residual value

40.1 Where the Underwriters pay for a total loss pursuant to Clause 28 (Constructive total loss) or Clause 29 (Actual total loss) or in respect of an Abandonment pursuant to Clause 31 (Abandonment), the Underwriters shall be entitled to take over the Assured's interest in the Subject Matter Insured.

40.2 Without prejudice to the generality of Clause 40.1, the Underwriters shall in such event be entitled to the residual value of some or all of the Subject Matter Insured and/or may require the transfer of title to them or to their order of some or all of the Subject Matter Insured.

PART IV—GENERAL PROVISIONS AND DEFINITIONS

41. Assured

Where the Assured consists of the Builder and the Buyer:

41.1 any act or any failure to act (whether before or after the Period of the Insurance commences) by or on behalf of the Builder which prevents recovery by the Builder (or would prevent recovery if a claim were made by the Builder) under this insurance shall also prevent any recovery under this insurance by the Buyer;

41.2 any act or any failure to act (whether before or after the Period of the Insurance commences) by or on behalf of the Buyer which prevents recovery by the Buyer (or would prevent recovery if a claim were made by the Buyer) under this insurance shall also prevent recovery under this insurance by the Builder;

41.3 any communication to or from the Underwriters from or to the Builder or their agents shall be deemed to have been made on behalf of or to the Buyer;

41.4 any communication to or from the Underwriters from or to the Buyer or their agents shall be deemed to have been made on behalf of or to the Builder.

42. Additional assureds

42.1 Additional Assureds shall be insured under this insurance to the extent of their respective rights and interests in the Subject Matter Insured, but in no case shall any Additional Assured be insured under this insurance to any greater extent than provided for in their written contract with the Assured. For the purposes of Section B, "Assured" shall include an "Additional Assured" where such Additional Assured becomes legally liable by reason of their interest in the Vessel.

42.2 Any act or any failure to act (whether before or after the Period of the Insurance commences) by or on behalf of the Assured which prevents recovery by the Assured (or would prevent recovery if a claim were made by the Assured) under this insurance shall also prevent recovery under this insurance by any Additional Assured.

42.3 The rights of any Additional Assured shall only be exercised through the Assured.

42.4 Additional Assureds shall at all times comply with and be subject to the terms and conditions of this insurance applicable to the Assured (save Clause 47 (Premium payment)). However, a failure to comply by an Additional Assured shall not prejudice the rights of other Additional Assureds or the Assured, save where such other Additional Assureds or the Assured are privy to such failure.

42.5 Any agreement between the Underwriters and the Assured relating to this Insurance shall be binding on Additional Assureds and neither the Underwriters nor the Builder nor the Buyer shall be obliged to provide notice of such agreement to Additional Assureds.

42.6 Any communication to or from the Underwriters from or to the Assured or their agents shall be deemed to have been made on behalf of or to the Additional Assureds.

43. Pre-existing vessel

43.1 This Clause 43 shall apply to this insurance if the Vessel is a Pre-existing Vessel that is to undergo conversion, repair, lengthening or any other work.

43.2 The following words shall have the meanings assigned to them by this Clause. Clauses 56.16 ("Period of the Insurance"), 56.20 ("Sum Insured"), 56.21 ("Vessel") and 56.22 ("Works Value") shall be deleted and replaced by Clauses 43.2.2, 43.2.5, 43.2.6 and 43.2.7 respectively.

43.2.1 "Going-in Value" means the sum agreed in the Schedule as the insured value of the Pre-existing Vessel at the commencement of the Period of the Insurance. The Going-in Value shall not be included in Material Cost.

43.2.2 "Period of the Insurance" under Section A, Section B and Section D means the period commencing on:

43.2.2.1 the handover to and acceptance by the Builder of the Pre-existing Vessel at the Yard; or

43.2.2.2 in respect of Preparatory Work, the commencement of the Preparatory Work at the Yard; or

43.2.2.3 such earlier date(s), if any, agreed in the Schedule, whichever shall first occur.

"Period of the Insurance" under Section C means the period commencing as described in Clause 43.4; and

ceasing, under Sections A, B, C and D, on:

43.2.2.4 re-delivery of the Vessel to the Buyer; or

43.2.2.5 the date agreed in the Schedule; or

43.2.2.6 such date at which this insurance shall be cancelled in accordance with Clause 47 (Premium payment); or

43.2.2.7 such date at which this insurance shall be terminated automatically in accordance with Clause 52 (Automatic termination),

whichever shall first occur.

43.2.3 "Pre-existing Vessel" means the ship, vessel, craft or other structure to undergo conversion, repair, lengthening or any other work.

43.2.4 "Preparatory Work" means fabrication, manufacturing and other work undertaken at the Yard and the storage of Items at the Yard prior to the arrival of the Pre-existing Vessel at the Yard.

43.2.5 "Sum Insured" means the sum agreed in the Schedule as the insured value of the Subject Matter Insured. Should the aggregate of the Works Value and the Going-in Value exceed the Sum Insured, the Sum Insured shall, subject to Clause 44.2 (Sum insured), be increased in the manner set out in Clauses 44.1 (Sum insured) and 43.3.

43.2.6 "Vessel" means the project bearing the hull number or project name identified in the Schedule and includes the Pre-existing Vessel.

43.2.7 "Works Value" means the total of:

43.2.7.1 the Allocated Series Cost spent by the Assured; and

43.2.7.2 the Contractor Cost spent by the Assured; and

43.2.7.3 the Labour Cost spent by the Assured; and

43.2.7.4 the Material Cost spent by the Assured,

but in no case shall the Works Value include the Going-in Value and in no case shall the Works Value exceed the Sum Insured.

43.3 Clause 44.1 (Sum insured) is deleted from the time the Pre-existing Vessel arrives at the Yard. From that time, if the aggregate of:

43.3.1 the Works Value plus the Profit Percentage thereon; and

43.3.2 the Going-in Value,

at any time exceeds the Sum Insured, the Assured shall advise the Underwriters as soon as possible of the amount of such excess and shall pay pro rata additional premium thereon and the Underwriters shall accept their proportionate shares of such increase.

43.4 Clause 9 (Attachment) shall be deleted and replaced by the following:

43.4.1 Subject always to Clause 43.4.2, the insurance under Section C shall attach on the handover to and acceptance by the Builder of the Pre-existing Vessel at the Yard (and not before) and then only to the Vessel. The insurance under Section C shall only apply to Items as they are placed on the Vessel on or after handover to and acceptance by the Builder of the Pre-existing Vessel at the Yard.

43.4.2 The insurance under Section C shall not attach if, between the commencement of the Period of the Insurance and the handover to and acceptance by the Builder of the Pre-existing Vessel at the Yard, there has occurred any event which would have automatically terminated the insurance under Section C in accordance with the provisions of Clause 15 (Termination).

43.5 Clause 27.1 (Partial loss) shall be deleted and replaced by the following:

43.5.1 The measure of indemnity in respect of partial loss of the Subject Matter Insured, but not including the Pre-existing Vessel, shall, where repairs have been undertaken, be the reasonable cost of the repairs, but shall in no case exceed the Sum Insured in respect of any one Occurrence.

The measure of indemnity in respect of partial loss of the Pre-existing Vessel shall, where repairs have been undertaken, be the reasonable cost of the repairs less the customary deductions. Customary deductions shall not be made where the Assured can establish that the repairs were to those areas of the Pre-existing Vessel intended to form part of the Vessel on completion. The measure of indemnity in respect of partial loss of the Pre-existing Vessel shall in no case exceed the Sum Insured in respect of any one Occurrence.

44. Sum insured

44.1 If the Works Value plus the Profit Percentage thereon at any time exceeds the Sum Insured, the Assured shall advise the Underwriters as soon as possible of the amount of such excess and shall pay pro rata additional premium thereon and the Underwriters shall accept their proportionate shares of such increase.

44.2 The Sum Insured shall in no case exceed 110% or such other percentage (if any) agreed in the Schedule of the sum agreed in the Schedule at the inception of this insurance,

unless the Underwriters' prior written agreement has been obtained and any amended terms of cover and any additional premium required by the Underwriters have been agreed.

45. Limit of liability

45.1 In no case shall the Underwriters' liability arising out of each separate Occurrence exceed their proportionate shares of the total of:

45.1.1 the Sum Insured in respect of loss of or damage to the Vessel (whether caused by a peril insured under Section A, Section C or Section D);

45.1.2 the Sum Insured in respect of general average and salvage under Clause 4 (General average and salvage) or Clauses 11.1 or 17.1;

45.1.3 the Sum Insured in respect of liability under Clause 6 (Collision) and 25% (unless the Underwriters' specific written agreement shall have been obtained) of the Sum Insured in respect of legal costs under Clause 6.3;

45.1.4 the Sum Insured in respect of liability under Clause 7 (Protection and indemnity), subject always to the provisions of Clause 7.6;

45.1.5 the Sum Insured in respect of sue and labour expenditure under Clause 25 (Duty of the Assured (sue and labour));

45.1.6 10% (or such other percentage agreed in the Schedule) of the Sum Insured in respect of material under Clauses 29.2 (Actual total loss) and 31.4 (Abandonment);

45.1.7 10% (or such other percentage agreed in the Schedule) of the Sum Insured in respect of trials under Clause 32 (Trials) (whether or not amended by Clause 60 (Trials amendment));

45.1.8 10% (or such other percentage agreed in the Schedule) of the Sum Insured in respect of failure to launch under Clause 33 (Failure to launch);

45.1.9 10% (or such other percentage agreed in the Schedule) of the Sum Insured in respect of Expediting Expenses under Clause 59 (Expediting Expenses).

45.2 In no case shall the Underwriters' liability hereunder be increased by reason of the inclusion of more than one Assured or Additional Assured under this insurance.

46. Separate insurances

If more than one Vessel is insured under this insurance, each Vessel is deemed to be separately insured, as if there were a separate contract of insurance in respect of each Vessel.

47. Premium payment

47.1 The Assured undertakes that the premium shall be paid:

47.1.1 in full to the Underwriters within 45 days (or such other period agreed in the Schedule) of the inception of this insurance; or

47.1.2 where payment by instalment premiums has been agreed:

47.1.2.1 the first instalment premium shall be paid within 45 days (or such other period agreed in the Schedule) of the inception of this insurance;

47.1.2.2 and the second and any subsequent instalment(s) shall be paid by the date(s) they are due.

47.2 The Assured undertakes that any additional premium payable under Clauses 15.1 (War termination), 20.1 (Strikes, terrorist termination), 44 (Sum Insured), 49 (Navigation) and 50 (Items) shall be paid in full to the Underwriters within 60 days of agreement of the additional premium or such other period agreed in the Schedule.

47.3 If the premium (or the first instalment premium) has not been so paid to the Underwriters by the 46th day (or the day after such period agreed in the Schedule) from the inception of this insurance (and, in respect of the second and any subsequent instalment premiums, by the date(s) they are due) or if the premium payable in accordance with Clause 47.2 has not been paid within such period(s) agreed in the Schedule, the Underwriters shall

have the right to cancel this insurance by notifying the Assured via the broker in writing.

47.4 The Underwriters shall give not less than 15 days' prior notice of cancellation in writing to the Assured via the broker. If the premium or instalment premium due is paid in full to the Underwriters before the notice period expires, such notice of cancellation shall automatically be revoked. If not, this insurance shall automatically terminate at the end of the notice period.

47.5 In the event of cancellation of this insurance by the Underwriters under this Clause 47, premium shall be due to the Underwriters on a pro rata basis for the period that the Underwriters are on risk but the full premium shall be payable to the Underwriters in the event of loss, damage, liability or expense arising out of an Occurrence commencing or occurring prior to the date of termination which gives rise to a recoverable claim under this insurance.

47.6 Where the premium is to be paid to the Underwriters through a Market Bureau, payment to the Underwriters shall be deemed to occur on the day of delivery of a premium advice note to such Bureau.

48. Due diligence

48.1 It is the duty of the Assured to exercise due diligence in the conduct of all operations relating to the Subject Matter Insured and in the utilisation of all safety practices and equipment considered prudent for such operations, such duty including but not limited to:

48.1.1 the exercise of due diligence in the selection and employment of Contractors, Sub-contractors and others in connection with the Subject Matter Insured; and

48.1.2 the exercise of due diligence in relation to such precautions as may be reasonably required to prevent loss, damage, liability or expense in connection with the Subject Matter Insured.

48.2 In the event of any breach of the duty under Clause 48.1, the Underwriters shall in no case be liable for any loss, damage, liability or expense attributable to such breach.

49. Navigation

49.1 The Vessel shall not at any time:

49.1.1 be towed outside the port or place of construction; or

49.1.2 proceed under its own power to a distance by water of more than 250 nautical miles from the Yard, or such other distance agreed in the Schedule,

unless the Underwriters' prior written agreement shall have been obtained and any amended terms of cover and any additional premium required by the Underwriters have been agreed.

49.2 In the event of a breach of Clause 49.1, the Underwriters shall in no case be liable for any loss, damage, liability or expense arising out of any Occurrence commencing or occurring during the period of such breach.

50. Items

50.1 Items shall not at any time leave the Yard, save when on the Vessel, unless the Underwriters' prior written agreement shall have been obtained and any amended terms of cover and any additional premium required by the Underwriters have been agreed.

50.2 In the event of a breach of Clause 50.1, the Underwriters shall in no case be liable for any loss, damage, liability or expense in respect of Items whilst outside the Yard.

50.3 Any material may be included as Items prior to its arrival at the Yard or prior to its allocation to the Vessel, but only where the Underwriters' prior written agreement shall have been obtained and any amended terms of cover and any additional premium required by the Underwriters have been agreed.

51. Other insurances

51.1 The insurance under Section A, save that provided under Clause 33 (Failure of launch), shall be primary to any other insurances in respect of loss of or damage to the Subject Matter Insured and the Underwriters shall not seek any contribution from the insurers of such other insurances. For the avoidance of doubt, Clause 38.2 (Subrogation) shall not be affected by this Clause 51.

51.2 In no case shall the insurance under Clause 33 (Failure of launch), Section B, Section C or Section D cover loss, damage, liability or expense recoverable under any other insurance or which would have been so recoverable but for the existence of the insurance under Clause 33 (Failure of launch), Section B, Section C or Section D.

52. Automatic termination

Unless the Underwriters agree to the contrary in writing, this insurance shall terminate automatically:

52.1 at the time of any transfer by the Assured of ownership of the Subject Matter Insured, save in respect of a transfer of ownership from the Builder to the Buyer in so far as such change occurs prior to delivery from the Builder to the Buyer; or

52.2 at the time of an Abandonment; or

52.3 when the Underwriters have admitted a claim for total loss of the Vessel.

53. Assignment

No assignment of or interest in this insurance or in any moneys which may be or become payable under this insurance is to be binding on or recognised by the Underwriters unless a dated notice of such assignment or interest signed by the Assured, and by the assignor in the case of subsequent assignment, is endorsed on the policy or other document evidencing the insurance and such policy or other document with such endorsement is produced before payment of any claim or return of premium under this insurance.

54. Several liability

54.1 The Underwriters' obligations are several and not joint and are limited solely to the extent of their individual subscriptions.

54.2 The Underwriters are not responsible for the subscription of any co-subscribing Underwriter who for any reason does not satisfy all or part of its obligations.

55. Contracts (Rights of Third Parties) Act 1999

55.1 No benefit of this insurance is intended to be conferred on or enforceable by any party other than the Assured, the Additional Assureds and loss payee (if any), save as may be expressly provided herein to the contrary.

55.2 This insurance may by agreement between the Assured and the Underwriters be rescinded or varied without the agreement of the loss payee (if any) or any other third party to whom the right of enforcement of any terms has been expressly provided.

56. Definitions

The following words shall have the meanings assigned to them below:

56.1 "Abandonment" means an agreement, with the prior written agreement of the Underwriters (such agreement not to be unreasonably withheld), between the Builder and the Buyer that the Builder is relieved of the obligation to build or deliver the Vessel to the Buyer, by reason of physical loss of or physical damage to the Vessel.

56.2 "Additional Assured" means:

56.2.1 a Contractor to whom benefit of this insurance has been provided for in their written contract with the Assured;

56.2.2 a Sub-contractor to whom benefit of this insurance has been provided for in their written contract with a contractor.

For the avoidance of doubt, "Additional Assured" shall not include:

56.2.3 a contractor with whom the Assured has not entered or does not during the Period of the Insurance and prior to loss enter into a written contract in relation to the construction of the Vessel;

56.2.4 a sub-contractor who has not entered or does not during the Period of the Insurance and prior to loss enter into a written contract in relation to the construction of the Vessel with a Contractor or where such written contract has not been approved by the Assured.

56.3 "Allocated Series Costs" means the allocation, agreed in the Schedule, by the Assured to the Vessel of:

56.3.1 Contractor Cost as defined in Clause 56.8, but deleting the word "solely";

56.3.2 Labour Cost as defined in Clause 56.12, but deleting the word "solely";

56.3.3 Material Cost as defined in Clause 56.14, but deleting the word "solely",

where such costs relate to the construction of a series of vessels, of which the Vessel is one, but in no case shall the total of the Allocated Series Costs exceed the sum agreed, if any, in the Schedule.

56.4 "Assured" means the Builder or the Buyer named as the Assured in the Schedule. The Assured shall consist of both the Builder and the Buyer, if both are so named in the Schedule.

56.5 "Builder" means the builder (or if Clause 43 applies, the prime contractor) named in the Schedule.

56.6 "Buyer" means the buyer (or in the event Clause 43 applies, the owners and managers of the Pre-existing Vessel) named in the Schedule.

56.7 "Contractor" means those with whom the Assured have entered or during the Period of the Insurance and prior to loss enter into written contracts in relation to the construction of the Vessel, but shall in no case include the Builder or the Buyer.

56.8 "Contractor Cost" means the cost (to include the Assured's overhead) to the Assured of contractors (whether or not the Assured has a written contract with such contractors) solely in relation to the construction of the Vessel and shall not include the Assured's profit on such cost, nor Labour Cost nor Material Cost. Where the Assured consists of the Builder and the Buyer, the "Contractor Cost" shall be the cost to the party which has retained the contractor.

56.9 "Contract Deduction" means the amount by which the sum payable by the Buyer to the Builder is reduced, with the prior written agreement of the Underwriters (such agreement not to be unreasonably withheld), by reason of physical damage to the Vessel not repaired by the Builder at the time this insurance terminates, but shall not include any amount which the Builder shall bear on account of delay which would be caused were such damage to be repaired or on account of any failure to meet performance criteria.

56.10 "Expediting Expenses" means the expenses incurred to expedite the repair of the Vessel following physical loss or physical damage covered under this insurance, including but not limited to the cost of overtime, night work, work on public holidays and express freight (to include non-schedule airfreight).

56.11 "Items" means any material within the Yard which has been allocated to the Vessel. For the avoidance of doubt, "Items" shall not include any material:

56.11.1 prior to its arrival at the Yard;

56.11.2 prior to its allocation to the Vessel;

save as agreed by the Underwriters in accordance with Clause 50.3 (Items).

56.12 "Labour Cost" means the sums payable by the Assured to labourers directly employed by the Assured solely in relation to the construction of the Vessel plus the Assured's overhead on such sums and shall not include the Assured's profit on such sums. Where the Assured consists of the Builder and the Buyer, the "Labour Cost" shall be the sums payable by the party which has employed the labourers.

56.13 "Launch Date" means the first date on which the Assured intends the Vessel's hull to float on water and the Vessel's hull does so.

56.14 "Material Cost" means the cost (to include the Assured's overhead) to the Assured of materials directly supplied by the Assured solely in relation to the construction of the Vessel and shall not include the Assured's profit on such cost. Where the Assured consists of the Builder and the Buyer, the "Material Cost" shall be the cost to the party which has supplied the material.

56.15 "Occurrence" means one loss, accident, disaster or casualty or series of losses, accidents, disasters or casualties arising out of one event. Without prejudice to the generality of the foregoing:

56.15.1 windstorms, tornadoes, cyclones, hurricanes, similar storms and systems of winds of a violent and destructive nature and any tidal surge arising therefrom within any period of 72 consecutive hours and arising out of the same atmospheric disturbance shall constitute one event;

56.15.2 each earthquake, shock, volcanic eruption or tsunami or tidal wave arising therefrom, shall constitute one event. However, if more than one earthquake, shock, volcanic eruption, tsunami or tidal wave shall occur within any period of 72 consecutive hours, such earthquakes, shocks, volcanic eruptions, tsunamis or tidal waves shall constitute one event.

For the purposes of Clauses 56.15.1 and 56.15.2, where the event lasts for more than 72 consecutive hours, the Assured shall be entitled to select the time and date at which the event commences for the purposes of this insurance, provided always that no one 72 hour period shall overlap with another.

Notwithstanding the provisions of this Clause 56.15, damage caused by heavy weather or contact with ice during a single sea passage between two successive ports shall be treated as having been caused by one event.

56.16 "Period of the Insurance" under Section A, Section B and Section D means the period commencing on:

56.16.1 the commencement of the construction of the Vessel at the Yard; or

56.16.2 such earlier date, if any, agreed in the Schedule.

Period of the Insurance under Section C means the period commencing as described in Clause 9.1 (Attachment); and

ceasing, under Section A, Section B, Section C and Section D, on

56.16.3 delivery of the Vessel to the Buyer; or

56.16.4 the date agreed in the Schedule; or

56.16.5 such date at which this insurance shall be cancelled in accordance with Clause 47 (Premium payment); or

56.16.6 such date at which this insurance shall be terminated automatically in accordance with Clause 52 (Automatic termination),

whichever shall first occur.

56.16.7 Termination or cancellation (whether or not such termination or cancellation be automatic) of the insurance under Section C or Section D shall not terminate or cancel the insurance under Section A or Section B.

56.17 "Profit Percentage" means 10% (or such other percentage (if any) agreed in the Schedule) of the Allocated Series Cost, Contractor Cost, Labour Cost and Material Cost in respect of the Assured's profit.

56.18 "Sub-contractor" means those with whom a Contractor has entered or during the Period of the Insurance and prior to loss enters into a written contract in relation to the construction of the Vessel, provided always the written contract has been approved by the Assured, but shall not include the Builder or the Buyer.

56.19 "Subject Matter Insured" means the Items and the Vessel.

56.20 "Sum Insured" means the sum stated in the Schedule as the sum insured in respect of the Subject Matter Insured. Should the Works Value plus the Profit Percentage exceed the Sum Insured, the Sum Insured shall, subject to Clause 44.2 (Sum insured), be increased in the manner set out in Clause 44.1 (Sum insured).

56.21 "Vessel" means the project bearing the hull number or project name identified in the Schedule.

56.22 "Works Value" means the total of:

56.22.1 the Allocated Series Cost spent by the Assured" and

56.22.2 the Contractor Cost spent by the Assured; and
56.22.3 the Labour Cost spent by the Assured; and
56.22.4 the Material Cost spent by the Assured,
but shall in no case exceed the Sum Insured.

56.23 "Yard" means the premises of the Builder named in the Schedule where the Vessel is being constructed or, if Clause 43 applies, where the Pre-existing Vessel is to undergo conversion, repair, lengthening or any other work.

PART V—OPTIONAL BUYBACKS

57. Defects

If the Underwriters have expressly agreed in writing:

57.1 the insurance under Section A shall also cover the cost that would have been incurred to replace, repair or rectify the defect in workmanship, defect in material or latent defect, had such defect been discovered immediately prior to the occurrence of the physical loss or physical damage covered under Clause 2 (Perils), but in no case shall the insurance under Section A cover any costs incurred to replace, repair or rectify a defect in design, plan or specification.

57.2 the insurance under Section A shall also cover 50% of the costs common to both:

57.2.1 the repair of physical loss and physical damage caused by a defect in design, plan or specification, where such physical loss or physical damage is covered under Clause 2 (Perils); and

57.2.2 the replacement, repair and rectification of the said defect,

but in no case shall the insurance under Section A cover any costs incurred solely in the replacement, repair and rectification of the defect in design, plan or specification or incurred by reason of betterment or alteration in design, plan or specification.

58. Profit on partial loss

58.1 If the Underwriters have expressly agreed in writing, Clause 27.2.1 (Partial loss) shall be deleted and the Profit Percentage shall be added to the Labour Cost, the Material Cost and the Contractor Cost in calculating the reasonable cost of the repairs for a partial loss.

58.2 However, notwithstanding the application of this Clause 58, Clause 27.2.1 (Partial loss) shall still apply for the purposes of Clause 28.3 (Constructive total loss) and Clause 31.1.1 (Abandonment).

58.3 For the avoidance of doubt, the reasonable cost of the repairs shall not include the Assured's profit on such cost, save as may be included within the Profit Percentage.

59. Expediting expenses

If the Underwriters have expressly agreed in writing, Clauses 27.2.2 (Partial loss), 28.4.2.1 (Constructive total loss) and 31.3.2.1 (Abandonment) shall be deleted and Expediting Expenses shall be covered under this insurance, subject to a limit of 10%, or such other percentage agreed in the Schedule, of the Sum Insured in respect of any one Occurrence.

60. Trials amendment

If the Underwriters have expressly agreed in writing, the words "*to the extent that such expenses are necessary to effect the repairs, but in no case shall the Underwriters be liable for the expenses incurred in re-running trials undertaken solely by reason of contractual provisions between the Builder and the Buyer.*" shall be deleted from Clause 32 (Trials).

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