LEXOLOGY
Getting the Deal Through

SHIPBUILDING 2023

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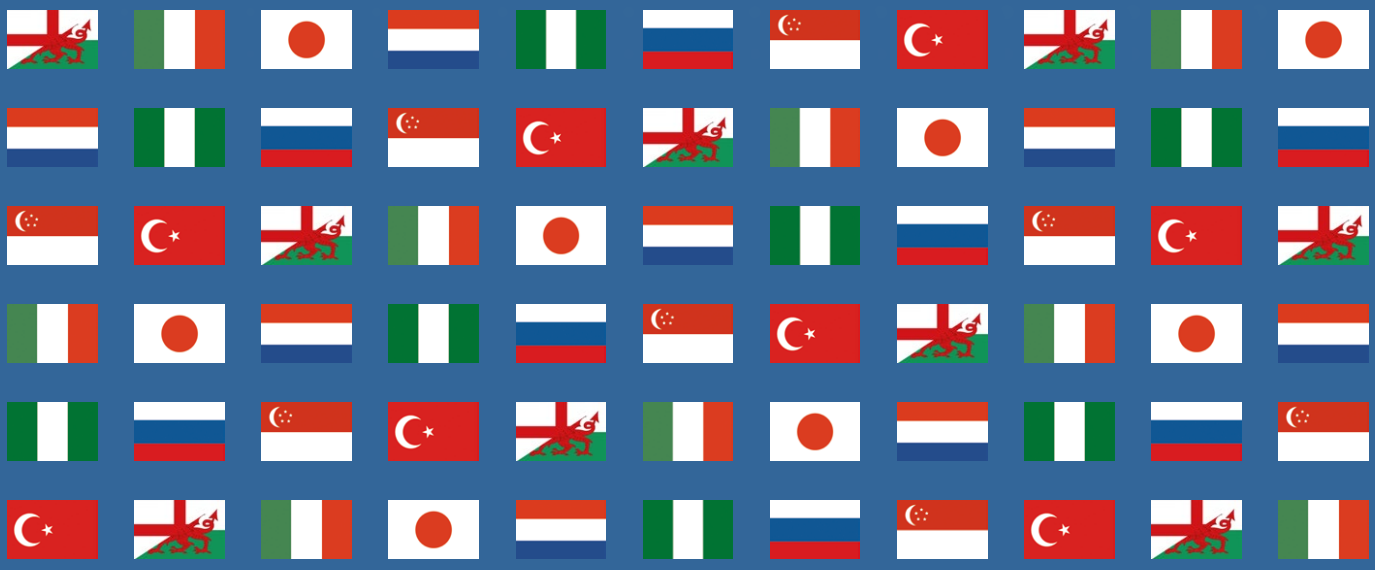

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START READING

Jurisdictions

Published March 2023

England & Wales

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

Yes, the shipbuilding industry is open to foreign participation and investment. In the context of commercial shipbuilding, there are no obvious restrictions.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

As a result of the Public Bodies (Abolition of British Shipbuilders) Order 2013, British Shipbuilders Corporation, a former public corporation that owned and managed the British shipbuilding industry, was abolished and its residual liabilities transferred to the UK Secretary of State for Business, Energy and Industrial Strategy.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

As long as the contractual formalities of offer and acceptance, intention to create legal relations and consideration are observed, a contract will be legally enforceable even if concluded orally and not committed to writing, although, in light of the complexities and

risks inherent in shipbuilding, this is extremely unlikely to be the case. It is usual for a shipbuilding contract to provide that any modification or variation to the contract must be in writing, rather than made orally, and where it does so, the Supreme Court confirmed in Rock Advertising v MWB Business Exchange [2018] UKSC 24 that it will give effect to the no oral modification clause, although the effectiveness of such clauses may still be prevented if the doctrine of estoppel applies (albeit that a claim of estoppel to circumvent a no oral modification clause will be strictly scrutinised by the court (see Kabab-Ji SAL v Kout Food Group [2021] UKSC 48). Where the contract is executed in writing, electronic signatures can be used.

Where a party to a shipbuilding contract is a company incorporated outside the United Kingdom (whether or not they have registered an establishment in the United Kingdom) their entry into the shipbuilding contract is governed by the Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 (as amended). Part 2 of the Regulations adapts the formalities set out for doing business under the law of England and Wales in sections 43 (company contracts), 44 (execution of documents) and 46 (execution of deeds) of the Companies Act 2006 for overseas companies.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

The parties to a shipbuilding contract are generally free to select the governing law of their contract. For contracts concluded on or after 17 December 2009, the applicable law of a contract is determined, for most purposes, in line with Regulation (EC) No. 593/2008 on the law applicable to contractual obligations (Rome I Regulations), notwithstanding the UK's departure from the European Union. This is a result of the Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc) (EU Exit) Regulations 2019 (as amended by the Jurisdiction, Judgments and Applicable Law (Amendment) (EU Exit) Regulations 2020) which introduced an equivalent regulation, UK Rome I, into English law from 1 January 2021. Where there is a conflict of laws as to contractual obligations in civil and commercial matters, the Regulation provides that a contract shall be governed by the law chosen by the parties (whether the law of a member state of the European Union, the United Kingdom or not) but that the choice must be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. Where no such choice is made, Rome I and UK Rome I provide that the relevant law is the law of the country with which the contract is most closely connected.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

English law of the sale of goods comprises common law principles as codified, amended and supplemented by a statutory scheme, the current principal legislation being the Sale of Goods Act 1979 and the Sale and Supply of Goods Act 1994. Shipbuilding contracts have historically been regarded as contracts for the sale of goods by the English courts (see

McDougall v Aeromarine of Emsworth Ltd (1958)). This was refined by the House of Lords in *Hyundai Heavy Industries Co v Papadopoulos and Others* (1980) and Stocznia Gdanska SA v Latvian Shipping Co, Latreefer Inc and Others [1998] UKHL 9 where it was recognised that the shipbuilding contract is not just one of sale alone but also resembles a construction contract. Accordingly, the current preferred view is that a shipbuilding contract in English law should be categorised as a contract of sale of goods (more precisely categorised under the Sale of Goods Act 1979 as an agreement to sell future goods by description) containing certain characteristics of a construction contract. While the decision of the High Court in Adyard Abu Dhabi v SD Marine Services [2011] EWHC 848 (Comm) did involve consideration of general (namely, non-marine) English construction law principles in the context of a shipbuilding contract dispute, such principles have to date had limited practical influence on English shipbuilding contract law.

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

The hull number has been held not to be an essential part of the description of the vessel but only a means of labelling or identifying her (see *Reardon Smith Line Ltd v Yngvar Hansen-Tangen (The Diana Prosperity)* (1976)). So long as the reference fits the vessel in question and no other vessel could be referred to, the buyer cannot refuse to accept delivery simply because the hull number is different from that stated in the contract.

However, the builder cannot unilaterally switch hull numbers between projects in an attempt to demonstrate performance of its obligations under a different shipbuilding contract, as was made clear by the House of Lords in Stocznia Gdanska SA v Latvian Shipping Co, Latreefer Inc and Others [1998] UKHL 9.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

The use of 'approximate' dimensions and descriptions is likely to imply that the builder has a small margin of leeway, but how much will be a question of fact to be decided by the relevant court or tribunal in light of the circumstances in which it is used and appropriate expert evidence. There is no absolute legal test: for example, in the context of a dispute concerning a vessel's warranted speed under a charter party, the Court of Appeal held that the margin provided by the word 'about' cannot be fixed as a matter of law (*Arab Maritime Petroleum Transport Co v Luxor Trading Corporation and Geogas Enterprise SA (The Al Bida)* (1986)). This is the kind of question that is often referred to as a mixed question of fact and law, as concluded at first instance in the same case. In the context of a shipbuilding contract, a cautious approach would be to proceed on the basis that the use of such a term simply allows the builder a margin up to the limits of normal construction tolerances for a vessel of the relevant type.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

Yes. Shipbuilding contracts commonly set out performance standards for the speed, fuel consumption and deadweight of the vessel and sometimes vibration and noise depending on the type of vessel. If any of these agreed performance standards are not met when tested during sea trials, the contract will typically allow a small percentage of agreed deficiency, but thereafter the buyer will be entitled to liquidated damages, often tiered depending on the extent of the deficiency. While the builder's liability for liquidated damages is generally capped, the buyer will have the option of rejecting the vessel and terminating the contract where the discrepancy is greater than an agreed percentage of the guaranteed figure. It would be unusual for a builder to agree to deviate from this approach.

It is usually the case that vessels that are to be constructed under a shipbuilding contract that is governed by English law will not be built in the jurisdiction. As a result, any trade standards in relation to shipbuilding and marine technology that have been developed by the British Standards Institution will not apply to a vessel built in another jurisdiction unless they are expressly referred to in the shipbuilding contract. Instead, the local trade standards in the place of construction may apply and, in such circumstances, appropriate legal advice should be sought from local counsel to clarify the position.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

Unless contractually excluded, three specific conditions relating to quality are implied in any sale contract governed by the Sale of Goods Act 1979 where a seller sells in the course of a business. These are compliance with description (section 13), satisfactory quality (section 14(2)) and reasonable fitness for purpose (section 14(3)). In Neon Shipping Inc v Foreign Economic 7 Technical Corporation Co of China [2016] EWHC 399 (Comm), the High Court found that section 14(3) was applicable to a shipbuilding project where the goods had been ordered for their normal purpose. Where the buyer is dealing as a consumer, the Consumer Rights Act 2015 gives the buyer comparable rights but also prevents a seller from excluding these.

A breach by a seller of any of these implied conditions entitles the buyer to reject the goods, unless the breach is 'so slight' that it would be unreasonable for the buyer to do so (section 15(A)(1)). Most newbuilding contracts expressly exclude these statutory implied terms. This is in line with usual practice by which the builder agrees to build a vessel in conformity with the requirements of the contract and specifications and provides a limited post-delivery warranty in respect of materials and workmanship, but otherwise makes no general guarantee of quality and almost always excludes liability for any losses arising from defects in the vessel.

Where the contract does provide for a quality standard, a phrase such as 'highest North European shipbuilding standards' or 'first-class shipbuilding practice in Western Europe' is often used. According to an unreported arbitration award issued in 2011, 'first-class shipbuilding practice in Europe for new vessels of similar type and characteristics as the vessel' imported into the contract an obligation to meet the agreed class standard, while the phrase 'of first-class quality' was considered in Rolls-Royce Power Engineering plc v Ricardo Consulting Engineers Ltd [2003] EWHC 2871 (TCC) and found to indicate that a higher standard is required than ordinary reasonable skill and care.

Accordingly, a requirement to construct a vessel to such a standard or in accordance with such practice does add something significant to other requirements of the contract. The interaction between express standards of care and other specific contractual requirements has been considered in MT Hojgaard A/S v E.ON Climate and Renewables UK Robin Rigg East Ltd [2017] UKSC 59).

The Supreme Court found that it was unnecessary to determine whether there was a warranty that the foundations of offshore wind turbines would have a lifetime of 20 years or a contractual term that the foundations would be designed for it to have such a lifetime, as neither had been achieved. Although the international design standard contained an error that meant that it would not be possible to comply with the prescribed criteria, this did not make it mutually inconsistent with the other terms of the contract.

Courts are generally inclined to give full effect to the requirement that the item as produced complies with the prescribed criteria, on the basis that, even if the customer has specified or approved the design, it is the contractor who can be expected to take the risk if it agreed to work to a design that would render the item incapable of meeting the criteria to which it had agreed. While this and other recent cases have shown that there can be tension between express standards of care and other specific contractual requirements, such as fitness for purpose obligations, much depends on the specific drafting.

Of the standard forms of shipbuilding contract typically encountered, only the Baltic and International Maritime Council's (BIMCO) Newbuildcon expressly provides for a quality standard. However, given that shipbuilding conditions and standards vary significantly from country to country and, sometimes, even among shipyards in the same country, the phrase 'in accordance with good international shipbuilding and marine engineering practice' set out in its clause 1 can give rise to disputes as to the precise standard imposed.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

Where employed solely by the builder, the classification society will not ordinarily be found to owe a contractual duty of care to the buyer to ensure that its surveyors identify defects in the vessel. Whether a classification society can be held liable in tort for negligence is controversial, and although theoretically possible if the claimant can make out the constituent

elements of the tort, the English courts have shown a marked reluctance to hold classification societies liable. In Marc Rich & Co AG v Bishop Rock Marine Co (The Nicholas H) [1995] UKHL 4, the House of Lords refused to impose tortious liability on a classification society, Lord Steyn stressing that classification societies act for the common good in setting maritime safety standards. Where, however, the vessel is being constructed outside England and Wales, the applicable law and jurisdiction that will apply to a claim against a classification society in tort are unlikely to be determined by the English courts under English law, even though the shipbuilding contract may be governed by English law and subject to the jurisdiction of the English courts or London arbitration. It may be possible to bring a claim where the tort has been committed abroad within the jurisdiction of the English court if the parent company of the classification society is domiciled in England and Wales and is found to have, for example, controlled the operations that gave rise to the claim; however, this has only been considered in respect of health and safety and environmental claims (Lungowe v Vedanta Resources and KCM [2019] UKSC 20).

With the development of international rules (both by the International Maritime Organization (IMO) and EU authorities) to improve maritime safety and environmental protection, flag states' powers have been delegated to some selected classification societies, each of which has acquired the status of 'recognised organisation' (RO). The degree to which a flag state may choose to delegate authority to an RO is for each flag state to decide, and the corresponding authority of the RO is generally set out in the relevant agreement individually negotiated between the RO and the relevant administration. These agreements are based on the Model Agreement for the Authorization of Recognized Organizations Acting on behalf of the Administration, issued by the IMO's Maritime Safety Committee and its Marine Environment Protection Committee (MSC/Circ 710 and MEPC/Circ 307), which imposes a duty of care on the ROs and a liability for breach of such duty to the appointing authority.

The Code for Recognized Organisations, a consolidated international instrument, sets out the minimum criteria against which organisations must be assessed towards recognition as an RO with general requirements including the capacity to deliver high standards of service and the need to act independently, impartially and transparently, as well as with integrity, competence and responsibility. Various other IMO resolutions lay down mandatory minimum requirements for ROs with respect to, inter alia, their technical competence, governance and certification. However, following the *Erika* and the *Prestige* disasters at the turn of the century, additional legislation was implemented in the European Union to tighten the regulatory regime applicable to classification societies when performing their duties as ROs and to harmonise their liabilities throughout the European Union (including Directive 2009/15/EC, as amended by Directive 2014/111/EU, and in Regulation (EC) No. 391/2009 included in the Third Maritime Safety (Erika III) Package). Following Brexit, this legislation has been introduced into UK law and amended by virtue of the Merchant Shipping (Recognised Organisations) (Amendment) (EU Exit) Regulations 2019, with separate authorisation agreements now required for ROs to operate in the United Kingdom and in the European Union. Under these rules, an RO may face unlimited liability for damages caused by gross negligence or intentional acts. However, this liability relates only to the indemnity obligations undertaken by the RO in favour of the authorising administration under the relevant agreement granting it RO status. A buyer seeking to sue an RO for damages in respect of loss arising from that RO's negligent acts or omissions could not, therefore, rely on the above rules alone to establish the RO's liability. However, given that the *Nicholas H* pre-dates

the RO regime described above, it is unclear whether it would now be followed in any future case where negligence of a classification society acting as RO was alleged.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

Compliance with flag-state legislation has been outsourced, but only to a limited extent to certain approved classification societies.

The bulk of the survey and certification work required for statutory purposes is delegated to non-governmental organisations that act as certifying authorities on behalf of the UK Maritime and Coastguard Agency (MCA). For surveys required by international conventions, those certifying authorities must be classification societies authorised as ROs in accordance with the EU regime resulting from the Third Maritime Safety (Erika III) Package, under the relevant UK legislation (see the Merchant Shipping (Recognised Organisations) (Amendment) (EU Exit) Regulations 2019 and the MCA Merchant Shipping Notice MSN 1672 (M+F) Amendment 4 issued in December 2020).

Following the UK's departure from the European Union, all agreements previously concluded between the MCA and the relevant classification societies have been terminated by mutual consent and replaced by new agreements with amended domestic provisions. The six classification societies that are ROs authorised by the United Kingdom are:

- the American Bureau of Shipping;
- Bureau Veritas SA;
- Nippon Kaiji Kyokai;
- DNV;
- Lloyd's Register; and
- RINA Services SpA.

To avoid unnecessary duplication of survey items between the relevant classification society and the MCA, classification society surveyors are authorised to conduct hull and machinery, electrical and control installation surveys on UK ships on the MCA's behalf, but the scope of such delegation is narrower with respect to roll-on, roll-off passenger ships. Furthermore, ROs' survey and certification powers may also be less comprehensive with respect to passenger ships as opposed to cargo ships, as the MCA's focus remains on the more critical aspects of passenger ship safety, such as fire protection and stability.

The MCA also operates the Alternative Compliance Scheme, which, in relation to newbuildings (other than passenger ships) to be registered in the United Kingdom, also allows the relevant classification society to perform most statutory surveys and associated plan approvals without the involvement of the MCA, save for the initial inspection of the vessel on delivery and the audits or inspections for International Safety Management Code, International Ship and Port Facility Security Code and Maritime Labour Convention 2006 requirements.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

Vessels under construction may not be registered on the UK Ship Register.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

According to section 17(1) of the Sale of Goods Act 1979, title to the vessel will pass when it is intended by the parties to do so; therefore, the parties may agree that the vesting of title to the buyer is continuous as the construction progresses, or that it occurs upon the builder's achievement of specified and ascertainable milestones.

The 'continuous transfer of title' structure tended to be the approach used in shipbuilding contracts with British shipyards, and it is still commonly encountered in contracts for the construction of superyachts and in ship conversion contracts.

While English law will uphold the parties' agreement as to the timing of the vesting of title to the partly built vessel, nonetheless the effectiveness of those agreements will ultimately depend upon the lex situs, that is, the law of the place of construction. For instance, the insolvency rules of the lex situs may render any transfer of title ineffective against a liquidator of the builder. These considerations obviously do not apply where the vessel is under construction in England and Wales, but where the contract is governed by English law with a place of construction abroad (as very frequently occurs). In such circumstances, appropriate legal advice should be sought from local counsel to clarify the position.

There is no legal restriction with respect to the moment when the vesting of title can start, but the parties usually choose the vessel's keel laying as the relevant trigger (although it is more common for title to be transferred on delivery). In any event, the parties should bear in mind that the English courts have tended, in the absence of clear drafting, to be slow to uphold contractual provisions providing for the transfer of title in the material and equipment intended for the vessel where these have not actually been physically incorporated into the vessel.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

The general rule, which is enshrined in section 20(1) of the Sale of Goods Act 1979, is that goods remain at the seller's risk until property in them is transferred to the buyer, unless the parties provide otherwise.

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For the vast majority of shipbuilding contracts, the parties agree that, regardless of the time of transfer of title, the risk of damage to or loss of the vessel remains with the builder until the delivery and acceptance of the vessel.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

Subject to the terms of the shipbuilding contract, the builder may subcontract part or all of the contract works to third parties.

However, depending on the parties' respective bargaining positions, the extent of the builder's rights to subcontract will be more or less extensively defined and limited in the contract. For instance, it may be agreed that certain key steps of the construction process (such as the assembly of the hull and other items of works directly affecting the agreed quality standards of the vessel) cannot be delegated without the prior approval of the buyer, or are not delegable at all.

No matter how wide the builder's liberty to subcontract, and subject to the parties' contrary provision, the builder will remain fully liable towards the buyer for any subcontracted work, and it is usual to find express language to that effect in the contract.

Although a maker's list is not provided for in the Shipbuilders' Association of Japan (SAJ) form, upon which international shipbuilding contracts governed by English law tend to be based, most international shipbuilding contracts, as well as BIMCO's Newbuildcon form, include a maker's list of potential major suppliers and subcontractors. Such a list, depending on where the vessel is being built, allows the builder to proceed to making the final selection of major suppliers and subcontractors without further approval from the buyer. If the buyer subsequently wishes to amend the maker's list, they will be liable for the builder's costs resulting from any change. The unamended SAJ form instead grants the builder sole discretion and responsibility to subcontract any portion of the construction. However, this is commonly amended to allow the buyer the right to approve major suppliers and subcontractors and such amendments can include a maker's list.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

Subject to any express term of the contract to the contrary, and provided that the contract does not otherwise restrict the ability of the builder to subcontract the construction of the relevant items without the buyer's prior approval, an English or Welsh shipbuilder has no obligation to inform the buyer of its intention to use subcontractors located in countries other than England and Wales. However, it is usually the case that vessels that are to be constructed under a shipbuilding contract that is governed by English law will not be built

in the jurisdiction. In those circumstances, appropriate legal advice should be sought from local counsel to clarify if there are any local content rules in that jurisdiction.

In addition to a provision detailing the builder's rights and obligations in respect of subcontracting, the builder's right to perform the contract works (or to have them performed) in a place other than the builder's shipyard may also be curtailed by a term expressly providing that the vessel shall be constructed at that shipyard.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

The price can be fixed by the contract either by reference to a specified sum for specific work or, where the work scope is uncertain at the time of contract signing, by measuring the work performed against a given schedule of quantities or rates. In the case of a fixed price, a claim by the builder for the relevant lump sum or an agreed instalment is a liquidated sum in respect of which the builder can apply for summary judgment. In the case of a cost-plus arrangement, the builder can recover the price when the relevant measurement can be ascertained and duly certified.

Shipbuilding contracts are generally fixed-price contracts, whereby the price agreed by the parties incorporates the cost of all materials and labour for the construction of the vessel (with a certain uplift to remunerate the builder), and of all activities and charges ancillary thereto (such as inspections, trials and tests, and supervision and certification by the classification society and the regulatory authorities). Where a contract or part of the work scope is placed on a cost-plus basis, the relevant price is often expressed to cover materials and related services at cost (on an open-book basis) with an agreed markup to cover the shipbuilder's overhead and an agreed profit element.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

No, any such increases will be at the builder's risk. Currently, it is unusual for international shipbuilding contracts to incorporate price escalation provisions, but in times of increased demand, steel price adjustment clauses have been agreed. However, shipbuilding contracts typically provide that the fixed price may be adjusted upward or downward 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. The builder must ensure it does not carry out any extra work until the parties have agreed and recorded any adjustment to the price or delivery date; failure to do so may prevent the builder from claiming these subsequently.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

In 2021, the Supreme Court confirmed that, under English law, economic pressure can amount to duress, provided that such economic pressure could be characterised as 'illegitimate'; the pressure caused the claimant to enter into the contract that it is seeking to avoid; and the claimant had no reasonable alternative to giving in to the pressure (see Pakistan International Airline Corporation v Times Travel (UK) Ltd [2021] UKSC 40), applied in London Arbitration 33/22, where a waiver in respect of future claims contained in a ship repair yard's final invoice was found to be unlawful and this, together with the refusal to permit the vessel to sail, were found to amount to illegitimate pressure.

The authorities indicate that each case involving economic duress is heavily dependent on its particular facts, including the conduct of the parties and circumstances of the victim. The remedy for economic duress is generally an action for restitution of money (or property) extracted under such duress rather than an action for damages, together with the avoidance of any contract found to have been induced by it. In some cases, however, the duress may also actually amount to an actionable tort, in which case the restitutionary remedy for money had and received is an alternative (not additional) remedy to an action for damages in tort.

Where conduct is found to amount to economic duress, the agreement (including a contract variation) is voidable (not void) but the right to rescind may be lost if a party is found to have affirmed the contract (or otherwise waived its rights) (see *North Ocean Shipping Co Ltd v Hyundai Construction Co Ltd (The Atlantic Baron)* [1979] QB 705).

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

Yes, the parties can include provisions in the shipbuilding contract that exclude or limit the buyer's rights to set off, suspend payment or deduct certain amounts.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

Section 4 of the Statute of Frauds (1677) (the Statute) provides that to be enforceable in England and Wales, a contract of guarantee must be evidenced by some form of written memorandum or note of the contract signed by the party against whom the claim is to be made. The note or memorandum evidencing the guarantee obligation does not need to be in any special form but must set out all the material terms of the guarantee and, crucially, must be signed by the guarantor or by its agent. 'Guarantee' in this context means a 'true'

guarantee where the guarantor acts as secondary obligor, as the primary liability remains with the principal debtor, as opposed to 'on demand' guarantees or indemnities (where primary liability is imposed on the party undertaking the obligation).

The above statutory requirements can be fulfilled by guarantees being issued via electronic communication, as the courts will uphold accepted contemporary business practice (such as issue of guarantees by the Society for Worldwide Interbank Financial Telecommunication (SWIFT)) and the use of electronic signatures to satisfy the requirements of the Statute for a guarantee to be 'in writing' and 'signed' (see Mehta v J Pereira Fernandes SA [2006] EWHC 813 (Ch), WS Tankship BV v Kwangju Bank [2011] EWHC 3103 (Comm) and Golden Ocean Group Limited v Salgaocar Mining Industries Pvt Ltd and another [2012] EWCA Civ 265).

The Newbuildcon form contains a draft refund guarantee, but this is not widely used, while the Baltic and International Maritime Council (BIMCO) issued a standalone standard form refund guarantee in 2021.

No permission is required from any UK authority for a builder in England or Wales to have refund guarantees issued.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

Section 4 of the Statute provides that to be enforceable in England and Wales, a contract of guarantee must be evidenced by some form of written memorandum or note of the contract signed by the party against whom the claim is to be made. The note or memorandum evidencing the guarantee obligation does not need to be in any special form but must set out all the material terms of the guarantee and, crucially, must be signed by the guarantor or by its agent. 'Guarantee' in this context means a 'true' guarantee where the guarantor acts as secondary obligor, as the primary liability remains with the principal debtor, as opposed to 'on demand' guarantees or indemnities (where primary liability is imposed on the party undertaking the obligation).

The above statutory requirements can be fulfilled by guarantees being issued via electronic communication as the courts will uphold accepted contemporary business practice (such as issue of guarantees by SWIFT) and the use of electronic signatures to satisfy the requirements of the Statute for a guarantee to be 'in writing' and 'signed' (see Mehta v J Pereira Fernandes SA [2006] EWHC 813 (Ch), WS Tankship BV v Kwangju Bank [2011] EWHC 3103 (Comm) and Golden Ocean Group Limited v Salgaocar Mining Industries Pvt Ltd and another [2012] EWCA Civ 265).

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

English law does not permit the registration of the vessel under construction in the UK Ship Register. Accordingly, neither the builder nor the buyer can create and register a mortgage over the vessel under construction to secure construction financing.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

In the case of *Aktiebolaget Gotaverken v Westminster Corporation of Monrovia and another* (1971), the High Court held that a clause that imposed upon a repair shipyard warranty obligations in respect of 'material used and work performed' (and that was linked to another clause referring to 'defects or deficiencies of material or workmanship') was also apt to encompass the shipyard's design errors. If there were design errors, there was no reason why these should not be characterised, and attract liability, as bad workmanship and, accordingly, be covered by the warranty provisions.

However, notwithstanding the above judgment, the parties often provide expressly that the builder's warranty covers defects resulting from inadequate or erroneous design discovered in the warranty period to avoid any uncertainty on this issue.

The extent to which a buyer can recover its losses for defective design or poor workmanship, or both, under a warranty clause was considered in Star Polaris LLC v HHIC-Phil Inc [2016] EWHC 2941 (Comm), which concerned the serious engine failure on a bulk carrier. The shipbuilding contract had excluded the builder's liability for 'any consequential or special losses' and the court, upholding the decision of the arbitrators, considered that 'consequential' should be considered in its 'cause-and-effect' sense, rather than the traditional Hadley v Baxendale [1854] EWHC Exch J70 distinction of direct and indirect losses. As a result, the buyer's recovery was limited to the cost of repair and did not include its claims for loss of hire and diminution in value that were considered consequential to the repair works provided for in the warranty provision. However, this non-traditional approach to the categorisation of losses has not been accepted by the courts in a non-marine context in relation to a differently worded clause (2 Entertain Video Ltd v Sony DADC Europe Ltd [2020] EWHC 972 (TCC)).

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

Under English law, it is not straightforward for third parties to seek redress for damage suffered as a result of the defectiveness of the vessel.

In the absence of a contractual relationship, a third party's ability to enforce the warranty rights under the shipbuilding contract is severely restricted. A third party may be entitled to enforce its terms, including the warranty clause, pursuant to the Contracts (Rights of Third Parties) Act 1999 (the 1999 Act), although contracts usually contain provisions expressly excluding its application. Taking an assignment of the buyer's rights under the shipbuilding contract could be an alternative contractual route that third-party claimants may wish to explore, but this may in fact be impracticable as the shipbuilding contract, as is often the case, may prohibit any assignment or subject the same to the builder's consent.

It may be open to a third party to establish the builder's liability in tort, but this is not without its difficulties. First, unless there is no foreign element involved in the case, a claimant has to address the preliminary questions of jurisdiction and proper law (namely, respectively whether English courts have jurisdiction to hear the claim and which system of law should apply to determine the builder's liability). Leaving aside the question of jurisdiction (which, depending on the circumstances, may be governed by the applicable English statutory provisions or by common law), the applicable law for determining whether an actionable tort has been committed will generally be governed by either the Private International Law (Miscellaneous Provisions) Act 1995 (the 1995 Act) or the Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc) Regulations 2019, as amended by the Jurisdiction, Judgments and Applicable Law (Amendment) (EU Exit) Regulations 2020, on the law applicable to non-contractual obligations (incorporating Regulation (EC) No. 864/2007 (Rome II) into English law following Brexit) where the damage occurred after 11 January 2009.

To the extent that English law is relevant and the claimants wish to sue the builder under the tort of negligence, a host of difficult issues will arise as to the nature of the relationship between the claimants and the builder, as well as the nature of the loss suffered. Essentially, any claimant must demonstrate that its relationship with the builder attracted a legal duty of care and that the builder's conduct breached that duty, and also that such conduct caused the claimant's loss and the type of loss suffered was foreseeable as a result of the builder's conduct. In Howmet Ltd v Economy Devices Ltd [2016] EWCA Civ 847, it was held that where a third party becomes aware of the defect before the damage occurs but continues to use the product, the defendant would be able to escape liability. The hurdles that a claimant has to overcome are significant, and even where a claimant can establish that the builder owed it a duty of care that the builder had then breached by building a defective vessel, the claimant might be unable to bring the type of loss suffered (for instance, pure economic loss as opposed to physical injury or property damage) within the types of losses to which the builder's duty of care extends. Notably, English courts are reluctant to allow third-party claimants to recover pure economic losses by suing in negligence unless they can demonstrate the existence of a special relationship with the defendant or otherwise establish the defendant's assumption of responsibility. A third party is, therefore, likely to

face a considerable challenge to succeed in recovering losses by pursuing the builder in tort for negligence.

Brief mention should also be made of the statutory regime provided by the Consumer Protection Act 1987 (the 1987 Act). Under the 1987 Act, a 'producer' of a defective product is made liable without proof of fault for any damage arising from the defect. Ships are expressly included in the definition of products, so there is accordingly scope for a claimant to bring a claim under the 1987 Act where it has suffered loss or injury because of the defective condition of a ship. A builder could, therefore, as a producer, face a claim where an accident can be proven to have resulted from a defect in construction. A defect under the 1987 Act was defined in Colin Gee and others v DePuy International Ltd [2018] EWHC 1208 (QB) as the abnormal potential for harm, namely, whatever it is about the condition or character of the product that elevates the underlying risk beyond the level of safety that the public is entitled to expect.

However, while personal injury claims are largely unqualified by the 1987 Act, liability for property damage is significantly limited. First, the 1987 Act does not provide a remedy in respect of any damage to the product itself, even if caused by the defect. Second, it only applies to damage to property that is of a description ordinarily intended for private use, occupation or consumption and that is intended by the person suffering the loss to be mainly for its own use, occupation and consumption. As a result, most cases of damage to commercial ships and their cargo and any cargo damaged on the defective vessel fall outside the scope of the 1987 Act, although, prima facie, damage caused by a defective vessel to private yachts and private property ashore would not be excluded.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

In the past, the effectiveness of liquidated damages provisions was subject to the requirement that the agreed level of damages must represent a genuine pre-estimate of the losses arising from the relevant breach. In light of this test, where the level of compensation was found to be extravagant or unconscionable, the clause would be treated as a penalty and would therefore be legally unenforceable.

The test was definitively clarified by the Supreme Court in 2015 in the conjoined appeals of Cavendish Square Holdings BV v Talal El Makdessi and ParkingEye Limited v Beavis [2015] EWCA Civ 402. In essence, whether a contractual provision is a penalty will depend on whether the impact of the clause on the contract breaker significantly outstrips the innocent party's legitimate interest (if so, the clause will be a penalty). A penalty clause can only exist where a secondary obligation (eg, to pay liquidated damages) is imposed following a breach of a primary obligation owed by one party to the other (eg, a failure to meet performance guarantees) and is to be distinguished from a conditional primary obligation, which depends on events that are not breaches of contract. It is, therefore, potentially possible to circumvent the penalty rule with careful drafting, as was the case in Holyoake and another v

Candy and others [2017] EWHC 3397 (Ch), although the court will examine the substance of a provision in reaching its determination.

Where a provision in substance, rather than in form, imposes a secondary liability for breach of a primary obligation that is out of all proportion to any legitimate interest of the innocent party in the performance of the primary obligation or is exorbitant, extravagant or unconscionable in comparison with the value of that legitimate interest it will be considered penal and therefore unenforceable. The onus lies on the party alleging that a clause is a penalty to show this. As the penalty rule is an interference with freedom of contract, the courts will not lightly conclude that a term in a contract negotiated by properly advised parties of comparable bargaining power is a penalty (see GPP Big Field LLP v Solar EPC Solutions SL (formerly Prosolia Siglio XXI) [2018] EWHC 2866 (Comm)).

While a number of cases have been decided since *Makdessi* (including the recent case of Ahuja Investments Ltd v Victorygame Ltd and Pandher [2021] EWHC 2382 (Ch), where a default interest rate of 12 per cent (compared to a pre-default rate of 3 per cent) was found to constitute a penalty and *London Arbitration 33/22*, where interest claimed at 0.1 per cent per day was found to be excessive), earlier case law considering whether specific clauses are penal will still be relevant, as the Supreme Court considered it impossible to lay down abstract rules as to what may or may not constitute 'extravagant' or 'unconscionable' (see the High Court case of Azimut-Benetti SpA v Healey [2010] EWHC 2234 (Comm) concerning a yacht builder's claim for an amount equal to 20 per cent of the contract price by way of liquidated damages on its termination of the yacht construction contract for the buyer's late payment of an instalment).

There is also authority to indicate that the courts will interpret liquidated damages clauses to prevent their application where the relevant underlying breach of contract is relatively minor. This de minimis approach was adopted by the Court of Appeal in Cenargo Ltd v Izar Construcciones Navales SA [2002] EWCA Civ 524, which concerned a provision for payment of liquidated damages for reductions in the vehicle-carrying capacity of ferry newbuildings. The cost of the modifications, at around US$11,000, was substantially less than the liquidated damages claim under the contract of around US$750,000. This judgment is considered to be controversial as it has been felt to run counter to the whole premise of a liquidated damages clause being to reflect the contractual bargain between the parties for a specific breach of contract, notwithstanding a party's loss. For example, more recently, in the first instance decision in MSC Mediterranean Shipping Company SA v Cottonex Anstalt [2015] EWHC 283 (Comm) and approved obiter by the Court of Appeal (MSC Mediterranean Shipping Company SA v Cottonex Anstalt [2016] EWCA Civ 789), demurrage, which was payable by a charterer to a shipowner for failure to load or unload goods on time and recognised as a payment of liquidated damages, did not require the innocent party to prove its actual loss or mitigate that loss when it fell due.

Even if the contract has been rescinded, (absent express contractual wording to the contrary) liquidated damages will normally be payable by the builder in respect of delay, even if the work is completed elsewhere, up until the point of termination. In Triple Point Technology v PTT Public Co Ltd [2021] UKSC 29, the Supreme Court rejected the Court of Appeal's finding that liquidated damages would not accrue if a contract was terminated before completion, noting that this would be 'inconsistent with commercial reality and the accepted function of

liquidated damages'. The builder will generally not be liable for liquidated damages after the date of termination (absent clear drafting to the contrary).

In circumstances where a liquidated damages clause is held to be void or unenforceable as a penalty, this does not necessarily mean the provision fails to operate as a cap on the general damages which a party can recover where it seeks to prove its actual loss. Buckingham Group Contracting Limited v Peel L&P Investments and Property Limited [2022] EWHC 1842 (TCC)), following Eco World – Ballymore Embassy Gardens Company Ltd v Dobler UK Ltd [2021] EWHC 2207 (TCC), confirmed that it is possible, at least in principle, for a penal liquidated damages clause to operate as a general limitation of liability provision even though it is expressed as applicable only to liquidated damages.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

As liquidated damages are a contractual mechanism, their scope will depend on the construction of the clauses that provide for them. Nevertheless, it will generally be the case that liquidated damages clauses are intended to liquidate the entirety of losses that they concern (eg, all losses incurred by the buyer as a result of the builder's failure to deliver the vessel by the contractual delivery date), and in doing so limit the liability of the party in breach to the agreed amount under the clause. In such circumstances, the claimant will need to establish an alternative or additional breach of contract to sue for its actual loss in such a case. However, where the liquidated damages clause is successfully challenged as constituting an unlawful penalty and is unenforceable, both parties are disabled from invoking it. In such a case, the innocent party is entitled to sue for its actual losses, subject to the usual rules of remoteness of damage and causation.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

Parties are free to design the force majeure clause and it is important that due consideration is given to doing so because English law, unlike some civil law jurisdictions, does not recognise any general doctrine of force majeure. Accordingly, the parties must specify the events, unforeseen at the point of contracting, that will constitute force majeure. These typically include events such as: acts of God; war or other hostilities; requirements of government authorities; blockade; civil war; strikes, lockouts or other labour disturbances; labour shortage; flood, typhoons, hurricanes, storms or other weather conditions not included in normal planning; pandemics; earthquakes; tidal waves; landslides; fires; and explosions. The parties must also specify the effect of the occurrence of such an event. The contract usually sets strict time limits within which the commencement and ending of the event must be notified, and failure to do so can be fatal to successfully claiming force majeure (see, by way of example, GPP Big Field LLP v Solar EPC Solutions SL (formerly Prosolia Siglio XXI) [2018] EWHC 2866 (Comm). The scope of the force majeure clause will affect the extent to which the builder is entitled to an extension of time for completion of the vessel and the remedies available to the buyer where the builder fails to meet the delivery date. Where

a party seeks to rely on a force majeure event, it must show causation and establish that it would have performed the contract but for the force majeure event (see Seadrill Ghana Operations Ltd v Tullow Ghana Limited [2018] EWHC 1640 (Comm) and Classic Maritime Inc v Limbungan SDN BHD & Anor [2018] EWHC 2389 (Comm)). A force majeure event, such as the imposition of sanctions, may be overcome by non-contractual performance where the force majeure clause requires the exercise of reasonable endeavours to overcome a potential force majeure event, if the same result is achieved and no detriment to the counterparty results (see MUR Shipping BV v RTI Ltd [2022] EWCA Civ 1406).

As all of the standard forms include epidemics as a force majeure event (and it is also common to find pandemics, quarantine, entry and exit restrictions, restraint of princes, rulers and people, and requirements of government authorities in such clauses), a builder may have been able to claim force majeure as a result of the coronavirus pandemic, provided that the builder:

- could show that construction or delivery was delayed;
- complied with the relevant notice provisions in the force majeure clause; and
- could show causation.

Where such a clause is not included, the common law doctrine of frustration may apply, but only where the performance of the contract has become impossible or radically different.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

The Institute of London Underwriters' Builders' Risks Clauses dating from 1988 (the 1988 Clauses) are recommended as the minimum insurance in the Baltic and International Maritime Council's BIMCO Newbuildcon and widely used to cover the risks of physical loss of and damage to the vessel and her components during the period of construction. Generally, the cover incepts at the stage of keel laying (although the parties may agree a different stage of construction) and lapses upon delivery of the vessel to the buyer. Insurance is on an all-risks basis (subject to certain limitations) in respect of loss or damage to the vessel or her components, including repair or replacement costs of parts condemned owing to latent defects discovered within the period of the insurance. It is usual for builders' risks policies to identify the insured parties in broad terms to include, in addition to the builder as the principal assured, other parties involved with the project, such as the builder's subcontractors and suppliers.

The more recent London Marine Construction All Risks 2007 Clauses were released to suit a wider range of projects (including conversion, repair, lengthening or other similar work, as well as the construction of liquefied natural gas carriers and high-value cruise vessels) than the 1988 Clauses and to address certain shortcomings perceived in those clauses. However, insurance written on the terms of the 1988 Clauses remains the norm.

An alternative wording for builders' risk insurances is that contained in the Nordic Marine Insurance Plan 2013, as updated in 2019, providing coverage against physical damage to a vessel and its components caused prior to delivery by marine perils, strikes and lockouts.

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War perils coverage can be purchased as an add-on from the date of launching. Regarding machinery and components, coverage can be purchased but only from the date they have been placed on board the launched vessel. Insurance coverage is for the 'builder's yard or other premises in the port where the builder's yard is situated and while in transit between these areas' and the designated area for the vessel's sea trials.

Coverage for the construction and modification of vessels and installations employed in the offshore oil and gas sector is usually provided on WELCAR 2001 Offshore Construction Project Policy (WELCAR 2001) terms. WELCAR 2001 provides general all-risks coverage throughout the construction process, from initial procurement to start-up. The Lloyd's Joint Rig Committee revised the WELCAR wording and circulated it for consultation in 2011. The amended wording, however, was criticised as too restrictive and pending further consultation it has not re-emerged.

Aside from WELCAR, it is not uncommon for parties to opt for contractors' all risks or erection all risks coverage. The former is designed to cover all loss or damage to insured property (such as permanent property resulting from the works, construction equipment, worksite property and removal of debris) and liability towards third parties for death, bodily injury and damage to property, while the latter predominantly provides cover for risks associated with the erection, installation and commissioning of equipment, machinery, plant and structures. Although both of these policies are generally used for onshore construction and infrastructure projects, subject to the insurance arrangements of the parties, they may also be suitable for some shipbuilding and offshore construction projects.

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

Where the contract provides for any dispute to be submitted to the High Court, the court will not normally be prepared to set terms for the parties if they cannot agree them themselves, although it may be willing to determine what would be a reasonable adjustment to the contract price or a reasonable delivery date. If, however, arbitration is the chosen means for dispute resolution, the position may be different.

Marine construction contracts governed by English law often include a term that, when making its award, the tribunal may include a finding as to any extension of the delivery date (which, for instance, allows the builder to seek extra time where the arbitration itself has caused delay to completion of the vessel). However, that is usually as far as the term goes – there is typically no provision for what criteria are to be applied by the tribunal in exercising this discretion. Further, if the parties wish the tribunal to determine any reasonable adjustments to other terms of the contract, such as the contract price, the contract should expressly confer that power on the tribunal.

Under the Arbitration Act 1996, the parties are free to agree on the powers exercisable by a tribunal as regards remedies. Unless otherwise agreed by the parties (or by reference to the rules of the applicable arbitral institution), the tribunal has wide powers, including ordering payment of a sum of money in any currency, making a declaration as to any matter

to be determined in the proceedings, ordering a party to do or to refrain from doing anything, ordering specific performance of the contract and ordering rectification, setting aside or cancellation of a deed or other document. However, neither the arbitral tribunal nor the court can amend the terms of the contract, unless agreed by the parties. It is also important to consider where such a non-damages remedy is sought and the other party subsequently does not act in accordance with the arbitral award, whether such a remedy can actually be enforced in the jurisdiction where the award would need to be enforced.

It is not unusual to encounter provisions in shipbuilding contracts requiring further negotiation or agreement between the parties. The general position under English law is that true agreements to negotiate or agreements to agree are unenforceable (see, eg, *Walford v Miles* [1992] 2 AC 128). In many cases where, therefore, parties fail to reach agreement on the contract price, delivery date or other key terms, neither the court nor an arbitration tribunal will usually be prepared to set such terms for them. However, that is not always the case, and often the court or arbitration tribunal will strive to uphold the contract that the parties have entered into by implying a term into the contract to make it enforceable. In Teekay Tankers Limited v STX Offshore and Shipping Company [2017] EWHC 253 (Comm), the court would not imply terms into the option agreement in circumstances where the parties were unable to reach agreement as to the delivery date for two options for the construction of up to four vessels each, because it took the view that such terms were at odds with the parties' scheme as set out in the option agreement. However, whether this approach is applicable in all cases will depend upon the construction of the contract.

The conclusion of a letter of intent is a typical first stage in most newbuilding projects, the main purpose of which is usually to secure the slot in the shipyard's building schedule for a period during which the parties will negotiate the contract and specification of the vessel, and also to set out certain key terms, such as delivery date, payment terms and perhaps options on further vessels. As a matter of English law, unless (unusually) the letter of intent expressly states that it creates a legally binding agreement, its enforceability will be a matter of construction, although that wording alone may not be sufficient to result in an enforceable letter of intent. Where the terms included contain provisions as to consideration and governing law and jurisdiction, the requisite intention to create a contractual relationship is likely to be found. However, even if such an intention is present, the letter of intent will still not be enforceable if, on its true construction, it provides no more than an agreement to agree or an agreement to negotiate. Recent case law has shown that, depending on the construction of the terms of the particular contract, it is possible for an agreement to agree or to negotiate to be enforceable, although recent reported cases demonstrate how nuanced the position can be. In Arcadis Consulting (UK) Ltd v AMEC (BSC) Ltd [2018] EWCA Civ 2222, the Court of Appeal found that where a party started work on a project following receipt of a letter of instruction that was sufficient to amount to acceptance, even though negotiations were ongoing and never finalised. The letter of instruction stood as the contract between the parties and incorporated the terms and conditions that the parties were already working under on another contract, even though the parties continued to negotiate the terms and conditions as part of the failed negotiations. However, in DHL Project & Chartering Ltd v Gemini Shipping Co Ltd [2022] EWHC 181 (Comm), a 'subject' provision in bold text at the start of a fixture recap email prevented there from being a binding charter.

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Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

The principal purpose of the protocol of delivery and acceptance is to record the time and date that title and risk pass to the buyer. It is also typically required to enable the builder to obtain the delivery instalment of the contract price.

The effect of the protocol of delivery and acceptance was reviewed by the High Court in the case of Riva Bella SA v Tamsen Yachts GmbH [2011] EWHC 2338 (Comm), which concerned the resale of a newbuild yacht. It was held that in certain circumstances (for instance, where the contract itself expressly provides), by accepting the vessel and by signing a protocol of delivery and acceptance, the buyer may be precluded from rejecting the vessel (at least with regard to patent defects) and prevented from claiming damages against the seller, and may instead be confined to the remedies arising under the contractual warranties. The court held, however, that, in the ordinary course, acceptance will not prevent a claim for damages (this was confirmed in Saga Cruises BDF Ltd and another v Fincantieri SPA [2016] EWHC 1875 (Comm), which concerned a contract for dry docking, repair and refurbishment of a cruise ship). This is also clear from the judgment of the Court of Appeal in Cenargo Ltd v Izar Construcciones Navales SA [2002] EWCA Civ 524 where acceptance of a vessel from the builder was held not to preclude the buyer from asserting at delivery or thereafter any claim for liquidated damages for breach of any performance warranty.

It is relatively unusual to find a protocol of acceptance stating that 'buyer's acceptance of the vessel is final and binding so far as conformity of the vessel to the contract and specifications are concerned'. Most protocols confine the statement to delivery 'in accordance with' or 'pursuant to' the contract. However, such a term is frequently encountered as part of the provisions regarding sea trials in the shipbuilding contract itself.

In China Shipbuilding Corporation v Nippon Yusen Kabukishi Kaisha and another [2000] EWHC 211 (Comm), it was held that, in the context of the buyer's express or deemed acceptance of the vessel following trials (namely, in the sense of confirmation of approval of the vessel as distinct from taking possession following formal tender of delivery), a provision that acceptance 'shall be final and binding so far as conformity of the vessel to this contract and the specifications is concerned' was limited. Such a term was found merely to prevent the buyer from refusing the later delivery of the vessel when she was tendered; it did not preclude the buyer from asserting after delivery the existence of specific defects whether previously notified to the builder or latent at the time of delivery.

However, the terms of a certificate of acceptance may be such as to constitute clear and unequivocal agreement by the buyer that the goods conform on delivery with the required contractual condition, thereby preventing the buyer from later claiming otherwise. The construction of such a certificate was central to the Court of Appeal's decision in Olympic Airlines SA (in special liquidation) v ACG Acquisition XX LLC [2013] EWCA Civ 369 in the context of delivery of an aircraft under an aircraft lease and to the High Court's decision in

ABN Amro Commercial Finance plc v McGinn [2014] EWHC 1674 (Comm) in the context of a conclusive evidence certificate given by the lender in relation to a claim under an indemnity.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

It is normally provided that any replacements or repairs will take place in the builder's shipyard, but that is rarely the case as any warranty works will have to be scheduled depending on a vessel's trading commitments and operations.

Where it is 'impractical to bring the vessel to the shipyard' (as under the Shipbuilders' Association of Japan (SAJ) and Newbuildcon forms) or when the builder 'cannot supply necessary replacement parts and materials without impairing or delaying the operation or working of the Vessel' (see Newbuildcon form), the buyer is entitled to have the warranty works undertaken at 'any other shipyard or works' provided that the builder has the right of pre-inspection of the alleged defects. In this case, under the SAJ form, the buyer is entitled to recover the sum 'equal to the reasonable cost of making the same repairs or replacements at the Shipyard'. Alternatively, contracting parties sometimes agree to limit the buyer's recovery to the lowest or the average price for the repairs quoted by two or three shipyards in the vicinity in which the vessel is located. Under the Newbuildcon, the builder shall pay the 'reasonable cost and expenses' of the warranty works. Unlike the Newbuildcon, the SAJ form explicitly provides that the vessel shall be taken at the buyer's cost and responsibility to the repair yard and be ready for the repairs or replacements.

Ultimately, it is for the parties to agree whether ancillary expenses such as towage, dockage, wharfage, port charges and anything else incurred by the buyer getting and keeping the vessel ready for repairs shall be borne by the builder or the buyer.

Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

Under English law, a lien is a right over the property of another arising by operation of law, independently of any agreement. There are various categories of lien but the most relevant here would be a legal lien (also known as a possessory or common law lien), which gives the lienor a right to retain the property until the owner has settled some debt owed to the lienor. There are various subcategories of common law liens. However, if the equipment is already in the possession of the builder, ready to be incorporated into the vessel, the essential element of the lien (namely, possession by the lienor) will be missing.

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In any event, it is usual practice for the builder to issue a written declaration at delivery of the vessel's freedom from encumbrances and the bill of sale typically provided at delivery will usually contain a similar express covenant. Such a warranty will (unless expressly excluded) also be implied by section 12(2)(a) of the Sale of Goods Act 1979.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

It is common for suppliers to incorporate into their contracts retention or reservation of title clauses. These usually stipulate that the supplier retains the property in the goods until such time as full payment has been made. The validity of these clauses was established in the case of *Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd* (1976), but while the practical effects of these clauses seem well understood, the legal issues arising are often less so.

It is important to distinguish the simple retention of title clause from a security agreement. The latter (where the transaction involves companies) may well require registration as a registrable charge under section 859A of the Companies Act 2006. A simple retention of title clause will not have this effect and is not a charge because property in the goods is retained by the original supplier and never passes to the buyer. As the buyer was never the owner, it would never be able to grant any interest in the goods to the seller by way of security. However, retention of title clauses vary considerably and a sophisticated clause may well be found to constitute a charge, especially where it grants back to the seller any beneficial or equitable interest. In company law, there is a regime for the registration of charges that serves as notice to any subsequent buyer or subsequent chargee of the existence of the charge. The failure of a supplier to register a registrable charge means that any such subsequent chargeholder or buyer can ignore the claims of the original supplier, who will be left with its claims against the buyer under the contract. This would clearly be disastrous for the original supplier if the buyer became insolvent. It is, therefore, important to ensure that any such clause is carefully reviewed.

Where material has been delivered by the supplier to the shipbuilder pursuant to a contract containing reservation of title provisions, to the extent that the material remains held in stock and available, the clause should be effective to ensure the property remains vested in the supplier. However, where the goods have been incorporated in, or used as material for, other goods, detailed analysis of the resulting product will be required to establish ownership. It cannot be assumed that if a supplier is unable to identify its particular goods, its retention of title clause will be defeated. In the first instance, it will be necessary to establish the extent to which the original goods supplied have retained their original identity. Where the identity of the original goods has been lost, the buyer is likely to have acquired title. If, however, the original goods have been mixed with goods owned by a third party, a supplier's retention of title claim will not necessarily be defeated, particularly if such goods retain their original identity or can be extracted from the manufacturing process.

There is authority for the assumption that the newly manufactured goods are owned by the buyer of the original goods (namely, the shipbuilder) but that the clause itself may then

provide evidence of a charge created in favour of the supplier (to which the issues raised above are then relevant). Depending again on the precise terms of the contract between them, notwithstanding any retention of title provision, the shipbuilder, as a buyer in possession after the sale from a supplier, is permitted under section 25 of the Sale of Goods Act 1979 to sell the goods and pass good title. The supplier is left with a claim for damages.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

The availability of any such right of a third-party creditor to obtain a security attachment or lien over the vessel (more commonly referred to as arrest) or equipment will depend upon the lex situs, that is, the law of the place of construction.

As the vast majority of shipbuilding contracts governed by English law provide for title to the vessel to pass to the buyer on delivery, at that point in time, the builder is required to issue a written declaration that the vessel is free from, among other things, charges and liens and will want to ensure that it can make the declaration required.

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

Whether such a warranty can be assigned will depend on the terms of the relevant contract. Under English law, in the absence of an express prohibition in the contract, the benefits (but not the burdens) of a contract can generally be assigned by either party to a third party.

Where the assignment is made in writing, is signed by the assignor, is in absolute terms (and not by way of charge only) and a written notice of the same is given to the contractual counterpart, it will satisfy section 136 of the Law of Property Act 1925 and constitute a legal assignment. As a result, the assignee assumes the rights of the assignor under the contract and may enforce such rights itself directly against the other contracting party. Where the statutory formalities have not been met, the assignee may still be able to enforce the assignment in equity by joining the assignor to any action. In Energy Works (Hull) Ltd v MW High Tech Projects UK Ltd & Others [2020] EWHC 2537 (TCC), it was decided following a preliminary issues hearing that the assignment of a subcontract from the contractor of a re-gasification plant in England to the employer on termination of the main contract transferred the benefit of all accrued and future rights, leaving the contractor with no contractual claim against the subcontractor including for defective work of the subcontractor which resulted in liability of the contractor to the employer, although it was also determined that the contractor was entitled to claim a contribution from the subcontractor under the Civil Liability (Contribution) Act 1978 in relation to certain types of damage. However, advice should be sought from local counsel to clarify the position in the jurisdiction where the vessel is being constructed, which is not normally England or Wales.

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Under the Contracts (Rights of Third Parties) Act 1999, it is possible in certain circumstances for contractual rights to be enforced directly by a third party provided that the contract expressly provides that the third party may do so or a relevant term 'purports to confer a benefit upon him' and, on the proper construction of the contract, it is clear that the parties intended that such third party should be entitled to enforce it. 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'. This third party is entitled to the same remedies as would have been available to it in an action for a breach of contract if it had been an original party. However, the contractual defences available to the original parties are preserved in relation to the third party and it is open to the original parties to set conditions on a third party's rights to enforce any term. This Act is, however, routinely excluded in manufacturers' warranties.

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

Parties usually agree that certain defined events of default will entitle the buyer to terminate the contract by exercising express rights in the contract to this effect. Most shipbuilding contracts define delay in delivery, technical deficiencies in the vessel, insolvency events, failure to maintain an effective refund guarantee and total loss as such events entitling termination.

It is important to ensure that the party seeking to terminate the contract complies with any contractual mechanism or procedure for terminating, including the service of notices of default. However, as illustrated in the first instance decision of Obrascon Huarte Lain SA v Attorney General of Gibraltar [2014] EWHC 1028 (TCC), strict compliance with such a procedure may not be essential, an approach that the judge considered 'accords with commercial common sense', although a party terminating a contract will certainly not want to have to rely on this decision. However, in a recent arbitration award (London Arbitration 2/19), the tribunal said that the builder was obligated to give notice of any delay for which it claimed an extension of time to the delivery date because certainty was of great importance in commercial contracts and it was essential that both parties knew when the right to cancel could be exercised.

When a party wishes to exercise its right to terminate at common law, it will not be necessary for that party to comply with the express contractual termination provisions, including any notice requirements, unless the express wording of the termination provision states that it applies to termination at common law, although such a term cannot be implied into the termination provision of a contract (see Vinergy International (PVT) Ltd v Richmond Mercantile Ltd FZC [2016] EWHC 525 (Comm)). However, there are no 'hard and fast rules' as to the relationship between contractual and common law rights of termination in respect of a particular contract. The extent to which the common law right to treat a contract as repudiated is impacted by the terms of a contract will be a question of contractual construction in each case (see *Digital Capital Limited v Genesis Mining Iceland EHF* [2021] EWHC 2462 (Comm)).

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If the buyer exercises a right to terminate, the builder will normally have to refund the instalments paid up to that point, together with interest at an agreed rate. Where title passes on delivery, the builder's obligation to refund the pre-delivery instalments is normally secured by a refund guarantee, the provision of which is usually a condition precedent to payment of instalments.

Even if the buyer is refunded its advance instalments and interest, the buyer may still incur substantial losses as a result of the termination. These losses may be categorised as either loss of bargain (usually expressed as the difference between the contract price and the market price for an equivalent newbuilding) or reliance loss (wasted expenditure as a result of the termination of the contract). These losses are not normally recoverable from the builder, as shipbuilding contracts invariably seek to limit the builder's obligations on termination by the buyer to repayment of the advance instalments with interest.

Where the victim of a breach of contract prefers performance of the contract rather than its termination, in theory, it may be possible for it to obtain an order of specific performance from the High Court or arbitration tribunal. This is an order directed to the party in breach to fulfil its contractual obligations. However, it is a discretionary remedy and seldom granted: for example, an order for specific performance will not be made where an award of damages would adequately compensate the victim, nor where the defaulting party is based outside the jurisdiction and has no assets within the jurisdiction. Also, in a shipbuilding context, the courts have refused to order specific performance to ensure completion and delivery of a vessel, due to the difficulty of ensuring adequate supervision of a complex construction project (although the position may be otherwise where the vessel is actually complete, as the remedy has been granted in the context of sales of second-hand vessels).

It may, however, be possible to characterise the builder's conduct as being a repudiatory breach of contract, which is essentially where the breach is either in relation to a term that is correctly categorised as a contractual condition or is serious enough to deprive a party of substantially the whole benefit it intended to obtain from the contract (Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd [1961] EWCA Civ 7). If so, the breach gives that party a common law right to treat the contract as discharged and to recover damages for loss of bargain. This position was reaffirmed in the important case Stocznia Gdynia SA v Gearbulk Holdings Ltd [2009] EWCA Civ 75. The Court of Appeal in the *Gearbulk* case held that the particular contractual provision (regarding delay in delivery) did not exclude a right to terminate under common law and also did not exclude the claimant's rights to recover losses in the usual way, so the buyer could claim damages for loss of bargain. Furthermore, the exercise of its contractual rights to recover the instalments did not prejudice the claimant's ability to claim damages for the builder's repudiatory breach because it could recover those instalments under the doctrine of total failure of consideration, which was distinct from any right to recover damages for loss of bargain. The *Gearbulk* case provides an example of a failure to exclude the buyer's common law rights. However, where common law rights are not excluded but a party terminates in accordance with an express contractual right only, and that right does not amount to a breach of contract, the innocent party will subsequently be precluded from claiming common law remedies for breach because they had not terminated for a repudiatory breach of contract (actual or anticipatory). In Phones 4U Limited (in administration) v EE Limited [2018] EWHC 49 (Comm), the innocent party lost the right to claim loss of bargain damages because the basis for termination set out in the notice of termination was the appointment of administrators only. This case illustrates that

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it is crucial that a party carefully considers its legal options, and obtains legal advice before serving notice of termination.

The recent case of Havila Kystruten AS v Abarca Companhia De Seguros SA; Hijos de J Barreras SA v Havila Kystruten AS [2022] EWHC 3196 (Comm) makes clear the right of a buyer to recover instalments paid under a shipbuilding contract either under the relevant contract terms or at law by way of restitution on the basis of a total failure of consideration; or where that is not the case as reliance-based damages (a measure of wasted expenditure and therefore subject to the buyer giving credit for any value received under the contract).

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

Depending on the circumstances of the case and the terms of the contract, it may be open to the shipowner, in addition to any contractual remedies, to treat a protracted failure to construct or to continue construction as a repudiatory breach of contract by the builder entitling the shipowner to accept the repudiation (to bring the shipbuilding contract to an end) and to claim damages in respect of losses caused by the breach. A shipowner may have to wait until it is impossible for the builder to meet the delivery date before it can exercise such a right and cancel the contract. If beforehand the builder evinces an intention not to perform its obligations in some essential respect, the builder's actions may amount to renunciation of the contract, allowing the shipowner to accept the breach and sue for damages before performance is required under the contract. In Teekay Tankers Limited v STX Offshore and Shipping Company [2017] EWHC 253 (Comm), the judge considered obiter that it was clear from the statements made by the builder regarding the provision of refund guarantees that the builder did not intend to fulfil its obligations and the shipowner would therefore have been entitled to terminate on that basis.

Where the contract sets out the delivery date but does not already make time of the essence, the shipowner's position in the event of protracted failure to construct or continue construction by the builder may require, or at least be strengthened by, the serving of a notice making time of the essence, as long as it gives the builder a reasonable time to complete construction. That notice should be sent as soon as the breach arises, but the shipowner does not need to wait until there has been unreasonable delay before sending it (see *Behzadi v Shaftesbury Hotels* (1992)).

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

Clauses granting the buyer the right to terminate the contract if the builder becomes insolvent (or commits any other type of defined 'financial default') are not uncommon in English law shipbuilding contracts (such a provision appears in the Newbuildcon form, although not in the SAJ form). In Fibria Celulose S/A v Pan Ocean Co Ltd and another [2014] EWHC 2124 (Ch), Fibria was found to be entitled to cancel a contract of affreightment with the South

Korean shipping company in accordance with the terms of the contract on the basis of it being subject to an insolvency process. The company was subject to a rehabilitation process in Korea, which was regarded as being broadly comparable to an English administration coupled with a scheme of arrangement or company voluntary arrangement. The English court had no power under the Cross Border Insolvency Regulations 2006 (SI 2006/1030) to order a stay in relation to Fibria's entitlement to serve such a termination notice under the contract and nor could it make an order restraining it from doing so.

The judge noted that in some jurisdictions, a clause that allows a party to a contract to terminate the contract by reason of the insolvency of the counterparty is called an ipso facto clause. While in some jurisdictions such clauses are automatically invalid or the court has power to stay the exercise of rights under such clauses, there was no dispute in this case as to the efficacy of such a provision under English law. However, it should be noted that ipso facto clauses which allow a supplier to terminate a contract because of a customer's insolvency are no longer enforceable, subject to the right of a supplier to apply to the court for permission to terminate, on the basis that not being able to terminate the contract would cause the supplier hardship (see section 233B of the Insolvency Act 1986). Indeed, the judge remarked that it was accepted that those provisions are valid in English law. In particular, it was accepted that the rule of insolvency law, known as the anti-deprivation rule, does not strike down such provisions. The anti-deprivation rule can be briefly summarised as that which on insolvency prevents parties from depriving the insolvent company of property that would otherwise be available for creditors.

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

The parties commonly choose which arbitration institution or country's courts will have jurisdiction over any disputes that arise under or in connection with the contract. Such clauses commonly override the basic principle that a defendant should be sued in his or her country of domicile. Arbitration is the preferred mechanism to resolve disputes arising under shipbuilding contracts. References are usually to a sole arbitrator or to a tribunal of three arbitrators in accordance with the rules of an arbitration institution, such as the London Maritime Arbitrators' Association (LMAA) and its Terms (the current version is the LMAA Terms and Procedures 2021), and the provisions of the Arbitration Act 1996. Where judicial proceedings are selected, disputes are typically agreed to be submitted to the Commercial Court or the Technology and Construction Court in London, part of the Business and Property Courts of England and Wales.

Arbitrations are often preferred because they are typically confidential and awards are generally more easily enforced around the world than English court judgments, owing to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention. In both instances, appropriate legal advice should be sought from local counsel. The procedure for enforcement of UK court judgments in EU states has changed as a result of the UK's departure from the European Union and is generally now subject to the local laws of the foreign country.

It is possible to challenge an arbitrator's award for lack of substantive jurisdiction, for serious irregularity or on a question of law (although the parties can agree to exclude the last of these), and as a result, the dispute may end up before the courts. Where there are related contracts, for example, the shipbuilding contract and the refund guarantee, it is not uncommon to find that disputes arising under the former will be dealt with by arbitration, while the latter is subject to separate court proceedings.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

Where a buyer has an express contractual right to take possession of a vessel under construction and continue construction, such a right would survive the bankruptcy or moratorium of the creditors of the builder under English law, however, this is an issue that would be determined by the lex situs, that is, the law of the place of construction, which is not normally England or Wales. In such circumstances, appropriate legal advice should be sought from local counsel to clarify the position.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

Of the standard forms of shipbuilding contract typically encountered, only BIMCO's Newbuildcon contains extensive, formal ADR provisions. In particular, this standard form provides a detailed mediation clause that permits the parties to refer any dispute arising out of the contract to mediation even if they have previously agreed to submit such dispute to arbitration and even if arbitration has already been commenced (in which case the arbitration proceedings are to continue during the conduct of the mediation and the tribunal has the power to adjust the arbitration timetable to take the mediation into account). Aside from BIMCO's Newbuildcon, it still remains relatively unusual to see provision for formal ADR procedures such as mediation, early neutral evaluation or the like provided for in shipbuilding contracts, although it may be agreed that the parties are to convene a meeting between senior management to try to resolve any dispute before arbitration or court proceedings are commenced. Where litigation is the agreed mode of dispute resolution, the English High Court encourages and has the power to order parties to engage in ADR procedures before or after formal proceedings are commenced and may stay the proceedings to allow for this to happen.

It is not uncommon for maritime construction contracts, particularly those in the offshore sector, to provide for an escalation procedure in an attempt to settle disputes through senior management before commencing formal arbitration or litigation. It was generally considered that where such a 'tiered dispute resolution clause' was included in a contract, any requirement for the parties to hold such discussions before the dispute was referred to formal dispute resolution was likely to be held unenforceable as it amounted to an agreement to agree. However, in the case of Emirates Trading Agency LLC v Prime Mineral Exports Private Limited [2014] EWHC 2104 (Comm), the High Court held that, provided such

a term is not incomplete and not uncertain, a requirement to hold 'friendly discussions' may well not be a mere agreement to negotiate and could, depending on the facts, be enforceable, although subsequent judgments have declined to follow this approach. Stipulating that those discussions are conducted in good faith generally does not add to the obligations on the parties and can instead lead to a dispute as to whether a duty of good faith has been imposed and what this amounts to.

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

As with default by the builder, it is usual for the parties to agree that certain defined events will entitle the builder to terminate the contract by exercising express rights in the contract to this effect in the event of default by the buyer. Most shipbuilding contracts define the buyer's failure to make timely payment of the instalments of the contract price or to take delivery of the vessel when it is tendered for delivery as events entitling termination, but depending on the financial standing of the buyer, such a clause could also include insolvency events.

Some shipbuilding contracts provide that the builder must give notice of default to the buyer, specifying a period during which the buyer can remedy the default, as a condition precedent to the builder's right to terminate the contract, but it is common for the builder to have the automatic right to terminate the contract upon the buyer's breach without notice of default.

The shipbuilding contract will set out the consequences of the buyer's default. Where the buyer fails to pay any instalments, the shipbuilding contract will commonly provide that the buyer is obliged to pay an agreed rate of interest from the date of the default until payment, including interest, is made in full. It may also require the buyer to pay all charges and expenses incurred by the builder as a consequence of the default. Such provisions also commonly provide that the delivery date will automatically be extended for the period of such default regardless of whether the construction of the vessel has been delayed as a result, although they are often amended to limit the extension to the period of time by which the builder's construction programme is delayed. If the default continues for more than a set number of days, the builder will normally have the option to terminate the shipbuilding contract by giving notice to the buyer.

By cancelling the shipbuilding contract, the builder has brought an end to its obligation to construct the vessel and the buyer's obligation to purchase the vessel. On cancellation, the builder is normally entitled to retain the instalments of the contract price already paid by the buyer. The builder must, however, give credit for such sums in the 'final accounting'. As to instalments that are due but unpaid, termination of a contract of sale can prevent the recovery of any unpaid instalments from the buyer on the basis that the price is no longer payable (see *Dies v British and International Mining and Finance Corporation Ltd* [1939] 1 KBD). In the context of shipbuilding contracts, however, unless the builder has done nothing in the performance of the contract such that there has been a total failure of consideration (see *Hyundai Heavy Industries Co v Papadopoulos and Others* (1980) and Stocznia Gdanska SA v Latvian Shipping Co, Latreefer Inc and Others [1998] UKHL 9), the buyer cannot contend

that the unpaid instalments are no longer due and instalments that have therefore accrued due, but remain unpaid by the buyer at the time of builder's termination, are recoverable by the builder. As to future payments, in the absence of express wording to the contrary, the builder's cancellation of the shipbuilding contract will prevent the builder from seeking to recover any future instalments of the contract price. Shipbuilding contracts also commonly provide that on cancellation by the builder, title in the buyer's supplies will transfer to the builder. However, this is normally limited to those buyer's supplies that have been installed or have been utilised on board the vessel.

Following termination of the shipbuilding contract, the builder will normally be entitled to sell the vessel, either in its existing condition, or to continue with the construction of the vessel and sell it once it has been completed. Shipbuilding contracts usually expressly provide for the application of the proceeds realised upon sale for each such scenario. In *Stocznia Gdanska*, the House of Lords held that the vessel did not need to be completed in accordance with the original specification to amount to a sale of the vessel under the relevant default clause. The appropriate course of action will normally be determined by the stage that construction has reached, together with the state of the newbuilding market at the relevant time. While shipbuilding contracts generally allow the sale to take place publicly or privately, the builder is normally subject to either an implied or express duty to act in good faith to prevent the sale of the vessel at an undervalue. Once the vessel has been sold, a final accounting will take place and take into account the original contract price or the builder's costs of construction or any anticipated lost profit of the builder (depending on the contract terms and whether the vessel was sold in a complete or incomplete state), and the instalments paid by the buyer. Any surplus will then usually be shared between the buyer and the builder, although the buyer is not usually entitled to recover more than the aggregate of the instalments paid and the supplies purchased. Where, however, there is a shortfall, the builder can demand the difference from the buyer.

Unless they have been excluded by clear words, the builder will also be entitled to rely on its common law rights, which may entitle it to treat the buyer's conduct as a repudiatory breach of the contract. In such circumstances, the builder can either affirm the contract, or accept the breach as bringing to an end the parties' respective obligations to construct and purchase the vessel, but require the buyer to pay damages for the builder's losses.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

Most international shipbuilding contracts governed by English law tend to follow the Shipbuilders' Association of Japan's (SAJ) 1974 standard contract SAJ form, which forms the basis for many standard forms used in China, Singapore, South Korea and Taiwan. Other forms include the Baltic and International Maritime Council's BIMCO 2007 standard newbuilding contract Newbuildcon, and the Community of European Shipyards' Associations' 1999 form (commonly referred to as the AWES form). These forms are commonly substantially amended either by the parties when negotiating the specific contract or by the builder

to create its own standard form, which it presents to potential buyers (who may then negotiate further amendments, depending on the respective bargaining power of the buyer and the builder).

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

Where the contract assignment is made in writing, is signed by the assignor, is in absolute terms (and not by way of charge only) and a written notice of the same is given to the contractual counterpart, it will satisfy section 136 of the Law of Property Act 1925 and constitute a legal assignment. As a result, the assignee assumes the rights of the assignor under the contract and may enforce such rights itself directly against the other contracting party. Where the statutory formalities have not been met, the assignee may still be able to enforce the assignment in equity by joining the assignor to any action.

Under the Contracts (Rights of Third Parties) Act 1999, it is possible in certain circumstances for contractual rights to be enforced directly by a third party provided that the contract expressly provides that the third party may do so or a relevant term 'purports to confer a benefit upon him' and, on the proper construction of the contract, it is clear that the parties intended that such third party should be entitled to enforce it. 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'. This third party is entitled to the same remedies as would have been available to it in an action for a breach of contract if it had been an original party. However, the contractual defences available to the original parties are preserved in relation to the third party and it is open to the original parties to set conditions on a third party's rights to enforce any term. In light of its significant implications, this Act is routinely excluded in manufacturers' warranties.

English law regards an attempted assignment of contractual rights in breach of a contractual prohibition as ineffective to transfer such contractual rights. In Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1993] UKHL 4 it was held that, were the law otherwise, it would defeat the legitimate commercial reason for inserting such a contractual prohibition, namely to ensure that the original parties are not brought into direct contractual relations with third parties (see also BG Global Energy Limited (formerly BG International (NSW) Limited) and others v Talisman Sinopec Energy UK Limited (formerly Talisman Energy (UK) Limited) and others [2015] EWHC 110 (Comm)). However, while any assignment in breach of a contractual prohibition is incapable of transferring any interest to the assignee, it may well create enforceable obligations between the assignor and assignee themselves. Moreover, *Linden Gardens* established that an intended assignee may still have a remedy in spite of such a contractual prohibition on assignment, although any claim must be brought by the assignor, who would hold any damages recovered on trust for the assignee.

It is not uncommon to see such a prohibition qualified by requiring a party seeking to assign to obtain prior written approval or consent of the other party, such approval or consent not to be unreasonably withheld. The authorities establish that such approval or consent operates as a condition precedent to the validity of such an assignment (see *BG Global Energy* and the cases cited therein).

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Assuming no contractual prohibition, and assuming compliance with the statutory requirements, a lawful assignment by one party of its rights to an assignee will not discharge the original contract. The position is different where one party wishes to transfer both its rights and obligations under an existing contract, whereby the original parties must agree to the substitution of the transferor by the new party, usually by novating the contract (by way of a novation agreement). This creates a new contract between the continuing party and the new party, replacing the rights and obligations of the original parties under the existing contract, which is thereby discharged. Prior to executing any novation, it is essential to consider the effect it would have on any third-party security issued in connection with the original contract, because the novation will be likely to discharge a guarantor from any liability under any guarantee. Accordingly, refund guarantees provided to the buyer should be carefully reviewed in advance of execution of any novation to check whether they need to be reconfirmed by the relevant guarantor or replaced as necessary.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

Alternative fuels

The increasing pressure to reduce emissions (eg, the International Maritime Organization (IMO) has targeted a 50 per cent reduction in carbon emissions from shipping by 2050, relative to 2008, and the EU Emission Trading System will extend to shipping on current proposals from next year), together with the rising costs of fossil fuels and an uncertain regulatory future for traditional fuels, have led to a variety of alternative fuels featuring in discussions regarding newbuildings. The demands of financiers, many of whom will refuse to finance the construction of vessels unless they comply with their environmental, social and corporate governance and green lending policies, are also leading to significant investment and progress in vessels powered by alternative fuels. The first tanker classed ammonia ready was delivered in January 2022 – although it currently remains fitted for conventional fuel, and the South Korean shipyard, K Shipbuilding, received approval in principle from the American Bureau of Shipping (ABS) for a methanol-ready tanker design in December 2021. Nuclear power, which currently only has civil maritime implementation on Russian icebreakers (albeit with a long, and safe, pedigree in military vessels), may also hold promise – ABS is under contract by the US government to research how new reactor technologies can be deployed for commercial use, and Lloyd's Register is also taking steps to facilitate nuclear powered commercial vessels operating inside the decade.

What remains to be seen is whether the potential of these alternative fuels will, or can, be harnessed or whether we will see a large number of 'alternative fuel ready' vessels, which never actually run on those fuels, or perhaps more likely we will see multiple alternative fuels but with certain fuels being adopted for particular trades and geographic areas.

Autonomous vessels

Developments have continued in respect of autonomous vessels both internationally and in the United Kingdom. In May 2022, the IMO's Maritime Safety Committee provided an update on the development of the regulation of maritime autonomous surface ships. This included approval of a road map to develop IMO goal-based instruments for cargo ships to be adopted in the second half of 2024. While these will not be mandatory, they will be used to develop a mandatory version that it is proposed will enter into force on 1 January 2028.

In the United Kingdom, the Maritime and Coastguard Agency released a consultation for a new statutory instrument, the Merchant Shipping (Small Workboats and Pilot Boats) Regulations 2023 and The Safety of Small Workboats and Pilot Boats – a Code of Practice (Workboat Code Edition 3). This will include positive recognition for autonomous vessels and will apply to workboats less than 24 metres in length, including remotely operated unmanned vessels operating as workboats when they are in commercial use as well as certain other types of vessels. It will apply to applicable UK vessels wherever they may be, as well as to non-UK workboats in UK waters operating out of UK ports.

Guarantees

The English courts continue to determine cases concerning guarantees. This includes the Supreme Court's hearing of the appeal of Shanghai Shipyard Co Ltd v Reignwood International Investment (Group) Company Limited [2021] EWCA Civ 1147 on two key issues:

- whether a guarantee to secure a buyer's final instalment payment obligation was an 'on demand' guarantee or a 'see to it' guarantee, the latter imposing a secondary obligation only on the obligor (the Court of Appeal held it was the former); and
- whether a proviso in the guarantee allowing the guarantor to 'withhold and defer' payment in the event of a dispute between builder and buyer referred to an arbitration concerning the buyer's liability to pay the final instalment, resulted in an obligation on the guarantor to make payment before the arbitration award was issued (the Court of Appeal held it did not; the obligation to pay against a document remained but the document in question was an arbitration award rather than a written demand – this did not mean that the guarantor's liability in such a case was secondary).

A summary of the statement of principles from the Court of Appeal decision as to the types of guarantees was given in Havila Kystruten AS v Abarca Companhia De Seguros SA; Hijos de J Barreras SA v Havila Kystruten AS [2022] EWHC 3196 (Comm). These were surety guarantees (an undertaking by the guarantor to be answerable for the debt or obligation of another if that other defaults, or 'to see to it that the debtor performed its own obligation to the creditor'), demand guarantees (where security may be provided by an undertaking to pay a sum on or following demand, irrespective of whether the obligor or debtor is under a liability to make the payment), and conditional bonds (a guarantee that may require payment upon or by reference to an event other than a demand, or be conditional upon such an event).

In a further recently decided case, Geoquip Marine Operations AG v Tower Resources Cameroon SA and Others [2022] EWHC 531 (Comm), a contract variation signed on behalf of the party to the original contract, but not the guarantor, was treated as valid because the signatory was the chief executive officer of both companies and therefore was treated as

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having given consent on behalf of the guarantor, despite not signing in that capacity. As a result, the guarantor's obligations were not discharged by the modification of the contract.

Sanctions

Given the current geopolitical landscape, parties to shipbuilding projects are increasingly focused on issues relating to sanctions, both at the contracting stage and during the course of projects.

The difficulties caused by sanctions are illustrated by the following two cases:

MUR Shipping BV v RTI Ltd [2022] EWCA Civ 1406 illustrates the interpretation of a force majeure clause requiring the exercise of 'reasonable endeavours' to overcome a potential force majeure event before an affected party could rely on a force majeure clause. Here, the Court of Appeal held that a party seeking to rely on force majeure could not resist contractual performance that departed from the contractual terms (on the facts, payment in euros of sums due plus additional costs and currency exchange losses were offered in place of US dollars as a result of US sanctions impacting a charterer's parent company) when non-contractual performance would:

- achieve the same result as contractual performance; and
- cause no detriment to the counterparty; and
- in Gravelor Shipping Limited v GTLK Asia M5 Limited [2023] EWHC 131 (Comm), in circumstances where payments in the contractual currency (US dollars) became incapable of being processed by the relevant banking institution due to sanctions and the relevant charterparty provided that in such circumstances the owner and the charterer were to 'take all necessary steps in order for the payments to be resumed', it was held that the 'all reasonable steps' wording extended, as a matter of construction, to requiring the Defendants to:
- nominate an alternative bank account into which the required payments could be paid;
- nominate a frozen account into which the required payments could be made; and
- accept payment in euros rather than US dollars.

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

Until Law No. 56/2012, there were no legal restrictions on foreign investment in privately owned shipbuilding businesses, whereas the Italian government reserved to exercise its golden share to prevent or limit foreign participation in publicly owned businesses. After the new law, passed to make the Italian legislation more compliant to EU economic freedoms, the state may impose restrictions only if national strategic interests are endangered. The shipbuilding sector is not, per se, included as such in the list of strategic assets; however, it may fall within the definition given by Decree of the President of the Council of Ministers No. 108/2014, depending on how close to defence and national security issues a business is.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

The Italian government does retain control over shipbuilding facilities indirectly through the state-controlled company Fincantieri, and there are no plans to disinvest.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

Whereas under the Italian Civil Code in general, there are no formalities required to enter a valid workmanship, supply or building agreement, a set of special rules contained in the Code of Navigation do require specific formalities for the shipbuilding sector:

- if the construction is to be performed in Italy, article 232 of the Code of Navigation requires the shipbuilding facilities to be run by directors provided with specific authorisation;
- prior to commencing the building operation, a specific declaration – including the indication of the shipyard, the facility and the building director – must be filed with the competent authority at the location of the shipyard where hull and machineries will be built;
- the competent maritime office shall record the declaration in the special Register for vessels under construction;
- the shipbuilding agreement must be in writing unless the contract is for vessels not exceeding 10 tonnes of mechanical propulsion or 25 tonnes for other vessels;
- article 238 of the Code of Navigation requires the shipbuilding agreement to be made public through registration in the above-mentioned special register, failing which the vessel will be considered, under a rebuttable presumption, to be built for the account of the builder him or herself; and
- to undergo such a registration the shipbuilding agreement must be in the form of a notarial deed or, alternatively, a private agreement with a notarised and authenticated signature, and legalised in the case of an agreement executed in a foreign country.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

Italian law fully empowers the parties to a contractual agreement to select the applicable law to the entire agreement or to split the chosen law for distinct sections of the agreement, except for public policy and mandatory rules that may, from time to time, be passed by the legislation (typically for reasons and purposes of a technical nature, safety of navigation, environmental sustainability or tax-related issues).

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

A shipbuilding contract is not restricted to the supply of workmanship and materials nor to the mere transfer of ownership over the built vessel, whereas its core relates to the commitment by the builder to realise and accomplish the construction with an implied obligation to

employ its own workmanship under its own organisational risk. These are the legal features of the contractual scheme named '*appalto*', which article 241 of the Code of Navigation refers to, as governed by articles 1655 ff of the Italian Civil Code). This also applies to the yachting sector according to article 24 of Legislative Decree Nos. 229/2017 and 160/2020.

It is most likely, outside the corporate market, that a shipbuilding contract may be regarded as a consumer contract inasmuch as the legal requirements set by the Italian Code of Consumer Law are met, specifically with regard to the definition of 'consumer' (depending on whether the buyer may fall within the concept of 'consumer' being a natural person and entering the contract purely for leisure purposes).

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

The hull number is not required by any statutory provision as an essential item for the ship-building contract to be legally valid. However, it is normally considered essential to define the risk underwritten by the hull insurers.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

Although it is unusual for a shipbuilding contract not to specify this information in greater detail, in the case of an approximate indication of technical data, such as the dimensions and description of the vessel, the general rules contained in the Italian Civil Code should apply. A thorough reconstruction of the parties' intention would be necessary to ascertain whether the builder has gone beyond the express or implied common contractual programme so as to disrupt the buyer's interest, in which case article 1677 of the Italian Civil Code (on lack of conformity) will apply. In addition, article 1660 of the Italian Civil Code (on necessary variations) will apply: whenever a design variant is necessary for the work to be compliant with the rule of art, the builder must seek the buyer's agreement; alternatively, the parties should apply to the competent court in the case of disagreement. According to some case law, however, if the builder unilaterally proceeds in executing the variations, he or she may do so, but at their own risk that a subsequent judicial decision will not uphold this technical evaluation.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

The parties to the contract are free to incorporate guaranteed standards of performance whose breach will entitle the buyer to liquidated damages or termination.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

Statutory provisions do not give greater definition to contractual quality standards. It is common practice to refer to the highest West European shipbuilding standards.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

In addition to a liability in contract upon the builder, based on the appointment of the classification society by the builder (even if usually on indication and selection by the shipowner), authorities and case law (see *The Redwood*, Tribunal of Genoa, 24 February 2010) have admitted an action in tort by damaged third parties (including the buyer) on the basis of a general principle of fault-based liability.

Article 5(2)(b)(ii) and (iii) of EU Directive 2009/15/EC – enacted by Legislative Decree No. 104/2011 – has opened to limitations of liability in the case of fault leading to personal injuries or damage to goods. However, compensation cannot be less than €4 million or €2 million, respectively; no limitation is allowed in the case of wilful act of omission or gross negligence.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

The Italian shipping register was incorporated in 1861 and recognised by statute in 1870 to pursue either private shipowners' interests (such as the need to have impartial certifications on which to base a vessel's commercial value and to provide underwriters a reliable risk and insured value assessment) and a public interest mission (releasing of official class certificates of seaworthiness, based on technical expertise). A law passed in 1998 to enact EU Council Directive 94/57/EC (subsequently replaced by EU Directive 2009/15/EC and EU Regulation (EC) No. 391/2009) has also implemented in Italy the EU general freedom to provide services in the field of classification activities. Functions of ascertainment, inspection, controls, survey and class certification have also been delegated, pursuant to Legislative Decree No. 104/2011, to a number of foreign classification societies.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

According to article 238/2 of the Italian Code of Navigation, if the shipbuilding contract is not registered in the Register of vessels under construction, the building is presumed (rebuttably) to be in the builder's interest. Registration has the effect of making the contents of the contract and all of its terms opposable to third parties.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

The parties to the contract may agree on the time when the transfer of title over the vessel will occur and, in particular, they may agree on a gradual transfer upon progress of the construction when it reaches certain agreed milestones or upon payment of pre-delivery instalments of price. Although not very common, it is possible to agree on a transfer of ownership as soon as the item under construction assumes the legal feature of a shipping unit (normally, with an identifiable hull).

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

The parties are free to determine contractually the time of passing of risk; failing any specific term on this issue, the statutory rule provides that the risk will pass on vessel delivery and acceptance. Article 1673 of the Italian Civil Code states that if the built works perish or are damaged before acceptance by the buyer, or before the buyer is notified of an undue delay in taking delivery, the perishing will be at the builder's risk if materials had been supplied by the builder, whereas if materials were supplied by the buyer the perishing will lie with the buyer as far as the materials are concerned. Finally, under a general rule on total frustration of contracts, the party that is discharged from the obligation to perform due to a frustration event is not entitled to ask for the full the price and must return the instalments received.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

According to a general rule in the field of workmanship-supply-building contracts (article 1656 of the Italian Civil Code), a shipbuilder is not allowed to subcontract any part of the

works unless previously authorised by the buyer. When subcontracting is allowed, however, it is usual for the parties to include a makers' list of main parts or items for which subcontracting will be accepted by the buyer.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

Provided that subcontracting is allowed by the agreement, it is normally considered immaterial where and by whom certain parts of works are delegated under a subcontract, except for specific mandatory rules that might, on occasion, exclude certain operators or geographical areas for reasons of international public order (eg, embargo laws).

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

In general, the rules contained in the Italian Civil Code for workmanship-supply-building contracts do allow two alternatives as far as price is concerned: fixed price (ie, lump-sum price) contracts, or 'labour and cost plus' contracts, where the price is to be calculated as a proportion of the employment of materials, labour and dimensions of works. The second option is normally avoided for shipbuilding contracts.

It is quite usual for contracts to have specific clauses incorporating adjustments and changes of the basic price to make the pre-agreed lump-sum price more flexible, depending on various external economic factors. These clauses reflect a typical codified 'device' for price revision (article 1664 of the Italian Civil Code).

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

According to article 1664 of the Italian Civil Code, if the cost of materials or labour increases or decreases as a consequence of unpredictable external circumstances such as to cause an increase or decrease of over 10 per cent of the overall agreed price, then the builder or the buyer may claim a price revision. This revision may be granted only for the excess over 10 per cent.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

A special rule on contract rescission allows an action by a contracting party that is the victim of undue influence by the other who has profited from the former's situation of duress. The action is granted to each contracting party. However, if applied in practice, it would allow the following remedy:

- in the case of disproportion between the economic value of works on one hand, and the price, or price increase allowed by the buyer, on the other hand;
- if this disproportion exceeds the half of the value of the promised price at the beginning of the contract; and
- if the disproportion is a consequence of the state of need on the buyer's side from which the builder has profited, then the buyer will be entitled to rescission.

The contracting party against whom this special rescission is demanded (in our example, the builder) may avoid it by offering an adjustment of the contract provided that it is enough to return it to an equitable level of consideration.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

Set-off is generally allowed only if the due amounts are equally overdue and liquidated. However, the parties may agree on different terms for set-off or even exclude it. The parties may also agree on the waiver to the right to set off, which, according to Italian case law, would otherwise automatically operate in the case of reciprocal receivables and past due payments.

The buyer's right to suspend payment or deduct certain amounts may also be waived through contractual agreement.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

It follows from the general rule requiring written form for shipbuilding contracts that refund guarantees accessory to them must also be agreed upon in writing, whereas no third-party or authority permission is required.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

Italian law and practice essentially provide for three types of payment guarantees, often released by parent or holding companies:

1 accessory guarantees: the guarantor undertakes towards the creditor to personally guarantee the main debtor's performance. The guaranteed party or beneficiary need not be aware of the guarantor's commitment for the binding effect to be operating. The obligation of guarantee is, however, null and with no effect if the main obligation bought by the main debtor also proves to be null. The guarantor remains obliged towards the creditor even after the main or guaranteed debt becomes overdue, provided that the creditor enforces its rights against the main debtor within six months and then diligently cultivates them;
2 variants of the 'autonomous guarantee' (eg, performance, bid or repayment bonds; standby letter of credit); and
3 insurance bonds (to be issued by insurance companies).

Points (1) and (2) do not require written formalities, but verbal agreements in this field are almost unknown in practice. Insurance bonds do require written form for the purposes of judicial evidence in the case of litigation.

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

A mortgage over the vessel may be constituted to secure the credits, receivables and rights of the financing entity by registration, according to article 566 of the Italian Code of Navigation, in the special Register for ships under construction from the moment when the note of the construction is made on the Register itself.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

If the project is produced by the shipyard the builder bears liability for lack of conformity or defects in the works according to article 1677 of the Italian Civil Code (the builder owes a guarantee to the buyer entitling the latter to ask, at its discretion and choice, for the non-conformity or defects to be amended at the builder's expense, or for a proportionate price reduction, plus compensation for loss in the case of builder's fault). Termination may also be claimed if the lack of conformity or defects are such as to make the work totally

unfit for its purpose. From the point of view of the burden of proof, according to recent case law in the subject matter of the sale contract, a guarantee is not an obligation automatically arising from the agreement (ie, it does not create a duty to do anything 'specific' after the agreement is entered into) and it is rather a 'subjection' to any subsequent claims by the buyer, on condition that the buyer specifically proves the defects.

The guarantee is not due if the buyer has accepted the works and if the lack of conformity or the defects were known by the buyer, or could have been known provided – in the latter case – that the builder had not maliciously remained silent about them.

Unless the builder has recognised the lack of conformity or the defects or has hidden them, the buyer has 60 days from delivery to claim against the builder.

In the case of defective design provided by the buyer or shipowner, the builder has an obligation to double check and evaluate whether the project is actually defective, on condition that the defect is not hidden and that it can be discovered with a normal and reasonable degree of due diligence. Should the builder fail to prudently filter the technical indications in the buyer's project, it will be directly liable in contract under articles 1677–1668 of the Italian Civil Code.

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

According to article 1669 of the Italian Civil Code, in the case of a contract for the construction of buildings or immovables, should these works be entirely or partially defective, or should their construction be defective, within 10 years of their construction being completed, the builder will be held liable towards the buyer or towards any third party having title from the builder. The applicability of this general rule to the shipbuilding contract is, however, very uncertain under Italian law and it would, in any case, cover situations of privity of contract only. Outside contractual privity situations, the general rules of tortious liability should apply: whenever a builder is found in breach of the general duty of diligent behaviour and has provoked an unjust loss to any third party or bystander, it will be liable to compensate the loss, provided that a direct causal link is established between the negligent (or malicious or intentional) conduct and the suffered loss (the time limit to claim in tort is five years).

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

Liquidated damages clauses are common practice. However, they are subject to article 1382 of the Italian Civil Code, under which, on one hand, the innocent party is not requested to prove the party-in-breach's fault (eg, supposing that it is the builder who has caused the delay, then it will be liable on an objective basis) nor to prove that actual damage was

suffered nor that a genuine link of causation between the breach and the claimed damage did exist. On the other hand, the innocent party is not entitled to any further loss compensation unless the agreement expressly allows it; in this case, specific proof of loss is required.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

If the building contract contains a liquidated damages provision the buyer is precluded from claiming proven higher damages unless the contract expressly provides for the extra claim for higher damages, which will then need to be specifically proved.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

Italian law has its own notion of force majeure, considering as such only those events that are unavoidable (ie, cannot be resisted) and unpredictable (ie, could not have been foreseen by the party owing the obligation by using normal or reasonable diligence and care). However, it is common practice to include in the agreement specific force majeure clauses, and courts will generally uphold their validity provided that the list of events does not lead to the consequence of substantially excluding or limiting the parties' contractual liability for malicious breach or gross negligence, in which case the clause will be deemed entirely or partially null and void.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

The Italian shipbuilding market usually adopts the Institute Clauses for Builders' Risks 1988 or the MAR CAR 2007 terms for the construction's all-risk cover, to be entered by the builder as a policy holder and with named coassureds (eg, the shipowner or buyer and often subcontractors and suppliers).

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

According to article 1660 of the Italian Civil Code, if it is necessary to modify some specifications for the work to be compliant with the rule of art and if the parties cannot reach any agreement, the courts – if requested – have the power to set the terms of alteration and modification along with the relevant price variations. However, if the variation price exceeds one-sixth of the overall agreed price the builder is entitled to rescission of the agreement and may obtain an equitable reimbursement for the works carried out until then, whereas

if the variations are of considerable degree (also from the buyer's subjective point of view, having consideration to its financial standing and economic or business planning) the buyer is entitled to rescission and owes an equitable indemnity to the builder.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

The rule on builder's liability for non-conformity or defective construction is not mandatory, so that the buyer may well waive the right of claim for guarantee and even the hidden defects warranty. Bearing this in mind, the true extent and meaning of a statement of final and binding acceptance will need to be investigated to check whether the buyer's intention was to limit its declaration to the apparent conformity of the vessel to the contract and to the specifications, or it implied a waiver to the rights of claim in the case of subsequent failures (in respect of the performance warranties) or in the case of the emergence of latent defects. If the protocol of delivery and acceptance also contains the buyer's final and binding recognition that the vessel meets the level of conformity and the contractual specifications, this declaration will most likely be considered valid and legally effective under Italian law. However, it could in theory be enforced later on – as with any other contractual declaration – if any of the vitiating factors of the agreement recognised under Italian law (more or less equivalent to the concepts of mistake, negligence or fraudulent misrepresentation, duress or undue influence) are operative.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

If the builder is available to effect repairs or replacements and is about to proceed within its own facility, there is no case law indicating the power of opposition by the buyer should it wish to insist on other solutions; however, if the buyer directly entrusts a third-party shipyard with the works, recent case law entitles the buyer to claim for full compensation of the relevant costs (Court of Cassation judgment Nos. 23923/2021 and 12935/2021). This claim falls within the general rules on damages compensation for breach of contract; therefore, full compensation of all connected costs, including docking, will be awarded only if directly consequent to the breach (eg, if the buyer's opposition to the carrying out of works at the builder's facility will prove unreasonable or the cost of docking at a third-party shipyard exceeds a reasonable amount, the Italian courts are likely to reduce the claim for compensation).

Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

Italian statutory law does not provide for a lien in favour of a corporate builder (see Court of Cassation judgment Nos. 4383/2015; 12136/2014; 4184/2018). However, every supplier or subcontractor of the shipbuilder may seek for security over the vessel or piece of equipment by application to the competent jurisdiction.

Even if there is no express statutory provision obliging the builder to deliver the vessel free from third-parties' charges, this duty may be held as implied within general principles on complete performance and breach of contract.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

Among the Italian Civil Code rules on sale of goods, articles 1523 ff expressly provide for the parties to be free to agree on a reservation of title, and article 1524 provides that this reservation may be opposed to third parties having title against the buyer only if the reservation agreement is proved in writing with certainty of date prior to the third party's execution. No such provision is, however, reproduced among the rules on the workmanship and building contract. There is no case law on this issue and authorities doubt that this extension is allowed.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

The general rule on transfer of ownership in the case of building contracts of movables (which includes vessels) would establish the time of transfer as soon as the works or equipment are incorporated into the main body of construction. However, in theory, a subcontractor could agree with the builder on a reservation of title (although it is unlikely that a builder would accept it). In any case, this agreement could not be opposed to the buyer if the main contract is silent on that reservation (as according to article 238/2 of the Italian Code of Navigation, no change to or amendment of the shipbuilding contract has effect towards third parties if not registered in the ships under construction Register).

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

A subcontractor's or manufacturer's warranty may be assigned to the buyer according to general rules on assignment of contracts and – as per article 1406 of the Italian Civil Code – the assigned party (in this case, the subcontractor or the manufacturer) will have to agree at a preventative stage (ie, when releasing the warranty to the main contractor-builder) or at a later stage. Italian shipbuilding practice acknowledges the passing of the subcontractors' warranty up the contractual chain according to the most common contract forms.

Italian law does not entitle the buyer to claim directly against the subcontractor or manufacturer unless the assignment of their warranties was validly agreed upon.

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

The buyer has the right to control the execution of works and verify their stage at its own expense. If the performance is not proceeding according to the contractual terms and timing and according to rule of art, the buyer may give a reasonable deadline for the builder to comply with the contractual obligations, failing which the agreement is terminated. According to Italian authorities, this kind of termination is, however, not an automatic effect of the unfruitful lapse of the deadline and it needs to be wanted and threatened, expressly or implicitly, by the buyer. The buyer does not need to justify this remedy by proving that the builder's breach or delay is fundamental or remarkable, it being sufficient that the contractual terms set for the performance and the rule of art are not fulfilled.

As a second remedy, the buyer has the alternative option of enforcing the general rule on termination for breach of contract by sending the builder a written notice containing the invitation to fulfil the obligation within a reasonable time (not less than 15 days, unless the agreement or trade usages make a lesser deadline permissible) along with the declaration that, after the lapse of the deadline, the agreement will be considered automatically terminated. In this case, once the deadline is reached, the contract is terminated automatically by operation of law; this termination is, in any case, prevented if the contractual breach of contract is not to be considered fundamental having regard to the innocent parties' interest.

Both these remedies aim at contract termination. However, the buyer maintains the right to also claim for damages.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

If the builder continues to fail to construct or keeps on constructing in non-compliance with the contractual provisions even after notice has been given by the buyer according to article 1662 of the Italian Civil Code (where the buyer gives the builder a deadline requesting it to recover the lost time and to proceed with the works in compliance with the contractual timing and the rule of art) or despite the notice given according to article 1454 of the Italian Civil Code (where the buyer sends a notice requiring the builder to perform within a reasonable time, still provided – in this case – that a fundamental breach by the builder may be envisaged), and if the buyer is not willing to have the contract terminated then the general remedy provided by article 2931 of the Italian Civil Code is still granted to the client or innocent party (whenever the obligation to do something is not fulfilled the creditor may seek for an order of execution or performance from the competent court).

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

Pursuant to article 81 of the Italian Insolvency Law, a supply of workmanship and building agreement is terminated if one of the parties goes bankrupt unless the Bankruptcy Receiver declares his or her intention to enter into the agreement by giving notice thereof to the counterpart within 60 days from the bankruptcy declaration. In the case of builder's bankruptcy, the agreement is terminated only if the builder's personal or subjective qualities had been the main reason inducing the parties to enter the agreement. On this statutory basis, a contractual term providing for the buyer's right to terminate the contract in the case of the builder's insolvency would most likely be upheld by Italian jurisdiction, being compliant with the above statutory provision. In the case of a less severe insolvency situation (eg, insolvency procedures aimed at supporting the business's survival and helping its return to solvency) a contractual right to termination established in favour of the buyer would equally be upheld as deemed consistent with article 1461 of the Italian Civil Code (contracting parties may suspend the performance of the due works or obligations if the economic or financial conditions of the counterparty have worsened so as to create a serious danger that the innocent party will not obtain its consideration) and with article 1456 of the Italian Civil Code (the contracting parties may expressly agree that the contract will be terminated in the case one or more obligations will not be fulfilled according to the agreed specifications and terms; in the case of breach, the termination takes effect when the interested party declares to the other its intention to enforce this right of termination).

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

Alternative dispute resolutions (ADRs), and arbitration in particular, are commonly used in Italy, either as institutional arbitration panels established within the local chamber of commerce or specialised ADR centres, or as private or ad hoc arbitration panels appointed by the parties according to the usual arbitration clauses in the contracts.

There are no specialised courts for marine litigation or shipbuilding disputes, and courts will be sought according to the territorial competency rules based on the defendant's domicile, the place of contract, the place of performance and forum selection clauses.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

In the event of the builder's bankruptcy, a contractual right to take possession of the vessel will be recognised in favour of the buyer if the transfer of ownership is considered already effective at the time of bankruptcy. This will be the case when specific transfer of ownership clauses (after the payment of each price instalment) have been included by the parties and the shipbuilding contracts (containing those clauses) have regularly been made public by way of registration in the Register of vessels under construction, as per article 238 of the Italian Code of Navigation.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

ADR and, in particular, arbitration, clauses are common in shipbuilding contracts.

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

It is the responsibility of the buyer before taking delivery to verify the stage of the works as accomplished and this check must be done as soon as the builder allows it. However, should the buyer, after the builder's invitation, fail to proceed with the verification without a valid reason, or should it fail to share, within a short time the results thereof, once effected, the works are considered as accepted and at that point the builder shall be at right to claim for the full price (or for the final balance in the case of previous-stage instalments having been paid).

In the case of failure by the buyer to pay the price, all normal remedies provided by general contract law or by specific contractual terms will be available to the builder, including the right to seek security by attaching the ship itself. A right to suspend works if not yet accomplished is also granted to the builder according to the general rule that every contracting party may keep the performance on hold if the economic and financial conditions of the counterparty are such as to put at risk the right to obtain the due consideration.

Under Italian law, a termination for breach of contract has retroactive effect also on the acts of performance already executed by the parties, so in the case of cancellation of the contract by the builder, it will not be entitled to retain the payment received. However, the builder will retain ownership over the vessel. In case of materials provided by the buyer for the construction, these will have to be returned to the client.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

The Italian market commonly uses SAJ, AWES and Newbuildcon, and on occasion CMAC and the Norwegian SHIP 2000.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

Assignment of contracts is allowed on condition that the assigned party so allows, either by way of an initial agreement allowing subsequent assignment (in which case the assignment will become effective towards the assigned on notice of the assignment done) or by way of subsequent agreement (in which case the assignment will become effective from the moment of the assigned's acceptance).

No tripartite agreement is required, but a mere notice of assignment to the other contracting parties will not suffice failing genuine consent by the assigned. The assignment does not bring the agreement to an end; rather, it has legal effects on the contract's subjective structure: the party assigning is discharged from its obligations towards the assigned party. If the assigned contracting party declares itself unwilling to discharge the assigning party it will retain the right to claim against the assigning party if the third party or assignee does not fulfil the assumed obligations.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

Lack of materials seems to be an emerging issue, pushing builders to negotiate delays in delivery if materials were to be supplied by them.

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Japan

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

The shipping industry in Japan is open to foreign participation and investment.

As to restrictions, if a company intends to establish, purchase or rent a new facility in Japan with a dock or shipyard for construction or to repair a steel vessel that is more than 500 gross tonnes or 50 metres long, the company must obtain permission from the Minister of Land, Infrastructure, Transport and Tourism (MLIT) (article 2 of the Shipbuilding Law). There seems to be no precedent of a foreign company applying for such permission on its own, but it would be advisable for a foreign company to first establish a subsidiary in Japan so that it is the subsidiary that applies to the MLIT for permission.

Detailed regulations stipulated in the Foreign Exchange and Foreign Trade Law apply to a foreign investor that intends to acquire shares in a shipbuilding company in Japan. For example, a foreign investor shall report in advance to the Minister of Finance and the MLIT details such as the purpose, amount and time of the acquisition, and whether they intend to acquire shares that will result in having more than 10 per cent of the shares issued by the shipbuilding company or to acquire unlisted shares from investors other than foreign investors. Further, in principle, foreign investors may not acquire the shares until 30 days after the Minister of Finance and the MLIT receive the report.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

The Japanese government does not retain ownership or control of any shipbuilding facilities.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

No, there are no statutory formalities in Japan that must be complied with in entering into a shipbuilding contract.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

Yes, the parties may select the law to apply to the shipbuilding contract (article 7 of the Law of General Rules for Application of Laws). The choice of law will be respected by Japanese courts. However, if the parties select foreign law to apply but the application of the provisions of the foreign law is found to be against Japanese public policy, those provisions will not be applied (article 42 of the Law of General Rules for Application of Laws). However, there are no court precedents holding that the application of the provisions of foreign law that the parties selected in a shipbuilding contract is against Japanese public policy.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

According to academics' views, a shipbuilding contract is regarded as a contract for work if a buyer supplies all or most of the materials, but it is regarded as a mixed contract of sale and contract for work if a builder supplies all or most of the materials. Normally the latter is the case. We have not found any court precedents analysing the legal nature of a shipbuilding contract.

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

There has been no case law or academic discussion of this issue. However, the hull number may be a matter of dispute in a case where the buyer of a vessel charters the vessel out under a charter party with a different hull number from that in the shipbuilding contract, and the charterer refused to accept delivery of the vessel because of the difference in hull numbers. In such a case, before deciding whether the charterer may refuse to take delivery of the vessel, Japanese courts are likely to take into consideration all the facts and circumstances, including the following:

- the hull number in the shipbuilding contract;
- the wording of relevant provisions in the shipbuilding contract and the charter party;
- the circumstances leading to the conclusion of the shipbuilding contract and the charter party; and
- the circumstances relating to the reason why different hull numbers were used.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

We have not been able to find any Japanese court precedents or any academic views dealing with this issue. Japanese courts or tribunals will judge whether the difference is allowed on a case-by-case basis, considering all of the facts and circumstances such as the circumstances leading to the conclusion of the shipbuilding contract, facts surrounding the construction in a shipyard and the purpose for which the buyer intends to use the vessel. In our opinion, if the figure given in the contract is 'approximate', the builder will be allowed to deviate by 3 to 5 per cent from the figure stated.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

Yes, parties may incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages and even rescission of the contract in certain circumstances. Japanese law recognises the principle of freedom of contract and there are no special provisions that prohibit the above-mentioned incorporation. Article III of the Shipbuilders' Association of Japan form, which is often used in Japanese practice, incorporates guaranteed standards of performance. We have not found court precedents that specified trade standards for coating, noise and vibration, and accordingly, we do not believe there are such trade standards.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

No. Japanese statute and case law have not given greater definition to contractual quality standards such as 'Japanese shipbuilding standards'.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

The classification society does not owe a duty of care to the buyer based upon the contract between the classification society and the builder because the buyer is not a party to the contract but is merely a third party.

To successfully sue the classification society in tort if certain defects in the vessel escape the attention of the class surveyors, the buyer has to establish the class surveyor's negligence, the buyer's damage and a causal connection between the negligence and the damage (article 709 of the Civil Code). To establish the class surveyor's negligence, the buyer will have to prove that the class surveyor was able to foresee and could have avoided the damage. The mere fact that the class surveyor overlooked certain defects in the vessel does not always satisfy the requirement of negligence.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

Yes. Non-passenger vessels classed by classification societies, which are registered with the Minister of Land, Infrastructure, Transport and Tourism (MLIT), are deemed to have passed inspections (except for special inspection) by the Japanese maritime authority with respect to certain items including the hull, machinery, sails, drainage equipment, rudder, mooring equipment, lifesaving and firefighting equipment, accommodation, sanitary equipment, loading equipment for special cargo including dangerous cargo, cargo operation equipment, electrical equipment and the load line (Ship Safety Law, article 2, paragraph 1 and article 8). The classification societies that are currently registered with the MLIT are Nippon Kaiji Kyokai and Lloyd's Register, DNV and the American Bureau of Shipping.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

Under Japanese law, registration of a vessel under construction shall be made for:

- the purpose of describing the details of the vessel under construction;
- the creation, transfer, alteration, restriction of disposition or extinction of mortgage on the vessel; and
- the person who will be the owner of the vessel (namely, the buyer).

In other words, a builder cannot register a vessel under construction in its own name. Further, ownership or title of a vessel under construction cannot be registered.

The order of priority of mortgages that are created on a vessel under construction follows the chronological order of registration (article 848, paragraph 3 and article 850 of the Commercial Code and article 373 of the Civil Code). A mortgage on a vessel under construction is, even if it is registered, subordinate to a maritime lien over the vessel under construction (article 848, paragraph 1 and article 850 of the Commercial Code).

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

Yes, the parties may contract that title will pass from a builder to a buyer during construction because Japanese law recognises the principle of freedom of contract.

If there is a provision in a shipbuilding contract regarding when and whether title to a vessel under construction is transferred from a builder to a buyer, title is transferred in accordance with the provision. For example, title will pass gradually upon the progress of the vessel's construction if there is a provision to that effect.

On the other hand, if there is no provision in a shipbuilding contract regarding when and whether or not title to a vessel under construction is transferred, normally the builder has title to a vessel under construction. The builder obtains title to a vessel upon completion of the work and title to the vessel built is transferred to the buyer upon delivery.

There are no legal provisions or court precedents relating to the earliest stage a buyer can obtain title to a vessel under construction. However, there is a Supreme Court decision dated 6 May 1916 (*Kisomatsu v Kondo*) to the effect that an agreement to transfer title of a vessel under construction to the buyer to the extent of the progress in the construction is valid despite the fact that the builder provided the materials of the vessel.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

If there is a provision in a shipbuilding contract regarding when risk is passed from the builder to the buyer, risk is passed in accordance with that provision. For example, risk is passed to the buyer with the title to the vessel upon delivery, if the Shipbuilders' Association of Japan form is used (article VII.5). If there should be a provision in a shipbuilding contract that title to the vessel is transferred to the buyer upon completion of the construction work while risk is passed to the buyer upon delivery, the title is transferred to the buyer upon completion of the construction but the risk remains with the builder until delivery.

If there is no provision in a shipbuilding contract regarding that point, Japanese courts or tribunals will generally follow the view of leading scholars that the risk and title are transferred to the buyer upon delivery.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

If there is a provision in a shipbuilding contract regarding whether or not and to what extent a builder may subcontract, the shipbuilder may or may not subcontract part or all of the contract in accordance with that provision.

If there is no provision in a shipbuilding contract regarding that point, it is difficult to foresee what the position of Japanese courts or tribunals would be. We have found no court precedents regarding this issue and academic views are split. The majority view is that a builder may not subcontract, but some influential opinions suggest that a builder may.

When a builder has subcontracted part or all of the shipbuilding contract, the builder will be fully liable to the buyer for negligent acts by the subcontractor.

We do see the gradual increase of contracts that include a maker's list. However, we do not believe this is customary.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

Whether or not the builder must inform the buyer of the intention to have certain main items constructed in another country depends on the provisions of the shipbuilding contract. A builder's basic obligation is to build and deliver a vessel pursuant to a shipbuilding contract

and it is not material whether or not a builder has certain main items constructed in another country.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

No, Japanese law does not have different provisions for fixed-price contracts and labour-and-cost-plus contracts.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

No, the builder does not have any statutory remedies to charge the buyer for price increases of labour and materials under a contract that provides for a fixed price. However, there is a possibility, although very remote, that the builder has remedies based on the 'principle of change of circumstances', which is recognised in a number of Japanese court precedents. The requirements of this principle are that:

- there has been a change in the circumstances that were the basis of the contract at the time of its conclusion;
- the contractual parties have not foreseen and were not able to foresee the change;
- the change has occurred by a cause that is not attributable to either of the parties; and
- as a result of the change, it is extremely unjust to bind the parties to the existing contract.

For sale contracts, there are court precedents that have applied the principle of change of circumstances and allowed an increase in price. For example, in the case where a land price increased by 620 times more than the agreed sale price, the Sendai Court of Appeal accepted that there had been a substantial change of circumstances and allowed the plaintiff's request to raise the sale price of the land. For contracts for work and shipbuilding contracts, we have not found any court precedents that applied the principle of change of circumstances.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

It is difficult for a buyer to retract consent to an increase in price included in the agreement. A buyer can rescind its manifestation of intention based on article 96 of the Civil Code if the buyer establishes that the builder tried to have the buyer decide to purchase by threatening or intimidating the buyer and the buyer became frightened and thereby made the decision

and manifested its intention. There is, however, no legal concept of 'economic duress' under Japanese law and one leading scholar has expressed the view that article 96 does not apply to cases of economic duress.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

Yes, they may agree to exclude the buyer's right. Japanese law recognises the principle of freedom of contract and there are no statutory provisions that prohibit the exclusion of those rights in a contract.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

If the applicable law to a refund guarantee contract is Japanese law, the contract shall be made in writing or shall be concluded by electromagnetic record that records the contents thereof; otherwise, the contract is not effective (article 446, paragraphs 2 and 3 of the Civil Code). There is no particular regulation governing the wording of refund guarantees.

Permission from the authority is not required for the builder to have refund guarantees issued.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

If the applicable law to the advance payment guarantee contract or parent company guarantee contract is Japanese law, these contracts shall be made in writing or shall be concluded by electromagnetic record that records the contents thereof; otherwise, these contracts are not effective (article 446, paragraphs 2 and 3 of the Civil Code).

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

A buyer can create and register a mortgage over the vessel under construction.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

We have not found any court precedents or academic views that have dealt with this issue.

If the parties to a shipbuilding contract agree that a builder will design and construct a vessel, a Japanese court will probably consider that the defective design falls within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause. If this issue is disputed, a Japanese court will carefully consider the purpose of relevant clauses in a shipbuilding contract, concrete contents of actual design, cause of defect and so on before deciding on the issue.

If the parties to a shipbuilding contract agree that the buyer will design the vessel and the builder will construct the vessel pursuant to the buyer's design, a Japanese court would probably not consider that the defective design falls within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract. However, if the shipbuilder, knowing the defectiveness of the design, failed to inform the buyer of such, a Japanese court is likely to hold that the shipbuilder must rectify the defect in the vessel (articles 559, 562 and 636 of the Civil Code).

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

Under Japanese law, a claim for compensation for damage based on article 3 of the Product Liability Law (PLL) or article 709 of the Civil Code is available to third parties against the shipbuilder for defectiveness.

The requirements of article 3 of the PLL are:

- a defect in a vessel that the shipbuilder manufactured;
- harm to life, body or property of a third party caused by the defect;
- the occurrence of damages by the infringement; and
- owing to the defect, damage occurred to something other than the vessel.

'Defect' is defined as 'a lack of safety that the product ordinarily should provide, taking into account the nature of the product, the ordinarily foreseeable manner of use of the product, the time when the manufacturer, etc, delivered the product, and other circumstances concerning the product' (article 2, paragraph 2 of the PLL).

Pursuant to article 709 of the Civil Code, a claim requires the following elements:

- the builder's or their employee's negligence;

- an illegal infringement of the third party's right;
- the occurrence of damage to the third party; and
- a causal connection between the negligence and the damage.

Where defect exists, the court is likely to assume that the builder's negligence was involved.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

In principle, the agreed level of compensation does not have to represent a genuine link with the damages suffered. Contractual parties may freely determine the amount of liquidated damages. However, there is a possibility that Japanese courts will hold that the liquidated damages clause is against public policy and, accordingly, void it if the agreed amount is excessively high. Penalty is presumed to constitute liquidated damages.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

The buyer is precluded from claiming proven higher damages. This is the effect of having a liquidated damages provision.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

Yes, contractual parties are free to design a force majeure clause. Japanese law recognises the principle of freedom of contract, and there are no provisions in Japanese law that prohibit the creation of a force majeure clause in a shipbuilding contract.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

In principle, it is possible to conclude an insurance contract to cover the builder and all subcontractors for the builder's risk. However, in general practice, only a builder is insured and subcontractors are not included in shipbuilding insurance. However, Japanese insurance companies usually pay out if the builder's subcontractors have caused events in the building process that satisfy the requirements for payments of insurance money. It is possible for Japanese insurance companies to undertake not one vessel but multiple vessels under a particular project as insured vessels for shipbuilding insurance. Japanese

insurance companies are unlikely to undertake shipbuilding insurance where Japanese companies are not involved at any point.

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

No, Japanese courts or tribunals will not be prepared to set terms in such a case. There are no provisions in Japanese law or rules for court proceedings or arbitration that empower courts or tribunals to do so. In practice, Japanese courts or tribunals often offer certain terms for the purpose of amicable settlement; however, they do not set terms in line with the offer if either or both of the parties refuse to accept them.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

Although there is no case law or academic discussion of this matter, we believe that a Japanese court or tribunal is unlikely to find the buyer's signature as precluding a subsequent claim if it finds that the buyer was unable to find the breach or defects at the time of the delivery. Normally, buyers are not aware of the actual performance or latent defects upon signing a protocol of delivery and acceptance. Signing the protocol of acceptance is not sufficient grounds to preclude subsequent claims, regardless of the terms employed in the protocol.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

Whether or not the buyer may insist that repairs or replacements covered under the warranty are to be carried out at a shipyard or facility not operated by the builder depends upon the terms of a shipbuilding contract. For example, if a shipbuilding contract provides that the repair shall be carried out at the builder's shipyard only and the cost of drydocking, if any, shall be borne by the builder, the buyer may have the vessel repaired at a facility not operated by the builder, only when the buyer obtains the builder's consent. In such cases, most probably the buyer needs to bear all costs associated with moving the vessel to the facility and the drydocking.

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Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

Article 842, item 8 of the Commercial Code provided that a person that had a claim that had arisen from the manufacture and outfitting of the vessel had a maritime lien over the vessel, its equipment and the unpaid freight. However, article 842, item 8 was deleted in the amended Commercial Code in 2018. One of the reasons for the deletion is said to be that, in present practice, vessels are not delivered to buyers or shipowners before the shipbuilder's payment to the suppliers. Even after article 842, item 8 of the Commercial Code was deleted, there is a possibility that suppliers may exercise a statutory lien over the vessel or the supplied equipment under article 321 of the Civil Code, while subcontractors may not. There is no implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

In principle, the reservation of title does not survive. When a builder incorporates materials or equipment to which a subcontractor or supplier has reserved title into a vessel under construction, the builder obtains the title to the vessel under construction with incorporated materials or equipment and the subcontractor or supplier who lost the title is only entitled to a claim for compensation (articles 243 and 248 of the Civil Code).

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

To obtain security, third-party creditors of the builder can attach the vessel under construction, and the equipment incorporated in the vessel, by obtaining an order for provisional attachment of the vessel under construction. To obtain such an order, the creditors must post counter security.

It is very unlikely that third-party creditors will have a lien on the vessel under construction.

The creditors cannot have possessory lien on the vessel under construction because the vessel under construction is possessed not by the creditors but by the builder.

It is very unlikely, although theoretically not impossible, for third-party creditors to have a maritime lien on the vessel under construction. Article 850 of the Commercial Code of Japan provides that article 842 of the Commercial Code, which provides for maritime lien on the vessel, should apply mutatis mutandis to vessels under construction. An academic has suggested that the builder's employees may have a maritime lien on the vessel under construction for unpaid wages. However, we have not heard of any case in which third-party creditors of the builder attached the vessel under construction to enforce their claim.

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

A subcontractor's or manufacturer's warranty can be assigned from a builder to a buyer and if the builder gives a formal notice of assignment to the subcontractor or manufacturer, the buyer can make a direct claim under the subcontractor's or manufacturer's warranty. It can be assigned even if it was agreed in the contract between a subcontractor or a manufacturer and a builder that claims for performance of guarantee against the subcontractor or manufacturer shall not be assigned. If it is assigned under the contract, the subcontractor or manufacturer may reject performance of their obligation to the assignee if the assignee was aware of the prohibition term or had gross negligence in not being aware of it (article 466, paragraphs 2 and 3 of the Civil Code).

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

General position concerning remedies open to the buyer

If a builder does not deliver to the buyer the agreed vessel on the agreed date in the shipbuilding contract, the buyer may:

- claim for compensation for damages;
- rescind the contract if the builder's breach or delay is so serious as to make the buyer's purpose of contract not achievable;
- rescind the contract in the case of serious breach or delay and claim for compensation for damages;
- claim for performance of builder's obligation (namely, obtain a court judgment against the builder for completion of construction and enforce the judgment by way of indirect compulsory execution (namely, force the builder to pay fixed amount of penalty per day during the period of delay)); or
- claim for performance of builder's obligation and compensation for damages.

If the builder delivered the agreed vessel by the agreed date but defects in the vessel exist, the buyer may:

- claim for compensation for damages;
- rescind the contract if the defects are so serious as to make the buyer's purpose of contract not achievable;
- rescind the contract if the defect is serious and claim compensation for damages;
- claim for rectification of the defect; or
- claim for rectification of the defect and compensation for damages.

Notice

With respect to rescission of contract, the buyer is required to send a notice to the builder whereby the buyer fixes a reasonable period within which the builder should perform the contract. The buyer may rescind the contract if no performance is effected within the period. As to the other remedies, the buyer is not required to send notice before the buyer's claim for remedy.

When a shipbuilding contract contains provisions about notice, the provisions should be taken into account. For example, under article X.1 of the Shipbuilders' Association of Japan (SAJ) form, the buyer has to send a notice to the builder fixing a reasonable period and demanding performance and send another notice in writing or cable to the builder notifying rescission of the contract.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

If protracted failure to construct or continue construction by the shipbuilder results in failure to deliver the vessel by the agreed date, the buyer or shipowner may:

- claim for compensation for damages unless the failure is caused by an event that is not attributable to the builder (article 415, paragraph 1 of the Civil Code);
- rescind the contract unless the failure is caused by an event that is attributable to the buyer (articles 541, 542 and 543 of the Civil Code); or
- claim for performance of builder's obligation (ie, obtain a court judgment against the builder for completion of construction and enforce the judgment by way of indirect compulsory execution) (article 414, paragraph 1 of the Civil Code).

However, when contractual provisions deal with them, the contents of the contractual provisions will prevail over those of legal provisions.

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

A buyer's contractual right to terminate a shipbuilding contract for the builder's insolvency is not enforceable under Japanese law.

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Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

Arbitration proceedings will commonly be held in Tokyo, Japan, by the Japan Shipping Exchange, Inc.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

If a Japanese court decides to start bankruptcy proceedings for a builder, the court-appointed administrator may rescind a shipbuilding contract. If the administrator rescinds, the buyer's contractual right to take delivery of the vessel pursuant to the contractual terms would not survive. If the administrator does not rescind, the buyer's right would survive. As to the vessel under construction, in general, the buyer does not have a contractual right to take possession of it.

The position is similar when a Japanese court decides to start civil rehabilitation proceedings or corporate rehabilitation proceedings for a builder.

Moratorium may be admitted when a debtor asks major claimants (normally financial institutions) for workout by the Guidelines for Workout and the major claimants agree to issue moratorium notice. During the moratorium period, the buyer's contractual right to take delivery of the vessel survives. In the workout process, a rehabilitation plan is prepared. If all of the claimants agree to the plan, the claimants' rights and obligations may be changed in accordance with the plan. Therefore, the buyer's contractual right would survive as long as the buyer does not consent to the plan.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

No, parties do not tend to incorporate an ADR clause in shipbuilding contracts in Japan.

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

Remedies available to the builder depend upon relevant provisions in a shipbuilding contract.

For example, if an SAJ form is used, the builder is entitled to claim an agreed rate of interest on unpaid instalments and all charges and expenses incurred in consequence of the buyer's

default (article XI 2). If the buyer's default continues for 15 days, the builder may rescind the shipbuilding contract by giving notice to the buyer (article XI 3). The consequences of the builder's cancellation of the contract are that items furnished by the buyer become the builder's property (article XI 3); the builder may have the right to complete or not to complete the vessel, sell it and obtain proceeds (article XI 4); and, for example, if the builder completed the vessel and sold it, the builder may claim against the buyer the difference between the amount of the proceeds and the total amount of expense of the sale, unpaid instalments and interests thereon (article XI 4(b)(e)).

If there is no provision in the shipbuilding contract in relation to remedies available to the builder:

- the builder is entitled to claim for unpaid instalments and compensation for damage based upon the contract, when the builder completes a vessel, makes preparation to deliver it and sends notice thereof to the buyer. The amount of claimable damage is, in principle, 3 per cent, or the rate designated by the Ministry of Justice, per annum of unpaid instalments for unpaid period; or
- the builder is entitled to send notice to the buyer notifying that the builder will cancel the shipbuilding contract if the buyer does not pay unpaid instalments within a reasonable period, and cancel the shipbuilding contract after lapse of the period without the buyer's payment. The consequences of the builder's cancellation of the contract are that items furnished by the buyer are the builder's property; the builder may have the right to complete or not to complete the vessel, sell it and obtain proceeds; and the builder may claim against the buyer for compensation for damage. However, the amount of claimable damage is unclear.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

The Shipbuilders' Association of Japan form is predominantly used in Japan.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

The requirements for assigning a contract to a third party is that one party of the contract agrees with a third party to assign its position under the contract to the third party, and the other party gives consent thereto (article 539-2 of the Civil Code).

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

New or amended legislation has not been found.

There is a court case in which the shipowners claimed damages against the licensor of the main engine (which is different from the company that manufactured the main engine and sold it to the shipyard) in relation to an accident caused by a non-conformity between the main engine components and the stern shaft system. The court found the facts in detail and dismissed the claim, finding that there was no 'defect' under the Product Liability Act, that the licensor had exercised its duty of care and was not negligent, and that there was no contractual relationship between the licensor and the shipowners. While it is not unusual for shipowners to claim damages against parties other than the shipyard, it is rare for shipowners to sue the licensor of the main engine.

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

The Netherlands has an open economy that depends heavily on foreign trade, with the export value reaching a total of €587 billion in 2021 (most recent available figures).

The Dutch shipbuilding industry is open to foreign participation and investment. Dutch tax law provides a very attractive fiscal climate for foreign investors. For innovative shipbuilders, companies in the field of R&D can benefit from the 'innovation box', resulting in an effective corporate tax rate of 9 per cent instead of the normal 25.8 per cent (from 1 January 2022), as well as an allowance for income tax and social security contribution deductions.

The standard corporate income tax rate currently stands at 25.8 per cent (article 22 of the Corporate Tax Act 1969). There are two taxable income brackets. A lower rate of 19 per cent applies to the first income bracket, which consists of taxable income up to €200,000 (as from 1 January 2023, compared to 15 per cent in 2022, and a taxable income up to €395,000). The standard 25.8 per cent rate applies to the excess of the taxable income. There are no restrictions on foreign participation.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

The development and building of ships for governmental activities like defence and security is also a key aspect of the Dutch shipbuilding industry. Many companies are active in the wider commercial market as well as the defence and security markets. The Dutch

government, however, has not retained ownership or control of any shipbuilding facilities. In recent years, the Dutch government did facilitate a refinancing and restructuring attempt of maritime engineering company Royal IHC, by allowing a short-term bridging loan and guarantee facility from the Dutch Ministry of Economic Affairs and Climate Policy, and an export credit insurance contribution from the Ministry of Finance. In this way, the Dutch state supports the preservation of high-quality technology and employment in the Netherlands.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

Parties are free to negotiate the terms and conditions of a shipbuilding contract and to design the contract as they wish. The general rule is that the formation of contracts and other juridical acts is not subject to requirements as to form. Contracts may also be concluded orally, or even tacitly by the conduct of the parties from which the parties' intentions can be inferred. The contract will be legally enforceable even if concluded orally, provided the terms and conditions of the oral contract can be proven.

For certain specific contracts, statutory requirements of form exist, but this does not apply to shipbuilding contracts. For example, certain terms in contracts of employment must be in writing. Further, there are instances where Dutch law prescribes the use of a notarial instrument, such as for the formation of companies or the sale of real estate. There are no statutory formalities to be met when entering into a shipbuilding contract.

A shipbuilding contract is formed by an offer of one party and the acceptance thereof by the other party. Acceptance is a declaration of will on the part of the offeree addressed to the offeror, which establishes the consent of the offeree to the terms of the offer. Acceptance can be expressed by means of a statement, express or implied, or by conduct. An act of the performance of the proposed contract may also result in acceptance. An acceptance at variance with the offer is considered to be a new offer and a rejection of the original offer. In principle, offers are revocable by the offeree up until accepted. Where an offer indicates that it is made without obligation, it may even be possible to revoke the offer after acceptance, provided that the revocation occurs without delay. In some cases, an offer will be irrevocable. For example, where a time limit for acceptance is specified in the offer, the offer will be irrevocable during this period. Where offer and acceptance refer to different general terms and conditions, the second reference is without effect, unless it expressly rejects the applicability of the general terms and conditions indicated in the first reference.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

The parties to a shipbuilding contract are free to select the law applicable to their contract. The choice of law shall be made expressly (preferably), or at least must be clearly

demonstrated by the terms of the contract or by the circumstances of the case. The parties have the option of selecting the law applicable to the whole contract, or to parts thereof.

The parties are at liberty to agree to subject the contract to a law other than the law that previously governed the contract as a result of an earlier choice of law clause. The Rome I Regulation (Regulation (EC) No. 593/2008 of 17 June 2008) on the law applicable to contractual obligations applies. The choice of law made by the parties will be upheld by the Dutch courts and the existence and validity of the consent of the parties as to the choice of law applicable shall be determined in accordance with the provisions of articles 10, 11 and 13 of the Rome I Regulation.

In the majority of cases, though, Dutch law is chosen as the governing law for projects being realised at shipyards in the Netherlands. It is a fact that without a choice of forum the contract will be governed by the laws of the country in which the builder is domiciled. This means that without another choice of law, Dutch substantive law will apply to construction projects realised in the Netherlands.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

Although the wording of a specific shipbuilding contract will be decisive to conclude whether it should be construed as a contract for the sale of goods or as a contract for the supply of workmanship and materials, generally, a shipbuilding contract is qualified as a contract to construct a vessel in accordance with Dutch construction law principles. If the vessel does not meet the specifications, which usually include certain performance criteria, there is a breach of contract on the builder's side. A shipbuilding contract amounts to an obligation for the builder to meet the agreed targets (specifications). From the builder's perspective, it is not a contract to use its best endeavours to construct a vessel.

Briefly put, interpretation of a contract is generally conducted on the basis of the *Haviltex* criterion, named after the 1981 Supreme Court judgment in case *Ermes/Haviltex*. Upon application of the (subjective-objective) *Haviltex* criterion, the question at issue is what the parties thought and could think they agreed to; in that context all circumstances of the case are relevant. However, in some cases, notably, when interpreting collective bargaining agreements, a merely objective criterion is applied. According to this collective bargaining agreement criterion, the question is what third parties think the disputed text means; in that context not only textual arguments are relevant, but other arguments also, provided they are objectively apparent.

It comes down to the intention of the parties, given the particular circumstances, and what they could reasonably expect of one another. In this regard, the social or business field of expertise to which the parties belong (and what knowledge is involved) is of importance. This criterion is leading in Dutch case law.

The Dutch trade association Netherlands Maritime Technology Association has issued certain standard trade terms (VNSI General Yard Conditions 2018), which are frequently

used by its members. By entering into the agreement, the other party or customer shall be deemed to waive other conditions or stipulations, even if the same are expressly referred to or are stated expressly in or on any offer, acceptance or other document (such as an invoice).

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

The hull number stated in the shipbuilding contract is an essential element to identify and apportion title to the building materials and equipment. The builder should label any building materials and equipment with the hull number for identification purposes upon arrival of same at the builder's premises. All goods labelled with the hull number are identifiable as belonging to the particular shipbuilding project unless a supplier has made a reservation of title in respect of materials and equipment.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

The use of the word 'approximate' in the dimensions and description of the vessel will allow the builder to deviate slightly from the figure stated. A court will have to decide case by case the exact latitude that the builder has. If it is of paramount importance that a certain measurement (eg, the draft of a vessel) is met precisely, the use of 'approximate' should be avoided.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

Clauses guaranteeing certain standards of performance are frequently included in shipbuilding contracts. If upon delivery of the vessel, the guaranteed performance standards are not met by the builder, the shipbuilding contract may allow for payment of liquidated damages or a penalty by the builder. If a certain benchmark cannot be met, rescission of the shipbuilding contract can be applied for. In article 6:91 of the Dutch Civil Code, Dutch civil law defines a penalty clause as any clause that stipulates that an obligor, should he or she fail in the performance of his or her obligation, must pay a sum of money or perform another obligation, irrespective of whether this is to repair damage or only to encourage performance. Penalty clauses as described above are enforceable, but the constraining function of the reasonableness and fairness principle may prohibit the obligee from claiming the benefit of a full penalty when such a claim may be unreasonable in the circumstances (Dutch Supreme Court, 7 December 2004, NJ 2005, 271). Penalty clauses can have two different functions: to act as an incentive to ensure compliance by the obligee; or to function as a liquidated damages clause (eg, in a situation where it may be difficult to substantiate

the amount of damages incurred as a consequence of a breach of contract). A combination of these two functions is possible, depending on the way in which the penalty clause was drafted.

In accordance with article 6:94 of the Dutch Civil Code, the court may reduce the contractually agreed penalty at the request of the obligor if it is considered fair and reasonable to do so. However, the court may not award the obligee less than the damages due by law for failure in the performance. This underlines the importance of being clear about the function of a penalty clause when drafting. Dutch courts can mitigate contractual penalties upon request of the builder, whereas a liquidated damages clause reflecting a genuine compensation for the loss of the owner cannot easily be set aside in whole or in part. A penalty that was intended as an incentive only may be more susceptible to reduction than a penalty intended to recover (liquidated) damages.

In the luxury yacht industry, the HISWA/COT standard for the paint aesthetics of luxury yachts and the ICOMIA Technical Guideline are frequently used as guaranteed standards of performance in respect of coatings.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

The inclusion of a certain contractual benchmark will make the standard of performance of the builder more transparent. Quite often in the shipbuilding agreement reference will be made to other previous ship- or yacht-building projects of the yard, with the notation that the new build will have to be built in accordance with the standard of performance of said previous project. Reference to 'highest North European shipbuilding standards' or 'highest Dutch shipbuilding standards' will eventually have to be demonstrated to the court or the arbitral tribunal by an expert opinion should there be a dispute between the parties as to what the scope or application of the standard is.

In this respect, Directive 2013/53/EU on recreational craft and personal watercraft should also be mentioned. Products covered by this Directive may be placed on the market or put into service only if they meet the general requirement not to endanger the health and safety of persons, property or the environment, and only if they meet the essential requirements set out in the Directive. The CE marking, indicating the conformity of a product, is the visible consequence of a whole process comprising conformity assessment in a broad sense. The general principles governing the CE marking are set out in Regulation (EC) No. 765/2008. Rules governing the affixing of the CE marking to watercraft, components and propulsion engines are laid down in the Directive. It is appropriate to enlarge the obligation to affix the CE marking also to all inboard engines and stern drive engines without integral exhaust that are regarded as meeting the essential requirements set out in the Directive.

The Regulation Safety Seagoing Vessels is applicable to seagoing vessels from the day on which the keel of the ship is laid or the day on which a stage of construction similar to the laying of the keel has been reached in compliance with the relevant provisions of the Codes, resolutions or guidelines that are applicable under this Regulation. Unless explicitly stated otherwise, the Regulation is applicable to ships that are entitled to fly the flag of the

Netherlands. This Regulation, containing further rules with respect to the safety and certification of seagoing vessels registered in the Netherlands, as well as rules with respect to the safety of foreign ships in Dutch estuaries, also contains quality standards applicable to seagoing vessels.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

The party commissioning the construction of a new build will decide which flag the vessel will fly and will also nominate the classification society to be used. The contract with the classification society, however, will be concluded between the builder and the classification society. In this regard, the commissioning party is a third party and the classification society does not owe a contractual duty of care to the commissioning party. If any defects in the vessel are attributable to errors or omissions of the classification society, the claim of the commissioning party should be directed to the builder based on contract. A claim from the commissioning party directly against the classification society should be based on tort. If a claim is brought in tort by the commissioning party, the classification society may seek to rely on any exonerating clauses contained in the contract concluded between the classification society and the builder.

The responsibility and liability of statutory certification as a public task was addressed in the barge *Linda* case (Dutch Supreme Court, 7 May 2004, NJ 2006, 281). Although no classification society was involved, the grounds of this judgment are illustrative of the hesitant attitude of the Dutch legislature to make inspection and certification institutes liable. In this case, a claim was directed against the Dutch government as well as the surveyor involved, who had assumed the delicate task of certifying tug-pushed barge *Linda*. One year after the certificate was extended, the barge *Linda* capsized, sank and took with her a dredge combination that had been lying moored next to her. The owner of the dredge combination claimed damages on the grounds that a careful inspection would have prevented extension of the certificate for the barge *Linda*. After the claim had been rejected by the district court and the Court of Appeal, the case was brought before the Dutch Supreme Court. Here, the owner of the dredge-combination argued that the legal standard that had been infringed by the surveyor, being the requirement of a survey under the Rhine Vessel Inspection Regulations (RVIR), is intended to offer protection against damages as suffered here by him being the injured party. The Court of Appeal had made a distinction in two standards: a general standard that concerns advancing safety within the territorial waters (in this case, the aforementioned RVIR); and a code of conduct that concerns the standards of due care to be exercised when inspecting and certifying.

This distinction has been confirmed by the Dutch Supreme Court, which also outlined that the standards of due care may envisage contributing to the general standard of safety of shipping within the territorial waters, but are not intended to protect the individual assets and interests of third parties.

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In other words, although in the Netherlands the state has a duty to take care of safety within its territorial waters and has for that purpose introduced a certification system, neither an intention for introducing a liability for damages towards third parties can be derived nor has such a liability been caused by operation of law. In theory, this decision will probably also be relevant for all other situations of testing, survey and inspection.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

The Dutch flag-state authorities have outsourced compliance with flag-state legislation to the classification societies. In the Netherlands, the government agency responsible is the Human Environment and Transport Inspectorate (Inspectorate) of the Ministry of Infrastructure and Water Management. The Dutch Shipping Act applies to all seagoing vessels flying the Dutch flag, and the Inspectorate monitors vessels flying the Dutch flag, but also foreign vessels, crews, shipping companies and classification societies operating in the Dutch jurisdiction. The Inspectorate has authorised a number of organisations, including classification societies, to perform certain inspections. These are the recognised organisations (ROs). These ROs conduct inspections and certification on, for example, seagoing vessels, marine equipment, recreational craft and rescue boats. Supervision of these ROs is the responsibility of the Inspectorate. The European Commission recognised the relevant classification societies and also reviews their abilities and performance records on an annual basis.

The Netherlands has appointed seven ROs to act on its behalf. The working method and procedures are laid down in an agreement combined with a mandate. It concerns inspections and certifications required by international conventions such as SOLAS, MARPOL, Tonnage Measurements, Load Lines and ILO 152 on Dutch seagoing vessels. The Inspectorate continues to perform inspections on vessels that are not or are only partially within the scope of the international conventions. The Inspectorate also conducts inspections based on national legislation and as part of the flag-state control requirements.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

Registration in the Dutch Ships Register of a seagoing vessel under construction is only possible if the vessel is under construction in the Netherlands (article 8:194, section 1 of the Dutch Civil Code). Registration must be requested by the shipowner or commissioning party. A declaration must be submitted and signed to the effect that, to the best of the shipowner's or commissioning party's knowledge, the vessel is registrable as a seagoing vessel. If it concerns a request for registration as a seagoing vessel under construction, this declaration must be accompanied by proof that it is a vessel under construction in the Netherlands. Shipbuilding contracts in this jurisdiction usually contain a provision allowing the commissioning party to register the vessel in its name as a seagoing vessel under construction upon payment of a certain milestone instalment. The earliest possible moment is the laying

of the keel of the vessel. The legal consequences of registration of the vessel are mainly in respect of the possibility to register a mortgage over the vessel under construction. If the vessel under construction has not been registered yet, a right of pledge could be created as a security for a financial institution.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

The parties are free to contract that title to the vessel will pass from the builder to the buyer during construction. The earliest moment during construction that this passing of title can be recorded in the Dutch Ships Register is the laying of the keel of the vessel or reaching a similar milestone in construction (provided that the vessel is under construction in the Netherlands). Title will pass immediately to the buyer. Title will not pass gradually.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

After delivery, the vessel constructed shall be at the risk of the buyer. The risk of loss and damage will remain with the builder until delivery and acceptance of the vessel unless other contractual arrangements have been made.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

Shipbuilding contracts often stipulate conditions in favour of shipyards for the engagement of subcontractors. Standard general terms and conditions often attach conditions to subcontracting. The principal can stipulate the obligation that contractors impose back-to-back conditions of the main contract on their subcontractors.

Unless otherwise agreed upon in the shipbuilding contract, the builder will be entitled to have the works performed by one or more subcontractors under its supervision and, with respect to parts of the works, the builder will also be entitled to delegate the supervision to others, without prejudice, to its responsibility for the proper performance of the contract (article 7:751 of the Dutch Civil Code). If an owner wants a certain subcontractor to be involved in the project, this will usually be agreed upon with the builder and included in the shipbuilding contract. The same agreement is required with the exclusion of a certain subcontractor or supplier. It is common practice to negotiate a maker's list of suppliers and subcontractors and to include this list in the shipbuilding contract as an annex.

Naval architects, engineers and other consultants are generally on board early in ship-building projects. Information modelling (a digital working method used in this phase to share information) is of vital importance in the project. Employers are recommended to check the quality of shipyards in this respect.

Foreign professionals from outside the European Union who work on a ship construction project in the Netherlands must have a work permit requested by the employer, which is the builder or contractor employing said foreign professionals on a project.

In the absence of a valid work permit, the Netherlands Labour Authority may impose fines on contractors, but also on the principal. Further, contractors and their principal will be registered in a register open to the public for inspection.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

Subject to any express term of the shipbuilding contract, and also provided that the contract does not otherwise restrict the ability of the builder as main contractor to subcontract the construction of certain items without the commissioning party's prior approval, the builder is under no obligation to inform the buyer of an intention to have certain main items constructed in another country. However, to avoid claims for misrepresentation, for example, 'highest Dutch build quality', it is advisable that the builder discloses this fact, should it have the intention to construct main sections of the vessel outside the country where the builder is located.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

Where, at the time of entering into the shipbuilding contract, no fixed price has been agreed upon or only a target price has been set, Dutch law provides that the commissioning party owes a reasonable price (article 7:752 of the Dutch Civil Code). In setting the price, account shall be taken of the prices usually stipulated by the shipbuilder at the time of entering into the shipbuilding contract and the expectations the builder has raised with respect to the presumed price.

Where a target price has been set, it may not be exceeded by more than 10 per cent, unless the builder has warned the commissioning party of the possibility of a further cost overrun in reasonable time to afford the commissioning party the opportunity to limit or simplify the works at that stage. Within reasonable limits, the shipbuilder must cooperate with such limitation or simplification.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

Where, after the shipbuilding contract has been concluded, circumstances arise or become apparent that increased costs that are not attributable to the builder, the court may, upon the demand of the builder, adjust the stipulated price to the cost increase in whole or in part, provided that the builder, in setting the price, was not obliged to take the likelihood of such circumstances happening into account (article 7:753 of the Dutch Civil Code). This shall apply only if the builder has warned the commissioning party of the necessity of a price increase as soon as possible, so that the latter can exercise in good time its right to make a proposal to limit or simplify the works (article 7:753, section 3 of the Dutch Civil Code).

The duty to warn is considered to be particularly relevant in construction contracts and design contracts. This duty follows from the general duty to carry out the works with reasonable care and skill. If the builder fails to perform its duty to warn, the builder will become liable towards the commissioning party for the consequences of that failure. However, the supply of inadequate materials or directions may serve to render the commissioning party liable for negligence. The expertise of the commissioning party can be a relevant factor here.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

In general, a juridical act may be annulled when it has been entered into as a result of economic duress, fraud or undue influence (article 3:44, section 1 of the Dutch Civil Code).

Duress occurs when a person induces another person to perform a specific juridical act by unlawfully threatening him, her or a third party with harm to their person or property. The duress must be such that a reasonable person would be influenced by it. Duress under Dutch law comprises not only threats to a person but also to property. A threat of committing an unlawful act against any person may be sufficient, provided that it is such that it would influence a reasonable person. This means that the person exercising economic duress will most probably also act in tort towards his or her victim.

The economic and financial downturn after the summer of 2008 has led to a number of cases where parties have tried to invoke economic duress (eg, the extreme price increase of steel), but as far as we know these attempts have not been successful. It could be the case that the current price increases lead to a range of fresh litigation cases, whereby one party tries to invoke economic duress. This remains to be seen.

Upon the demand of one of the parties, the court may modify the effects of a contract, or may set it aside in whole or in part on the basis of unforeseen circumstances that are of such a nature that the other party, according to the criteria of reasonableness and fairness, may not expect the contract to be maintained in an unmodified form (article 6:258 of the Dutch Civil Code). The test to be met for a party invoking this provision is to successfully

argue that the contract has no allowance for the occurrence of these circumstances in the first place. This largely is a matter of interpretation of the contract.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

It is a principle of Dutch contract law that the parties have autonomy to agree upon the contents of the contract, and to submit it to a form and application of a chosen law. The principle of freedom of contract forms the basis of Dutch commercial and contract law. This means that, in principle, contract parties are only bound by the rules agreed between themselves. However, a contract that violates public morality or public policy is null and void.

The parties are free to (contractually) exclude the buyer's right to set off, suspend payment or deduct certain amounts (eg, when it is time for the buyer to make a milestone payment).

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

Until the builder hands over the completed vessel at delivery, the buyer's deposit and milestone payments made during construction are at risk. Under Dutch law this risk may be mitigated to a certain extent by passing title from the builder to the buyer during construction; however, depending on the stage of construction, the buyer is likely to have an unsecured claim against the shipyard should the shipyard default or become insolvent during construction. A refund guarantee from a creditworthy bank is usually used to cover this risk.

If the contract price is payable by the buyer in pre-delivery instalments according to certain milestones, a refund guarantee from the builder will usually be in the form of an undertaking from its bank to refund the relevant instalments upon the buyer's first written demand.

Article 7:850, section 1 of the Dutch Civil Code defines the contract of suretyship as a contract whereby one party, the surety, obliges itself towards the other party, the creditor, to perform an obligation to which a third person, the principal debtor, is or will be bound towards the creditor.

Another possibility is the issuance of a bank guarantee, on the basis of which a bank is obliged to pay if the conditions contained in the guarantee are met. A bank guarantee is detached from the underlying juridical relationship, namely, the contract between the creditor and the principal debtor. In the case of suretyship, there is always a link between the obligation of the principal debtor and the surety, although suretyship for future obligations can be agreed upon.

The builder does not require permission from any Dutch authority to have refund guarantees issued.

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Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

As for advance payment guarantees, there are no formalities to be met prior to issuance of the letter of guarantee. The articles of association of the guarantor should allow the guarantor to issue letters of guarantee, and the same applies to parent company guarantees when a parent is supposed to guarantee the performance of a daughter company.

Under Dutch law, such a letter of guarantee is usually in the form of a contract of suretyship, whereby one party, the guarantor, obliges him or herself towards the other party, the obligee, to perform an obligation to which a third person, the principal obligor, is or will be bound towards the obligee.

Suretyship is dependent upon the obligation of the principal obligor in respect of which it has been entered into. Because the guarantor may also avail him or herself of the defences that the principal obligor has against the obligee if they relate to the existence, content or time of performance of the obligation and the guarantor is not obliged to perform until such time as the principal obligor has failed in the performance of his or her obligation, these defences are usually explicitly excluded in the wording of such a letter of guarantee.

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

During the construction of the vessel, the builder or the buyer is able to create and register a mortgage over the vessel under construction, provided that the buyer or the builder owns the vessel.

The owner of the seagoing vessel shall make a request for registration, accompanied by a declaration signed to the effect that, to the best of the owner's knowledge, the vessel is suitable to be registered as a seagoing vessel. Where it concerns a request for the registration of a seagoing vessel under construction, this declaration shall be accompanied by proof that the vessel is under construction in the Netherlands. When making a request for registration, the applicant shall elect a domicile within the Netherlands.

As long as the registration has not been deleted from the Dutch Ships Register, the registration of a seagoing vessel in a foreign register or the creation abroad of rights (titles or interests) in the vessel, for which creation of a registration in the public registers would have been required in the Netherlands, shall have no legal effect. In derogation from this, a registration or creation of rights (titles or interests) shall be recognised when it took place under the condition of deletion of the registration in the Dutch Ships Register after the registration of the vessel in the foreign register.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

After delivery and the commissioning party's acceptance of a vessel, the builder shall have no liability whatsoever, except as set forth in the warranty clause of the shipbuilding contract. Customarily, the builder warrants that the vessel and all its components and equipment – except for owner's supplies – upon delivery shall comply with the requirements of the shipbuilding contract and specification and shall be new, free from liens and encumbrances, and of the best quality, free from defects in material and workmanship.

The question may arise whether defects in design are included within the scope of this warranty. Defective design does not fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of a shipbuilding contract. Parties should explicitly include the builder's liability for defective design in the warranty clause if it is their intention that the builder will be liable for that under the warranty clause. It was held in a Transport and Maritime Arbitration Rotterdam-Amsterdam (in 2018, renamed UNUM Transport Arbitration and Mediation) arbitral award of July 2013 that the claim under the warranty provisions of a shipbuilding contract – pursuant to which the yard undertook to remedy by repairing to a new standard or, if necessary, by replacing all defects due to poor design, workmanship or materials – had to be denied, although the contract contained a provision as follows:

> *The Builder undertakes responsibility with regard to strength, stability, functionality and further shipbuilding aspects, other than sailing performance and aesthetics of the Vessel. He is obliged to review the overall Design, the Plans and the Specifications as generally being suitable for this purpose. It is expressly acknowledged that 'the builder shall not be responsible for any aesthetic aspects of the Vessel's design which shall at all times be the responsibility of the Owner and his Naval Architect'.*

Within the warranty period, the hull of the vessel broke owing to slamming, but the arbitral tribunal held that the provision in the contract quoted imposes a general obligation on the yard, but cannot be understood to shift the responsibility for – and thereby the liability for any faults in – the overall design, the plans and specifications as prepared by the naval architect and the construction engineer, to the shipbuilder. Contrary to the claimant's assertion, responsibility and liability of the yard for the overall design, plans and specifications do not follow the wording of the provision quoted. Errors or miscalculations in the overall design, plans and specifications remain for the risk of the commissioning party, who has contracted with a naval architect and the construction engineer. This arbitral award shows that contractual language aimed at making the yard liable for the design cannot be clear enough.

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Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

In the absence of a contractual relationship with the builder, a third party's ability to enforce the warranty rights under the building contract is in principle non-existent under Dutch law.

Third parties suffering loss or damage because of the defectiveness of a vessel can try to make a claim against the shipbuilder based on tort. It will be difficult to successfully claim damages from a shipyard, as there is no obligation for the shipyard to repair the damage if the standard breached does not serve to protect against damage such as that suffered by the third party suffering the loss. Except where there are grounds for justification, the following are deemed tortious: the violation of a right and an act or omission breaching a duty imposed by law or a rule of unwritten law pertaining to proper social conduct.

In many cases, shipbuilding contracts contain assignment clauses, but if no assignment has taken place prior to delivery such clause will not be of assistance to a third party for defectiveness discovered after delivery.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

Any clause that provides that a shipyard (obligor), should it fail in the performance of any of the performance criteria of the shipbuilding contract, must pay a sum of money or perform another obligation, is considered to be a penalty clause. This is irrespective of whether the penalty is to repair damage or acts as an incentive only to encourage performance (article 6:91 of the Dutch Civil Code). The creditor may not demand performance of the penalty clause where the failure in the performance of the obligation cannot be attributed to the shipyard. A notice will be required to demand performance of the penalty clause in the same cases as such is required to claim damages due by law. Under article 6:94 of the Dutch Civil Code, the court may reduce the contractually agreed penalty at the request of the obligor if it is fair to do so. However, the court may not award the obligee less than the damages due by law for failure in the performance. A penalty that was intended as an incentive only may be more susceptible to reduction than a penalty intended to recover (liquidated) damages.

The statutory authority of the court to reduce a penalty cannot be excluded by the parties in their agreement. Although the wording of article 6:94 of the Dutch Civil Code suggests otherwise, this provision does not entitle the court to reduce the amount of penalties simply because it perceives the amount as being unfair. In its decision of 27 April 2007 (ECLI:NL:HR:2007:AZ 6638 *Intrahof v Bart Smit*), the Dutch Supreme Court ruled that the court should exercise its authority to reduce the penalty amount cautiously. A penalty may be reduced where there is an imbalance between the amount of penalties and the

damages incurred by the breach, in the given circumstances, that is excessive and therefore unacceptable.

The court should take into account not only the amount of damages but also the nature of the agreement, the content and purpose of the penalty clause and the circumstances under which the penalty clause was invoked. The Dutch Supreme Court has repeated the standard in various other cases over the past few years. More recently, the standard for reducing penalties has been confirmed by the Dutch Supreme Court in its decision of 16 February 2018 (ECLI:NL:HR:2018:207). The Dutch Supreme Court held in *Ampatil v Weggelaar* (Dutch Supreme Court, 17 December 2004, NJ 2005, 271) that claiming payment of a penalty under certain circumstances can be unacceptable according to standards of reasonableness and fairness. Dutch courts can mitigate contractual penalties upon request of the builder, whereas a liquidated damages clause reflecting a genuine compensation for the loss of the owner cannot easily be set aside in whole or in part.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

The innocent party may wish to recover its actual losses despite the fact that the contract contains a liquidated damages clause limiting the liability of the party in breach of the agreed amount under the clause. The innocent party may start litigation requesting the court to award supplementary damages, but such a claim would only have a reasonable chance of success if under the circumstances it is evident that principles of reasonableness and fairness so require.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

A general definition of force majeure can be found in article 6:75 of the Dutch Civil Code: the failure in performance cannot be attributed to the obligor if it is neither owing to his or her fault nor for his or her account pursuant to the law, a juridical act or generally accepted principles. As a result of force majeure, the builder will not default and cannot be held liable for a delay in completing the project.

Parties to a contract can limit or extend the circumstances that constitute force majeure. This is common practice in some areas of the construction sector (eg, offshore projects). But the rules of mandatory law and the standards of reasonableness and fairness still apply and may restrict such arrangements.

The scope of force majeure will be a matter of negotiation and the parties to the ship-building contract must carefully consider the contingencies with regard to the project. Here the experience of a seasoned legal adviser drafting the clause could make the difference. The clause providing that the builder must give notice in writing specifying the events that cause contractual force majeure, estimating the time the force majeure situation will probably last, could be of assistance. Under Dutch law, it is beyond doubt that there is also force

majeure in cases of 'relative impossibility': cases in which performance is possible in theory but, reasonably speaking, cannot be expected of the debtor in question.

Force majeure was discussed in the Court of Appeal case ECLI:NL:GHSHE:2013: BZ9854. There was a shipbuilding contract for the construction of the dredger *Simson*. The completion date was not achieved by the shipbuilder who claimed circumstances of force majeure. The parties agreed on a joint expert opinion that stipulated that because of construction defects in components delivered by a third party, which generally speaking has a good reputation, the shipbuilder faced delays. The court considered that, based on the expert's opinion, there were circumstances that constituted force majeure. However, the shipbuilder was liable to pay liquidated damages owing to further delays, which could have been reduced by the shipbuilder. In a nutshell, the shipbuilder argued that weather conditions partially caused further delays. The court considered that further delays were caused by the shipbuilder's own fault, and that the statement that weather conditions partially caused the further delay was non-substantiated. Therefore, these arguments did not constitute force majeure.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

The majority of shipbuilding contracts impose upon the builder an obligation to insure the vessel in respect of 'builders' risks'. The Dutch Bourse Policy for Construction Risks 1947 is the prevailing builders' risk insurance available in the Dutch insurance market. According to this policy, a shipyard can take out insurance not only in its name alone, but also on behalf of all co- and subcontractors and suppliers involved in the construction, conversion or repair of a certain named vessel. The insurance is to cover all risks, including fire and theft, in buildings, yards and shops of the assured, while under construction, fitting out and during trials, and it includes materials while in transit – except by sea – to and from the works or the vessel wherever it may be laying. Less used are the 1995 version of the Dutch Bourse Policy for Construction Risks (renamed Dutch Bourse Policy for Builders' Risks 1995) and the Institute Clauses for Builders' Risks 1.6.1988. The 1995 policy excludes coverage for coating, faulty welding and damage caused by volcanic activity and earthquakes. It is important to check when the insurance starts. Is it from the signing of the contract, the start of engineering work, the first cutting of steel, or keel laying? Note that article 21 of the 1947 policy provides:

> *should any loss or damage covered under this policy be insured under any other contract of insurance at the time such loss or damage arises, the present policy is to be only supplementary and therefore only to cover an excess, if any, not covered under such other contract of insurance.*

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

The parties have contractual freedom, but if there is disagreement on the proper construction of a contractual term, a court or arbitral tribunal will have to establish the presumed intentions of the parties. In *Vodafone Libertel NV v European Trading Company CV* (Dutch Supreme Court, 19 October 2007, JOL 2007, 686), the Dutch Supreme Court held that in finding the proper interpretation of a contractual clause, a mere linguistic approach will not suffice. The test must be to try to establish the meaning that the parties reasonably have given to the disputed clause, taking into account each other's position. The rights and obligations of parties in relationship with one another are not only determined by the explicit contractual terms prevailing between them, but also by principles of reasonableness and fairness.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

Regardless of the time of passing of title, the risk of loss or damage will under most contracts remain with the builder until the vessel has been delivered to and accepted by the buyer. The buyer's signature of a protocol of delivery and acceptance evidencing the vessel is in conformity with the building contract shifts risk to the buyer but will not be final and binding in the case of defects latent at the time of delivery. It must concern latent defects that have not been discovered and were not discoverable by a prudent buyer taking reasonable precautions to avoid such defects from escaping his or her attention. The liability of the shipyard for latent defects known to the shipyard and not disclosed cannot be excluded or limited and neither can it be made subject to a shorter prescription period as provided for by law (article 7:761 of the Dutch Civil Code).

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

Dutch (contracting) law does not contain any specific rules in this regard. In accordance with the Dutch principle of freedom of contract, the parties are entitled to make any contractual arrangements in this respect as they deem fit. Generally, unless the parties have made other arrangements in their shipbuilding contract, the warranty repairs or replacements should be carried out at the yard's premises. Parties tend to make contractual arrangements in

respect of the place where warranty works need to be carried out, the rights of the buyer in this respect and the cost aspect thereof. The same applies to the costs associated with moving the vessel and the docking costs; the parties tend to make arrangements in this respect in their shipbuilding contracts.

Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

A lien is a right to the assets of another party arising by a specific clause in an agreement or by operation of law.

A lien over the vessel or work or equipment ready to be incorporated in the vessel as security for payment of invoices can only be successfully exercised if the supplier or subcontractor effectively holds possession of the relevant work or equipment, and can prevent the shipbuilder, buyer or third parties from taking possession of this work or equipment without consent. The work or equipment will, therefore, need to be in the custody of the relevant supplier or subcontractor.

In case ECLI:NL:RBROT:2013:6587 (*Aeolus v Van de Grijp*), the subcontractor of the defendant claimed to have a right of retention towards the defendant. The subcontractor had the products in its possession and refused to hand over the products to the plaintiff invoking its alleged right of retention. The contract between plaintiff and defendant contains a provision that says that the contractor may not suspend its obligations under the contract when the client does not fulfil its payment obligations. The court considered that this provision held a prohibition for the subcontractor to exercise a right to suspension. Further, the court considered that, regarding the rights of third parties, a contracting party whose performance has become of such importance to the interests of third parties cannot neglect these interests that are largely dependent on the performance of the contracting party. The standards that are considered acceptable in society according to general principles of civil law may entail that the contracting party needs to respect these interests when these interests are closely related to the proper performance of the agreement. In its judgment, the court will need to consider the position of the parties involved, the contents and meaning of the contract, and the way the interests of third parties are involved (Dutch Supreme Court, 24 September 2004, NJ 2008, 587 (ECLI:NL:HR:2004:AO9069)).

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

Suppliers and subcontractors engaged by the shipbuilder in constructing the vessel will lose any right to retain their title to the goods supplied and the work performed from the moment the goods supplied or work performed is incorporated into the vessel. There is no

implied term or statutory provision that a vessel at the time of delivery shall be free from all liens, charges and encumbrances. This has to be agreed upon by the parties in their shipbuilding contract.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

Third-party creditors can obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel, provided that these (the vessel and the equipment) are registered in the Dutch Ships Register.

In this context, a distinction must be made between vessel components and vessel accessories. Whereas vessel components will, after being affixed or incorporated, lose their independent nature and follow the ownership of the vessel and, thus, become property of the owner of the vessel, vessel accessories will not. Vessel accessories have a separate legal status in view of a possible reservation of title. Any such reservations should be registered in the Dutch Ships Register. In fact, unlike vessel components, vessel accessories may – owing to reservations of title – remain outside the right of recourse of third-party creditors of the owner of the vessel.

Such security attachment or enforcement lien does not affect the builder's right of retention, inasmuch as the holder of a right of retention – the creditor – may invoke its right of retention against third parties that have acquired a right or an interest in the property after its claim arose and property had come into its possession. The creditor will lose its right of retention from the moment it loses possession or custody of the relevant property.

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

Unless the contract with the subcontractor or manufacturer contains a provision explicitly denying the shipbuilder's right to assign the warranty to the buyer, the shipbuilder and the buyer will be at liberty to agree on such assignment of the subcontractor's or manufacturer's warranty. There is no specific legislation entitling the buyer to make a direct claim under the subcontractor's or manufacturer's warranty failing a contractual assignment.

Failing a contractual provision to that effect, a claim against a subcontractor or manufacturer will require a written document (deed), signed by both the creditor and the third party, whose purpose is to transfer title of the claim against the debtor by the creditor to that third party. This deed must either be executed before a notary public, registered at the Dutch Tax and Customs Administration, or notice of the assignment by deed must be given to the debtor. Once these requirements have been met, the claim is validly transferred (assigned).

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

Where a builder defaults in the performance of the shipbuilding contract, the buyer will have the following remedies to choose from, unless the shipbuilding contract explicitly limits any of such rights:

- specific performance – as in most civil law jurisdictions – is the prevailing remedy. The buyer can request the court to impose a monetary penalty on an unwilling builder and if ordered by the court any penalties forfeited will accrue to the buyer;
- as an alternative, the buyer can request the rescission of the contract. Property should be returned if the damaged party so wants, subject to protection of bona fide purchasers of chattels; or
- in both cases of specific performance and rescission, the buyer may also recover damages for breach of contract.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

In the event of protracted failure to construct or continue construction by the shipbuilder, the buyer may seek a court order by way of an interim measure to force the shipbuilder to continue construction in accordance with the building schedule agreed upon. That court order can be enforced by a penalty, which will accrue to the plaintiff should the shipbuilder continue to default or default again. As an alternative, the buyer may at all times cancel the shipbuilding contract in whole or in part. In the event of such cancellation, the buyer must pay the price applicable to the entire works, after deduction of the savings resulting for the shipbuilder from the cancellation, against delivery by the shipbuilder of the works already completed. If the contract price was made dependent upon the costs actually to be incurred by the shipbuilder, the price owed by the buyer shall be calculated on the basis of costs incurred, the labour performed and the profit that the contractor would have made for the entire works (article 7:764 of the Dutch Civil Code).

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

The parties have contractual freedom; therefore, it is possible to include an insolvency clause in the shipbuilding contract, which provides that in case of the builder's suspension of payments or bankruptcy, the buyer may terminate the shipbuilding contract in whole or in part. Such clause may even provide that the shipbuilding contract will terminate automatically in the case of the builder's insolvency. This clause provides clarity to the contracting

parties; however, the downside of such a clause is that the other creditors in the bankruptcy may be disadvantaged.

An insolvency clause was discussed by the Dutch Supreme Court in case ECLI:NL:HR:2013:BY9087. The Dutch Supreme Court considered that an insolvency clause on the basis of which a party may terminate an agreement and no longer has to perform, while the same party already received compensation from the bankrupt party, may in some cases constitute an unacceptable violation of article 20 of the Dutch Bankruptcy Act.

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

The parties to a shipbuilding contract are free to make a choice in favour of one of the institutional arbitration institutes or ad hoc arbitrators. The institutions most commonly agreed on by the parties are UNUM Transport Arbitration and Mediation and the Netherlands Arbitration Institute.

Failing a decision in favour of arbitration, the Dutch state courts are competent to hear the case.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

If the shipbuilding contract provides for the buyer having title to the vessel under construction, this provision will survive the bankruptcy or moratorium of the builder. The administrator (moratorium of creditors) and trustee (bankruptcy) may call for a cooling-off period of two months, which means that the buyer is prevented from having the vessel under construction removed from the builder's yard during this period. This will have to wait until the end of the cooling-off period. A contractual right to take possession of the vessel and continue construction at the builder's site will in most cases not survive the bankruptcy or moratorium of creditors of the builder for a number of reasons. First, a trustee has the statutory right to terminate agreements that are not beneficial for the estate. Second, in this jurisdiction, the land and buildings of the shipyard are in most cases leased. This can be an intercompany transaction with an associated company or it may be at arm's length. In both cases, the lease agreements can be terminated on account of the moratorium or bankruptcy, which would leave the buyer empty-handed.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

There is no tendency to incorporate an ADR clause in shipbuilding contracts.

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Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

Where a buyer defaults in the performance of the shipbuilding contract, the builder will have the following remedies to choose from, unless the shipbuilding contract explicitly limits or excludes any of such rights:

- the prevailing remedy is to seek a court order to force the buyer to continue the performance in accordance with the contract agreed upon (specific performance). That court order can be enforced by a penalty, which will accrue to the builder should the buyer continue to default or default again;
- as an alternative, the builder can request the rescission of the contract. As a consequence of the rescission, the performances completed and the payments made must be undone or reversed – in this context, a distinction must be made between the rescission of a contract and the cancellation of the same. The latter does not result in the performances and payments to be undone; and
- in both cases of specific performance and rescission of the contract, the builder may also recover damages for breach of contract.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

The Netherlands Maritime Technology Association (NMT) has published a standard form of shipbuilding contract as well as general yard conditions. The shipbuilding contracts governed by Dutch law are still mainly based on either the form of the NMT or alternatively the well-known 1999 AWES form of contract, published by the Association of West European Shipbuilders and Shiprepairers.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

Under Dutch law, with the cooperation of its counterparty, a party to a contract may assign the legal relationship with the other contracting party to a third party by a document drawn up between itself and the third party, unless such transfer is prohibited or restricted by law or contract.

A transfer of contract is a tripartite agreement, whereby the transferor transfers its entire legal relationship with its counterparty under the contract to another party (that is, the

transferee), consisting of all rights and obligations, including any and all accessory rights and ancillary rights.

Pursuant to article 6:159 of the Dutch Civil Code, a transfer of contract requires an agreement between the transferor and transferee and the cooperation of the counterparty to the contract. Failure to meet any of these two conditions will cause the transfer of the contract to be void. No legal formalities apply in respect of the cooperation to be provided by the counterparty. Such cooperation could be provided in advance, in the transfer of contract agreement (should the counterparty be a party thereto) or following execution of the transfer of contract agreement.

A transfer of contract takes legal effect in respect of all three parties involved simultaneously. If cooperation has been provided in advance, the transfer of contract will take legal effect upon the date the transferor and transferee inform the counterparty of such transfer. If, however, the counterparty agrees to cooperate after the date on which the agreement by the transferor and transferee is executed, the transfer will not take effect until the date on which the counterparty agrees to cooperate.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

Builders nowadays frequently subcontract onboard electrical and automation system integration to specialised subcontractors. These IT suppliers offer and install integrated bridge control systems and automation solutions of all sorts. After delivery of the vessel and the elapsing of the (usually 12 months) warranty, the owner should be able to order maintenance, repair and an upgrade from another supplier than the original supplier who designed and built the system, if necessary and so desired. Regarding clauses protecting the owner's position to the source codes of such software systems: for maintenance, etc, customers remain largely dependent on the supplier. The Dutch Court of Appeal in *Bois le Duc* decided in a judgment of 7 February 1994 that the original supplier of the software system was obliged to surrender the source codes (free of charge) if the software had been developed specifically for the customer and was financed by the customer.

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

The shipbuilding industry in Nigeria is open to foreign participation and investment. There are no restrictions on foreign participation and investment in the industry. Foreign investors are guaranteed unrestricted return on investment capital with proceeds in any convertible currency, provided such capital was imported into Nigeria under a Certificate of Capital Importation issued by a Nigerian bank. (See the Nigerian Investment Promotion Commission Act, Chapter N117, Laws of the Federation of Nigeria 2004 and the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act, Chapter F34, Laws of the Federation of Nigeria 2004.) A foreign company intending to do business in Nigeria is required to register a Nigerian subsidiary at the Corporate Affairs Commission (the Nigerian equivalent of Companies House in the United Kingdom) with a minimum authorised share capital of 10 million naira. It is mandatory for a Nigerian subsidiary with foreign participation to apply for and obtain a one-off business permit to carry on business in Nigeria. It will also be subject to immigration requirements, including obtaining approved expatriate quota positions for the employment of foreigners in specialised job designations for which there are no skilled Nigerians. Expatriate quotas are renewable in two-year cycles. Furthermore, a foreign employee is required to obtain a Combined Expatriate Resident Permit and Alien's Card to reside and work in Nigeria.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

Prior to the enactment of the Public Enterprises (Privatisation and Commercialisation) Act, the government dominated all sectors of the Nigerian economy, including shipbuilding. The participation of the government was through wholly state-owned public sector enterprises. Owing to the problems associated with the efficiency of those enterprises, the government resolved to transfer ownership of those public enterprises and assets to private investors. The government, however, still retains a minority shareholding in certain privatised enterprises. One such privatised enterprise is Nigerdock Nigeria Plc, the largest shipyard in Nigeria (comprising a 25,000 deadweight tonnage graving dock and a 3,500 deadweight tonnage floating dock). The government's retention of ownership in privatised enterprises, including shipbuilding facilities, appears to be for the purpose of monitoring compliance with agreements reached during the privatisation exercise, particularly in respect of the retention of legacy staff. The government planned to fully divest its minority shareholding in privatised enterprises by way of initial public offers, but this is yet to materialise in the case of Nigerdock.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

As with any other contract, a shipbuilding contract will be enforceable where the elements necessary for a valid contract can be established, that is:

- offer and acceptance;
- intention to create legal relations; and
- consideration.

Parties enjoy the freedom to create obligations by contract and such obligations are enforceable provided the terms are not illegal or contrary to public policy. However, under section 251(2) of the Merchant Shipping Act, Chapter M11, Laws of the Federation of Nigeria 2004 (the MSA), the builder of a ship is required to submit the plans and specifications of a ship to the Minister of Transport for approval prior to the commencement of construction. Where a builder commences building without first obtaining the requisite approval as described above or builds a ship without undertaking alterations as directed by the Minister for Transport, the ship may be detained absolutely or until the builder carries out alterations as directed by the Minister for Transport. Failure to obtain the approval is an offence that is punishable upon conviction with a fine of not less than 100,000 naira.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

Under Nigerian law, the parties to a shipbuilding contract are at liberty to select the law of their choice to govern their contract. Generally, Nigerian courts uphold choice of law clauses in contracts on the basis of the common law principle of pacta sunt servanda (namely, parties are bound by their contract). It has, however, been held by the Supreme Court, per Oputa JSC, in *Sonnar (Nig) Ltd v Partenreedri MS Nordwind (Owners of the MV Norwind)* [1987] 4 NWLR (Part 66) 520, that to be effective, the choice of law must be real, genuine, legal, reasonable and made in good faith. It should not be capricious and absurd. Thus, Nigerian courts do not consider choice of law clauses as conclusive in all cases. Where the choice of law is capricious and absurd (or has not been expressly selected by the parties in writing), the law with the closest connection to the transaction will be applied by Nigerian courts.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

Shipbuilding contracts are regarded as contracts for the sale of goods, which are subject to the Sale of Goods Act 1893, a statute of general application in Nigeria. A shipbuilding contract will be regarded as a contract for the sale of goods whether the vessel is in existence at the time of the contract or yet to be constructed. (See sections 1(1) and 5(1) of the Sale of Goods Act 1893 to the effect that contracts for sale comprise contracts for existing and future goods.)

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

No Nigerian statute requires a shipbuilder to state a hull number in the description of a vessel in a shipbuilding contract. Therefore, the hull number stated in a shipbuilding contract is not essential to the vessel's description, particularly where the hull may be identified by other means. The hull number is, however, essential from a contractual perspective, as it assists a buyer to identify with certainty the specific hull being constructed by the builder in relation to the former's shipbuilding contract. The hull number is also important for the purpose of allocating materials and equipment in the shipyard or those supplied by the buyer to a specific hull. The hull number stated in the description of the vessel in the shipbuilding contract is placed on materials and equipment purchased or supplied for the hull to ensure traceability to that hull and safeguard against such materials and equipment being applied to a different hull in error.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

The law requires the plans and specifications of a newbuild to be submitted for approval prior to construction. Upon such approval, the builder will be restricted to the approved plans and specifications. Any deviation from the approved dimensions and descriptions contained in the plan and specifications will, therefore, require subsequent approval. Generally, where goods are sold by description and discovered upon delivery to have deviated materially from what was ordered, the buyer is entitled to repudiate the contract. However, where the agreed dimensions and description are 'approximate', it presupposes that the builder is at liberty to modify the specified figures, but such modification shall be within the contemplation of the parties. Essentially, therefore, the extent of any such deviation will be restricted to the reasonably permissible limits of the particular type of ship.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

Yes. Parties are at liberty to incorporate guaranteed standards of performance into their contract. Such agreed standards are enforceable. The remedy available to an innocent party will, however, depend on the nature and extent of the breach. Where there is a breach of a warranty, the innocent party will be entitled to damages, while a breach of a condition will entitle him or her to rescission.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

Contractual quality standards agreed by parties are generally construed within the limits set by the agreed standard. However, being a contract of sale governed by the Sale of Goods Act 1893, some terms relating to quality are implied in the contract. These terms relate to conformity with description, fitness for purpose and merchantable quality.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

Generally, a classification society does not owe a buyer a contractual duty of care, as the buyer is not privy to the contract between the builder and the classification society to ensure that construction of the vessel is in accordance with the buyer's desired class notation. As

a general rule, a contract cannot confer rights or impose obligations on any person except the parties to it. This is based on the English common law principle of privity of contract. Therefore, the buyer's recourse for any defect in the vessel will lie against the builder of the vessel for breach of contract.

However, notwithstanding the absence of a contractual duty of care, the buyer may be able to sue the classification society in tort to recover damages for negligence. This is subject to the buyer successfully establishing the elements of negligence. The builder will have direct recourse against the classification society for breach of contract.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

The flag-state authority has not outsourced compliance with flag-state legislation to any classification society. Flag-state duties are performed by the Nigeria Maritime Administration and Safety Agency (NIMASA). NIMASA was established by the NIMASA Act 2007. It has responsibility for performing all of the customary duties of a flag state.

Under the MSA, the approving authority may, by means of regulations, nominate any person within or outside Nigeria to be a classification society for the purpose of surveying and measuring ships and for other purposes subject to such conditions as the Minister of Transport may impose. This statutory provision has, however, not been implemented.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

Ships in Nigeria are registered at the Nigerian Ship Registration Office. The Register of Ships is maintained by the Registrar of Ships. Under the MSA, the Registrar of Ships is required to maintain such register or books as may be necessary, including a register for ships under construction. Ships under construction are registered in the name of the owner. An individual may be registered as sole owner of the ship in his or her own name, while a corporation may be registered as owner by its corporate name. On completion of the registration of the ship, the Registrar issues a certificate of registration.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

Pursuant to section 17(1) of the Sale of Goods Act 1893, title in specific and ascertained goods is transferred at such time as the parties to the contract intend it to be transferred.

Therefore, the parties may contract that title will pass from the builder to the buyer during construction.

Depending on the agreement of parties as to when title should pass, title may pass gradually upon the progress of the vessel's construction or at any other stage.

In addition to the foregoing, the parties may state in the shipbuilding contract that the title in the ship passes to the buyer on a block-by-block basis, that is, that title passes as construction progresses rather than on completion or delivery. An agreement that title passes to the buyer on a block-by-block basis allows the financier, where necessary, to take possession of an incomplete structure that can be sold to mitigate loss if the need arises.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

Under section 20 of the Sale of Goods Act 1893, risk passes with title unless otherwise agreed by the parties. Therefore, parties are at liberty to state when risk will pass. Where title passes on a block-on-block basis, the risk passes as well and the buyer takes on all risks that may occur during construction.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

The ability of the shipbuilder to subcontract part or all of its obligations to a third party will depend on the terms of the shipbuilding contract, which may require the buyer's prior consent in writing, which consent shall not be unreasonably withheld.

Notwithstanding the builder's ability to subcontract to a third party, it does not discharge the liability of the builder towards the buyer. In some instances, the agreement may expressly contain a provision to the effect that subcontracting is not a waiver of the rights of the buyer towards the builder with respect to the obligations of the builder under the shipbuilding contract. This liability may arise where a subcontracted portion of the construction does not meet the specification agreed under the shipbuilding contract.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

The parties may agree that the builder informs the buyer of any intention to have any portion of the ship constructed in a country other than that where the builder is located. Otherwise, where the builder is permitted to subcontract part or all of the construction to a third party,

the builder will not be under any obligation to inform the buyer of the location of any such subcontractor.

It is, however, important to mention that subject to any double taxation treaty between Nigeria and the other country, the profit on the subcontracted portion of the shipbuilding contract will be liable to tax in Nigeria.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

There is no distinction between fixed-price contracts and labour-and-cost-plus contracts in Nigerian statutes.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

There are no statutory remedies available to a builder to charge the buyer for price increases in labour and materials where parties have agreed a fixed price. Where the builder is desirous of charging the buyer for price increases of labour and materials in a fixed-price contract, a clause to that effect is usually inserted in the contract.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

In Nigeria, a contract will be vitiated where one of the parties successfully establishes that the contract or a portion of it was agreed under duress. The party alleging duress will be required to establish the duress by leading evidence in that regard. Therefore, a buyer may be able to retract consent to an increase in price where it can be proved that such consent was induced by economic duress. It has been held that a party who entered into a contract under duress may either affirm or avoid such a contract after the duress has ceased. Failure to avoid such a contract will render him or her bound by the contract as he or she will be deemed to have ratified the contract.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

Yes, the parties may choose to exclude the buyer's right to set off, suspend payment or deduct certain amounts. This is premised on the parties' freedom to contract.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

There are currently no rules guiding the form and wording of refund guarantees. However, a refund guarantee would generally be required to be in writing, by deed and signed by the guarantor. In addition, under the Banks and Other Financial Institutions Act 2010, where a shipbuilder seeks financial guarantee from a bank, the bank is required to obtain the permission of the Central Bank of Nigeria to issue the refund guarantee.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

In Nigeria, advance payment guarantees are usually issued by insurance companies or banks. Under the Insurance Act 2003 and the National Insurance Commission Guidelines on Insurance Premium Collection and Remittance 2013, an insurance company will not issue an advance payment guarantee unless the premium in that regard has been paid. All other requirements prescribed by the insurance company must also be fulfilled.

In the case of an advance payment guarantee issued by a bank, the approval of the Central Bank of Nigeria is required prior to the issuance of the guarantee.

Regarding the issuance of parent company guarantees, a board resolution of the parent company approving the issuance of advance payment guarantee will be required.

In addition to the foregoing, the advance payment guarantee and parent company guarantee must be in writing, by deed and signed by the guarantor.

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

In Nigeria, there is a register for ships under construction. However, while a mortgage may be created over a ship registered in Nigeria or a share in such a ship, it does not appear that a mortgage can be created and registered over a ship under construction.

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DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

Nigerian courts are yet to make any pronouncement on this. However, a Nigerian court will uphold the terms of a contract provided there are no vitiating elements. Therefore, in the absence of any vitiating elements, where parties have by their contract agreed that defective design shall fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract, a Nigerian court will enforce the intention of the parties.

Furthermore, the courts may allow a party to add to or vary the contract by oral evidence upon proof that it is a custom or usage common to agreements of such nature. Therefore, a shipbuilder may be liable under the warranty clause where the buyer is able to establish that defective design falls within the scope of poor workmanship in a shipbuilding contract.

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

Generally, third parties are not entitled to any contractual remedy against a shipbuilder for defectiveness. This is because, as a general rule, a contract cannot confer rights or impose obligations on any person except the parties to that contract. Applying the 'proximate principle' established in the locus classicus – *Donoghue v Stevenson* (1932) AC 562 – the Supreme Court of Nigeria has held that manufacturers and intermediate parties in the chain of distribution are equally liable for injury, death or damage caused to end users by defective products (see *Nigerian Bottling Co v Ngonadi* [1985] 1 NWLR (Pt 4) 739). Therefore, a third party may recover damages for the tort of negligence, provided that the elements of the tort are proved. Nigerian courts have held that the absence of privity of contract between a plaintiff and defendant does not preclude liability in tort. Thus, manufacturers of products, including shipbuilders, may owe a duty of care to the end consumer or user. In addition to tort law, end users of defective products in Lagos State may have recourse against a manufacturer for damages under section 20 of the Law Reform (Torts) Law of Lagos State, Cap L82, Laws of Lagos State of Nigeria, 2015 (LRTL). The law stipulates that a manufacturer is liable for any damage caused wholly or partly by a defective product. Besides Lagos State, other federating states of Nigeria have promulgated laws similar to the LRTL regulating the manufacture and sale of defective products within their territorial jurisdiction.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

Under Nigerian law, parties to a contract are at liberty to fix damages payable in the event of a breach. However, such agreed compensation must represent a genuine link with the damages suffered. Specifically, it has been held that where parties to a contract, as part of the agreement between them, fix the amount payable on the default of one of them or in the event of breach by way of damages, such sum is classified as liquidated damages where it is in the nature of a genuine pre-estimate of the damage that would arise from breach of the contract. Where the fixed amount is unrelated to the actual damage or loss suffered, it is considered a penalty and, therefore, unjustifiable. While penalty provisions are generally unenforceable under Nigerian law, a Nigerian court will not mitigate liquidated damages agreed in a contract.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

The liquidated damages provision in the contract limits the liability of the party in breach. Therefore, a buyer will be precluded from claiming higher damages where parties have agreed on a certain sum as liquidated damages in relation to a particular breach. However, nothing precludes a party from claiming higher damages where such arise out of a breach separate from that in respect of which there has been an agreed sum. Also, a buyer may claim higher damages if it is expressly stated in the contract that the buyer may do so in circumstances where the actual damages exceed the quantum of liquidated damages agreed by the parties.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

Under Nigerian law, parties to a contract are at liberty to design the terms of their contract, including terms concerning force majeure. Where a force majeure clause is included in the contract, it is common for the parties to specify the events constituting force majeure and the consequences of the occurrence of such events.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

In Nigeria, umbrella insurance is available to shipbuilders and their subcontractors. This takes the form of an 'all-risks' insurance covering each and every aspect of the project.

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

Nigerian courts have consistently held that it is not the duty of any court or tribunal to make contracts for the parties. The duty of the court is limited to the construction of contracts for the purposes of enforcement of the rights and obligations of the parties. The same can also be said of arbitration tribunals. The common practice is for parties to agree to refer any 'disputable' alteration to a clause in the contract to an agreed independent third party, usually an expert in the subject matter of the dispute. The decision of the expert in such a situation is usually final and binding on the parties.

Therefore, courts in Nigeria and arbitration tribunals are unlikely to set terms of a contract even where the parties are unable to reach an agreement on alteration to key terms or modification to specifications.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

Generally, in the absence of fraud or misrepresentation, parties are bound by the terms of their contract. Therefore, a buyer will be bound where he or she contracts that his or her acceptance of the vessel shall be final and binding to the extent that conformity of the vessel to the contract and specifications is concerned. However, because the purpose of the protocol is to confirm the time of the delivery of the vessel by the builder and the terms of acceptance by the buyer, the buyer may have a right of action for damages against the shipbuilder for latent defects. This is the case notwithstanding the fact that the protocol states that the buyer's acceptance of the vessel shall be final and binding. Essentially, where specific (latent) defects are detected after delivery, the buyer will have a right of action against the builder for breach of any implied term of the contract such as fitness for purpose.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

Nigerian law does not govern any of the foregoing scenarios. In such cases, party autonomy would prevail. As such, parties are at liberty to negotiate and agree suitable contractual terms in their shipbuilding contracts that would apply in such cases.

Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

In view of the fact that the subcontract is between the shipbuilder and third-party suppliers or subcontractors, any right or claim arising from the subcontract will be against the shipbuilder. Consequently, while suppliers or subcontractors may exercise a lien over work or equipment to be incorporated in the vessel pending the settlement of any outstanding invoices, they may not be able to exercise such lien over the vessel.

Under the Merchant Shipping Act, a shipbuilder may exercise a lien or right of retention to secure claims for building or repairs of the ship. The lien or right of retention is, however, extinguished where the shipbuilder ceases to be in possession of the ship.

It is an implied term of section 12(3) of the Sale of Goods Act 1893 that at the time of delivery, the vessel shall be free from all liens, charges and encumbrances in favour of any third party not declared to or known to the buyer before or at the time when the contract was made.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

A subcontractor or supplier may reserve title in the materials or equipment to be affixed or incorporated in the vessel under construction until payment is made by the shipbuilder for the materials or equipment. However, where the materials or equipment subject to a reservation of title clause are affixed to the vessel and the vessel is delivered to the buyer, the fact that the shipbuilder has not paid for the materials or equipment will not affect the title transferred to the buyer.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

Third-party creditors can obtain a security attachment over the vessel under construction or equipment to be incorporated in the vessel. This will, however, be subject to the builder's statutory right of retention.

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

Generally, rights and obligations under a contract can be assigned or novated respectively to a third party except where this is not permitted by the express terms of the contract. The legal effect of such an assignment is that the buyer assumes all the rights relating to the assigned warranty.

There is no legislation that entitles a buyer to make a direct claim under the subcontractor's or manufacturer's warranty. Therefore, unless such warranty is assigned to the buyer, the buyer cannot make a direct claim under the subcontractor's or manufacturer's warranty.

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

Generally, under Nigerian law, a party's default in the performance of its obligations under a valid contract constitutes a breach of contract. Parties, however, usually agree on the events that would constitute a breach of contract. The remedies are usually dependent on the nature and materiality of the breach. For example, where one party has committed a serious breach of contract, the innocent party has a right to rescind the contract. It has been held that the contract is in such circumstances rescinded de futuro. One of the legal effects of rescission is that it discharges the innocent party of further obligations under the contract.

Apart from rescission, an innocent party may also make a claim for damages or specific performance or both. With respect to damages, the damages recoverable are the losses reasonably foreseeable by the parties and foreseen by them at the time of the contract as inevitably arising if one of them broke faith with the other. It has been held that in the contemplation of such a loss, there can be no room for claims that are merely speculative or sentimental unless these are specially provided for by the terms of the contract on the occurrence of an event of default.

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Specific performance is an equitable relief usually granted against a defendant or respondent to ensure the performance of its obligations under the contract. It is a discretionary remedy and would not be granted where a claimant would be adequately compensated by damages.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

Generally, under Nigerian law, a party's default in the performance of its obligations under a valid contract constitutes a breach of contract. Parties, however, usually agree on the events that would constitute a breach of contract. The remedies are usually dependent on the nature and materiality of the breach. For example, where one party has committed a serious breach of contract, the innocent party has a right to rescind the contract. It has been held that the contract is in such circumstances rescinded de futuro. One of the legal effects of rescission is that it discharges the innocent party of further obligations under the contract.

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Specific performance is an equitable relief usually granted against a defendant or respondent to ensure the performance of its obligations under the contract. It is a discretionary remedy and would not be granted where a claimant would be adequately compensated by damages.

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

Nigerian courts will uphold the terms of a contract provided there are no vitiating elements. Consequently, where parties have by their contract agreed to terminate for insolvency, Nigerian courts will uphold such a clause.

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

Arbitration is the commonly agreed mechanism for the resolution of disputes arising from a shipbuilding contract. The London Maritime Arbitrators' Association appears to be the most frequently selected arbitral institution.

With regard to courts, however, by virtue of section 251(1)(g) of the Nigerian Constitution, matters pertaining to admiralty jurisdiction are within the exclusive jurisdiction of the Federal High Court. The admiralty jurisdiction of the Federal High Court includes maritime claims and section 2(3)(l) of the Admiralty Jurisdiction Act 2004 classifies claims in respect of shipbuilding contracts as a maritime claim. Therefore, disputes arising out of or in relation to a shipbuilding contract can only be entertained by the Federal High Court, except where the parties have agreed to refer the dispute to arbitration.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

In the event of insolvency or moratorium of creditors of the shipbuilder, the question of whether the buyer can exercise a contractual right to take possession of the vessel under construction and continue construction will depend on whether title to the vessel under construction has passed to the buyer. Where title to the vessel under construction has passed to the buyer, the buyer will be entitled to exercise proprietary rights of ownership (such as taking possession) to the exclusion of the receiver or liquidator. However, that will not be the case where title to the vessel under construction resides with the shipbuilder. In such circumstances, the right of the receiver or liquidator to possession of the vessel under construction will defeat the interest of the buyer.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

Parties have the freedom to agree on the mechanism by which disputes are to be resolved. This includes ADR. There is, however, a preference for arbitration over other forms of ADR.

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

Where a buyer defaults in the performance of the shipbuilding contract, the builder may have recourse to those remedies specified in the contract. However, the ship is the builder's ultimate security. Therefore, where, for instance, the buyer refuses to pay, the builder can enforce its rights as an unpaid seller as provided in the Sale of Goods Act 1893.

Generally, the consequence of cancellation of a contract is that parties are discharged from performing future obligations under the contract. However, the parties will still be liable for any breach of the contract that occurred prior to cancellation.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

No particular standard forms are predominantly used in drafting shipbuilding contracts in Nigeria. However, Norwegian forms and the Shipbuilders' Association of Japan form have been preferred in shipbuilding contracts concluded in Nigeria.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

In Nigeria, there are no statutory requirements for the assignment of shipbuilding contracts. However, general rules of common law of contract will apply.

The effect of an express clause prohibiting assignment in the contract is that neither party can assign its rights or benefits under the contract. Any assignment under the contract will be ineffective. It is, however, common for parties to specifically limit or prohibit either or both parties from assigning their rights under the contract. A typical example of such limitations is the requirement for consent from one or other of the parties to the contract, and such consent is not to be unreasonably withheld.

Generally, the form of an assignment will depend on the prior agreement of the parties. A mere notice will, however, suffice where the subject of the assignment is the rights or benefits of a party under the contract. Where the assignment relates to the liability or burden under the contract, a novation agreement will be required.

Where the subject matter of the assignment is the rights or benefits under contract, the original contract will survive such an assignment. However, where the assignment relates to the liability and obligations under the contract (usually pursuant to a novation agreement), the original contract is discharged and the new party will assume the liability and obligations originally agreed by the relevant party novating its obligations under the contract.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

No updates at this time.

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

There are no restrictions on foreign participation in the capital of shipbuilding companies as such. However, certain shipbuilding companies are involved in building both civilian vessels and naval ships and are, thus, licensed to produce military equipment and armaments. Under the current regulations, transactions aimed at imposing direct or indirect control (through shareholding, obtaining the right to nominate the majority of members of executive and advisory bodies of the company and otherwise) on enterprises of strategic importance, including companies that hold licences for the production of armaments and military equipment, require special permission from the competent federal authorities.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

In the recent past, the majority of state-owned assets relating to shipbuilding have been consolidated into the United Shipbuilding Corporation (USC). Through a 100 per cent stakeholding in the USC holding company, the Russian Federation controls over 40 shipbuilding and ship-repair facilities.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

In accordance with Russian law, transactions between legal entities and between legal entities and individuals must be made in writing. Theoretically, the legal requirements for a written contract may be considered satisfied if the parties do not sign a single document, but instead exchange a number of documents, as well as signing documents with an electronic signature. However, in most cases, shipbuilding contracts are executed as a single principal document, with addendums and attachments if necessary. Until the recent amendments to the Civil Code of the Russian Federation, a foreign trade contract, meaning a transaction between a Russian and a non-Russian party was considered to be void unless it was made in written form. This restriction has now been abolished, but owing to customs, currency control and other administrative requirements, it is still highly advisable, when entering into contracts with Russian counterparts, to execute them in the form of one single document.

No taxes, duties or other such payments to the state are due when entering a shipbuilding contract (unless the parties choose the contract to be made in notarial form, in which case state duties and notaries' fees are payable for certification).

It should also be taken into account that where the customer is a state-owned entity, or a company with state capital, entry into shipbuilding contracts would be subject to procurement regulations. In most cases, this would mean that a contractor will be chosen on the basis of a tender procedure.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

Generally, Russian law recognises the right of the parties to a contract to choose the law applicable to the contract. However, ships are considered to be immovable property, and article 1213 of the Civil Code provides that contracts in respect of immovable property that is physically located on the territory of the Russian Federation are subject to Russian law. Therefore, when entering into a contract in respect of a vessel that is intended to be constructed in Russia, the parties will need to choose Russian law to govern it.

In cases where state-owned companies or companies with state capital declare tenders for newbuilding, forms of contracts are published in advance and these are normally subject to Russian law.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

There is no uniform practice and no single approach in this respect. Depending on the provisions of a particular contract and on the way in which particular issues are regulated by the contract (such as the moment of passing of title, the extent of the customer's rights to supervise or control works in the construction stage and the customer's role in supplying materials for construction), a shipbuilding contract may be treated as a contract for sale and purchase of immovable property, as a contract to construct a structure or as a contract of mixed nature. Russian law does not provide for specific regulations in respect of shipbuilding contracts, but provisions that regulate construction contracts are, in general, more suitable for reflecting the peculiarities of shipbuilding transactions than the provisions regulating contracts of sale and purchase.

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

The vessel's construction number is an essential element of description of the vessel under construction. Under the present regulations, registration of the vessel under construction and of the title thereto is not obligatory. However, if the parties so agree or otherwise wish the vessel or title to the vessel to be registered, the construction number becomes the principal number by which the vessel and information in the registry pertaining thereto are identified. Therefore, the construction number is an important element of the parties' agreement in general, whether or not it is intended for the vessel to be registered prior to completion.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

The builder will be able to deviate only within the explicit and implied parameters of the contract, taking into consideration also the applicable classification rules or requirements of law (or both). In case of dispute (including cases when the contractual description is approximate and implies a certain possibility to deviate), the competent tribunal will be required to determine whether such deviation was acceptable.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

Yes, should the parties wish to include certain standards of performance in the contract, they are free to do so. As a general rule, the customer will be entitled to rescind and claim damages only where the breach or defects are substantial and incurable or where the builder fails to cure the defects within a reasonable time at no extra cost to the buyer. The builder may also be held liable for any delays (failure to meet a building schedule provided in the contract).

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

Russian law in general does not provide for specific quality standards in respect of ship-building contracts. In most cases, a shipbuilding contract will be treated as a sale and purchase contract or a contract to construct a vessel. General rules in respect of quality of goods, works and services, as provided in the law and, in particular, in the Russian Civil Code will apply. A special act that sets certain particular requirements to be complied with by shipbuilders is the Technical Regulations for Safety of Marine Transport Facilities. In addition, the builder will also need to comply with the requirements set by the classification society that will be supervising the construction of the vessel. However, court practice (judgments of commercial courts and practice guidance issued by the Higher Arbitration Court, the supreme commercial instance) is also important for understanding the courts' policy in construction of provisions of the legislation.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

Where it is the builder that contracts with the classification society, the customer will only be able to sue the builder directly and the builder would need to make a claim against the society for recourse. The customer may sue the classification society both for non-fulfilment and for improper fulfilment of the latter's obligations undertaken only under a direct contract with the customer. Practical implementation of this right will depend on the provisions of the particular contract between the customer and the classification society. For example, the standard contract of the Russian Maritime Register of Ships (the bigger of the two Russian classification societies, and a member of the International Association of Classification Societies) for supervision of the construction of a vessel substantively limits both the basis of the society's liability and the extent of such liability.

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Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

In accordance with both the Merchant Shipping Code (article 22) and the Code of Internal Water Transport (article 35), all ships that are subject to state registration (namely, all vessels with the exception of certain types of small craft) are subject to classification and survey. Responsibility for the classification and survey of vessels that are registered (or are intended to be registered) under the Russian flag is delegated to the specialist organisations authorised by the federal government – classification societies. Essentially, classification societies oversee compliance with most of the technical requirements of the flag state, namely, those relating to vessels' design, equipment, materials and technical operation. There are different classification societies for different types of vessel. At present, the classification societies are as follows: the Russian Maritime Register of Ships (for seagoing vessels), the Russian River Register of Ships (for riverine ships) and also, in respect only of those ships that are registered in the Russian International Registry of Ships – a foreign classification society, Bureau Veritas and Registro Italiano Navale.

At the same time, general control over compliance with the requirements of international conventions on merchant shipping to which Russia is a party and with the national legislation regarding merchant shipping is largely a responsibility of harbour masters.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

The parties are free to define in the contract the moment when the title to a vessel under construction shall pass. Registration of title to a vessel under construction is not obligatory under Russian law but is possible at the discretion of the parties concerned. In such cases, title to the ships may be registered with the harbour masters and with river inspectorates. Registration may be made in the name of either the shipbuilder or the buyer. The principal legal consequence is that, in the case of registration of title, any transfer of title and other rights must also be registered and shall not be valid without such registration.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

Yes. The parties may agree on the moment when the title may pass. A vessel under construction can be registered from the time when the keel is laid or equivalent actions signifying the commencement of construction are effected – thus, from this moment the buyer can obtain title thereto. Parties are also permitted to each hold a certain proportion of the title and for one party's title to transfer to the other on an incremental basis. It should, however, be

noted that in cases where the title to a vessel under construction is registered, any passing of title and any change in parties' shares of a title must be registered as well.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

By default, the risk will pass with delivery of the vessel to the purchaser and, in case of a contract to build a vessel, it may also be possible that certain parts of the vessel may be agreed to be accepted by the customer separately, in which case risk adhering to such parts as are accepted will pass to the customer. The law also allows the parties to agree on a different moment of passing of risks, but in such a case this must be clearly stated in the contract.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

The builder may, unless expressly restricted from doing so by the contract, subcontract part of the works under the shipbuilding contract. However, the builder shall remain responsible to the customer for proper fulfilment of the terms of the contract and both its own performance and the performance of any subcontractors. A maker's list is sometimes included in the contract; typically, the appointment of major subcontractors would require approval by the customer.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

There are no specific restrictions in this respect, unless the parties provide so in the contract.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

No. However, the parties are generally free to determine in the contract the price or a method of its determination.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

In accordance with the provisions of the Civil Code, the builder is generally entitled to demand an increase if the contract price if, owing to circumstances beyond its control, the total increase of cost of the building works exceeds the original estimate by more than 10 per cent.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

Theoretically, Russian law allows the invalidation of a transaction that has been entered into under the influence of deceit, error, violence, threats or conspiracy between the representative of one party and another party to the contract, or if it has been entered into by one of the parties in difficult circumstances and on extremely unfavourable terms. In practice, however, it is highly unlikely that the court will be willing to satisfy such a claim in case of a transaction between two businesses, other than in truly exceptional circumstances.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

Yes, the parties are entitled to restrict the right to set off, suspend payment or deduct payment in the contract.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

There are no special requirements for refund guarantees other than those that exist in respect of guarantees or suretyships of any kind, and no official permissions are required.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

As with refund guarantees, there are no specific requirements for payment and parent company guarantees other than the general legal requirements concerning such types of obligation. Regarding practical formalities, it must be noted that many Russian companies

restrict the authority of their executive bodies to issue and undertake financial obligations, especially guarantees and suretyships. In many cases, the issue of such undertakings requires explicit approval from particular managing bodies of the company, such as the board of directors or the general meeting and may be invalidated in case of failure to obtain such approval.

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

Yes. It is possible to mortgage a vessel under construction, provided that, prior to the registration of a mortgage, it has been registered as a vessel under construction. However, it should be noted that in accordance with the current regulations, if the vessel is being built for a foreign customer or buyer, its mortgage may not be registered in Russia.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

Yes – however, the builder may only be held liable for defective design where it undertook to provide such design to the customer and not in cases where the customer itself provided design documents and other technical elements to the builder.

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

As a general rule, remedies for defectiveness will be available to the customer only. Third parties who may have sustained losses when the ultimate cause of such losses is a confirmed misperformance on the part of the shipbuilder will need to claim, depending on the circumstances, against the owner or the operator of the vessel in question, and the latter may be entitled to recourse against the builder.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

Russian law recognises the right of the parties to include in the contract a provision on penalties (as sanctions) for non-performance or improper performance of obligations. To a certain extent, the obligation to pay a penalty is independent of the obligation to compensate losses: the injured party is neither obliged to prove that it sustained losses owing to improper performance nor the extent of such losses. However, if the injured party demands compensation of losses in addition to the payment of a penalty, losses shall be compensated to the extent in which they are not covered by the penalty, unless the contract explicitly provides otherwise. The courts are entitled to reduce the amount of a penalty due if that penalty is manifestly disproportionate to the consequences of the violation of an obligation.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

In accordance with the general rule, an injured party may claim for losses that exceed the amount of the penalty. However, the parties may also contractually agree to a different regime under which, for example, losses may not be claimed in excess of the contractual penalty, or when losses can be claimed in full in addition to the penalty.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

Yes, the parties are relatively free to design the force majeure clause, provided that they do not clearly depart from the general definition of force majeure as provided in the law (namely, 'extraordinary and unavoidable circumstances').

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

Such insurance is technically possible. Note that in accordance with Russian law, insurance of the risk of non-performance of the party's own contractual obligations is not possible, unless it is explicitly provided for by the law and currently the law does not provide such a possibility for construction contracts. Therefore, risks related to performance of the contract may be insured to the extent of risks relating to the safety of the object under construction and damage to third parties.

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Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

In cases of an adverse change of circumstances, the parties may, inter alia, demand to have the contract amended or terminated by the court. One of the instances where such right is explicitly provided for in law is when the initially intended cost of construction works is exceeded by not less than 10 per cent of the amount agreed to in the contract. A change of circumstances will be considered adverse if the court agrees that, should the parties have been able to reasonably foresee such change, they would not have entered into the contract in question, or would have negotiated substantially different terms. However, amendment of contractual terms by the court is an exception from the general rule that a contract may be terminated in case of an adverse change of circumstances – the court shall amend the terms only where the termination of the contract will be contrary to the public interest or would cause the parties more substantial damages than would performance of the contract on terms amended by the court.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

No. Even if a buyer has signed such a protocol, he or she is entitled to claim against the builder for defects that are owing to the underperformance of the builder within a term of five years of the date of delivery. However, it would be up to the buyer to prove that such defects exist and that the builder is responsible for them.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

Yes – if the contract provides for such right of the buyer, the buyer is entitled to arrange for the vessel's defects to be cured by a third party and claim the relevant costs from the builder, which include both the cost of actual work and expenses connected with moving the vessel to the repairs' facility and its docking, plus other associated costs.

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Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

It is unlikely that suppliers or subcontractors of the builder would be able to exercise a lien over the vessel, because, in accordance with Russian law (both in general and in respect of ships under construction or repair), a necessary precondition for the exercise of a lien is physical possession by the creditor of the particular item of the debtor's property. Therefore, it is most likely that only the builder will be able to exercise such right. Also, the general rule of Russian civil law provides that goods sold on condition of payment due after delivery of the goods remain pledged in favour of the seller until they are paid for. Therefore, there is also a slight possibility that the equipment in question may be under the original supplier's pledge. However, another general rule provides that the pledge is terminated by acquisition against consideration by a third party that was not aware, and should not have been aware, that the item in question was pledged.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

As a general rule, items incorporated into a vessel under construction will cease to be treated as separate items and, depending on the value of works relative to the value of materials and equipment, it will be either the owner of the incorporated equipment and materials or the builder that will obtain the title to a newly constructed vessel. However, considering the realities of an average shipbuilding project, this may be treated as a purely hypothetical situation and the title will most likely (depending on the provisions of the ship-building contract in question and in particular on how the parties have agreed to regulate the issue of passing of title in the contract) be acquired either by the builder or the buyer. If there are any unpaid debts to suppliers of equipment and materials, the party obtaining title to the vessel will assume the obligation to discharge those debts.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

Depending on whose property such items shall be at the respective time (customer's or builder's), third-party creditors may seek enforcement or security of claims against the respective parties, including application of the appropriate security measures, such as arrest.

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Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

Yes. The law allows the parties (provided that they directly agreed so in the contract) to entitle the buyer and subcontractors to be able to claim against each other directly. By default, each of them will only be able to direct their claims to the contractor that has direct legal relations with both sides.

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

Where the builder has permitted violations of the terms of the contract that resulted in a loss of quality or in other defects in the vessel, including violations of the design and other technical specifications in accordance with which the vessel was being built, the customer is normally entitled:

- to demand that the builder remedy the defects at no extra cost to the customer and within a reasonable time;
- to demand a proportionate decrease in the price of the vessel; or
- where the contract entitles the customer to remedy the defects by itself or by hiring third-party contractors, to compensation of the ensuing expenses.

If the defects have not been remedied as demanded by the customer or if they are substantial and incurable, the customer is entitled to treat the contract as repudiated and claim against the builder for the compensation of losses. There is no explicit requirement in the law to send a formal notice to the builder first, but where the buyer incurs costs without notifying the builder, it will be the buyer's duty in case of a subsequent dispute to prove that such expenses were due to the builder's breach, as well as the adequacy of the amounts of such expenditures.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

As a general rule that also applies to shipbuilding contracts, in the case of delay, the debtor that delays performance may be held liable for any losses of the creditor incurred owing to the delay. If a delay has been so substantial that the creditor has lost interest in the performance, the creditor is entitled to refuse to accept the object of the performance (in this instance the vessel itself), thereby terminating the contract, and to claim losses from the shipbuilder.

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Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

Yes, the parties may agree to terminate the contract in case of either party's insolvency. However, this would not affect the order of mutual settlements, which would still need to be performed in accordance with the requirements set by the legislation on bankruptcy. Thus, the customer's claims against the builder (if any) would need to be brought and will be satisfied in the same order as claims of any other creditors of similar ranking; any customer's debts to the builder's estate will also be recovered in general order. Transactions conducted between the buyer and the builder after insolvency was declared and prior to that – from the time when signs of insolvency became apparent, such as set-off, can be scrutinised in the course of insolvency proceedings and could be invalidated by the court.

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

Considering that Russian law regards ships as immovable property, Russian courts are likely to have exclusive jurisdiction. The parties are also entitled to resolve disputes arising from shipbuilding contracts by arbitration, but for the arbitral awards to be enforceable in Russia, a relevant arbitration institution needs to be admitted to resolving commercial disputes on the territory of Russia.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

This would depend on the particular situation, primarily on the title to the vessel and to the materials used in its construction, as well as on the availability of a mortgage on the ship.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

ADR and mediation have not yet gained popularity in Russia as methods of resolving commercial disputes, but in 2010, a special federal law was adopted, the main aim of which was to provide a basic framework for the development of alternative dispute resolution.

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

Depending on the particulars of the breach, either party may demand compensation of losses incurred (including, where appropriate, interest, lost profits, costs of works and services rendered by third-party contractors hired in place of the defaulting builder, etc), payment of penalties (if agreed on), termination of the contract, return of amounts paid and enforcement of security measures agreed on (guarantees, suretyships, pledges).

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

It is not unusual for standard forms of shipbuilding contracts, such as the Baltic and International Maritime Conference's Newbuildcon, to be used as a basis for drafting particular contracts, but normally they are substantially amended to reflect the requirements of Russian law and the realities of Russian commercial practice.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

The contract may be assigned to the third party with the exception of certain rights that are closely connected with the identity of the creditor (which is normally not the case for commercial contracts). The right to assign a contract may be limited by the contract itself but, in accordance with the current rules, such limitation may not always be enforceable. Assignment must be effected in the same way as for the principal contract, and in cases where the contract or its object are subject to state registration (eg, as vessels under construction that have been registered), assignment must also be registered for the corresponding rights of the customer to be valid. Notification of the debtor is not, strictly speaking, obligatory, but unless such notification is effected in writing, the creditors bear the burden of negative consequences. Notification may be effected by either a new or old creditor, but notification by a new creditor may be disregarded by the debtor unless accompanied by proof of assignment (eg, a copy of the assignment agreement). The contract and respective rights and obligations are assigned in the full extent in which they exist as on the date of the assignment.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

In the past few years, the Russian government has undertaken substantial efforts to facilitate the development of the regions of the far east and the extreme north (the Arctic coast) of the country. These measures are, among other things, aimed at the development of these regions' transport infrastructure and promotion of the northern sea route (the North-East Passage) as a new international transit route connecting Europe and Asia. The new projects fuel demand for new transport and service vessels and the development of the shipbuilding industry in Russia has been determined as one of the most important targets. Measures to support the industry include tax benefits, facilitation of international cooperation in the form of joint ventures and state procurement preferences.

* *The information in this chapter was accurate as at 10 February 2022.*

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

The shipbuilding industry in Singapore is open to foreign participation and investment. There are no restrictions on foreign participation.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

The government of Singapore, through its investment holding company, Temasek Holdings Limited, holds the majority stake in three publicly listed companies owning major shipyards in Singapore: Sembcorp Industries Limited, Keppel Corporation Limited and Singapore Technologies Limited. The reason for this is that shipbuilding and ship repair provide significant employment opportunities and also constitute a strategic industry. To the best of our knowledge, there are no plans for the government to divest itself of such participation or control.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

No.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

The parties to a shipbuilding contract may select the law to apply to the contract, and this choice of law will be upheld by the Singapore courts on condition that this law is not against public policy in Singapore.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

Shipbuilding contracts are regarded both as contracts for sale and purchase and as contracts for the supply of workmanship and materials.

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

The hull number stated in the contract is essential to the vessel's description.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

Approximate dimensions and description of the vessel allow the builder to deviate from the figure stated. The builder has a latitude of about 5 per cent.

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

Parties may incorporate guaranteed standards of performance, the breach of which would entitle the buyer to liquidated damages or rescission. There are no trade standards for coating, noise and vibration in Singapore.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

No. Statutory provisions and case law in Singapore have not given greater definition to contractual quality standards. However, previous decisions that deal with general good practice in shipbuilding will guide the court or the arbitration tribunal on such matters.

There are no trade standards in this regard in Singapore.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

The classification society owes a duty of care to the buyer and the buyer can successfully sue the classification society if certain defects in the vessel escape the attention of the class surveyors.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

The flag-state authorities in Singapore have fully outsourced compliance with flag-state legislation to the following classification societies:

- the American Bureau of Shipping;
- Lloyd's Register of Shipping;
- Bureau Veritas;
- DNV GL;
- the Korean Register of Shipping;
- the China Classification Society;
- Registro Italiano Navale; and
- Nippon Kaiji Kyokai.

Read this article on Lexology

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

Singapore does not permit registration of a vessel under construction with the Maritime and Port Authority of Singapore in the name of the builder or the buyer until the builder's certificate in favour of the party intending to register the vessel, the tonnage attestation and the class attestation are issued.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

The parties may contract that title will pass from the builder to the buyer during construction. The issues of whether title passes gradually upon the progress of the vessel's construction or at a certain stage and the earliest stage a buyer can obtain title to the vessel will depend on the terms of the shipbuilding contract.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

The question of when risk will pass depends on the terms of the shipbuilding contract. If the issue is not addressed in the shipbuilding contract, the risk will pass with title.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

A shipbuilder may subcontract all or part of a contract. It will not, however, have a bearing on the builder's liability towards the buyer. There is a practice to include a maker's list of major suppliers and subcontractors in the contract.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

If title to the vessel passes to the buyer progressively, the builder must inform the buyer of its intention to have certain main items constructed in another country as it would have an impact on the security to be granted by the buyer to its financiers. Shipbuilding contracts may also specify that the vessel must be constructed at the builder's yard located in, say, Singapore and at no other location.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

Singaporean law does not have different provisions for fixed-price contracts and labour-and-cost-plus contracts. However, shipyards must be prepared to construct specific vessels on a turnkey basis or on cost-plus terms. This is typical in the construction of offshore vessels.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

The builder does not have any statutory remedies available to charge the buyer for price increases in labour and material, despite the contract having a fixed price.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

Depending on the facts of the situation, a buyer may be able to retract consent to an increase in price by arguing that consent was induced by economic duress. English common law principles relating to economic duress can be of assistance in Singapore.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

The builder and the buyer may agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts. In practice, however, if the buyer exercises these rights and if

this causes a delay in the delivery of the vessel, it is usual for the shipyard to obtain security by way of a banker's guarantee and to deliver the vessel.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

There are no rules with regard to the form and wording of refund guarantees. No permission is required from any authority.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

The guarantees must be in writing. For parent company guarantees, it would be prudent to obtain the resolutions of the board of directors of the parent company approving the issuance of the guarantee.

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

A mortgage over a vessel under construction can only be created if the vessel is registered with the Maritime and Port Authority and title to the vessel vests with the mortgagor. However, depending on who has title to the vessel (under construction), the builder and the buyer may create a charge over the vessel as constructed. If the builder or the buyer (as the case may be) is a Singapore-incorporated company, such a charge must be registered with the Accounting and Corporate Regulatory Authority of Singapore within the time period stipulated in the Companies Act.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

It depends on who takes design responsibility under the shipbuilding contract. If responsibility for designing vests with the shipbuilder and a defective design affects the vessel's performance, then the shipbuilder will be and can be held liable under the warranty clause of the shipbuilding contract.

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

Unless its application is expressly excluded by the terms of the shipbuilding contract, the Contracts (Rights of Third Parties) Act provides in essence that a third party may directly enforce a term of a contract where either the contract expressly provides that it may or the contracting parties intend that such third party should be entitled to do so. 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'.

Except as stated, there are no remedies available to third parties against the shipbuilder for defects.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

The agreed level of compensation must be a genuine pre-estimate of the loss. If not, the courts can strike down such liquidated damages or penalty clauses.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

Yes, the buyer is precluded from claiming proven higher damages for that head of claim (namely, for late delivery). The shipbuilder usually will not take responsibility contractually for consequential damages.

Force majeure

28 Are the parties free to design the force majeure clause of the contract?

Yes, parties are free to design the force majeure clause of the contract. However, being an exemption clause, it will be interpreted strictly.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

Yes, construction all-risks insurance is available in the market covering the builder and all named subcontractors of a particular project for the builder's risks.

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

If dispute resolution is taken through the Singaporean courts, this will be left to the builder and the buyer to resolve – the Singaporean courts will not be prepared to set terms. However, if dispute resolution is conducted by arbitration and if the shipbuilding contract gives the arbitrators the power to set terms, then the arbitration tribunal can set the terms if the parties are unable to reach agreement.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

It will not preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery. Those claims will be subject to the statutory limitation of claims under Singaporean laws governing limitation.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

These issues will be determined by the terms of the shipbuilding contract.

Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

Suppliers or subcontractors of the shipbuilder may exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices, provided they have possession over the equipment or work. Such claims are possessory in nature. There is an implied term that at the time of delivery, the vessel shall be free from all liens, charges and encumbrances.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

A reservation of title by a subcontractor or supplier of materials and equipment will not survive affixing to or incorporation in the vessel under construction, as it will be difficult to identify the work or equipment after it is integrated into the construction.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

Third-party creditors of the builder may be able to obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel.

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

A subcontractor's or manufacturer's warranty may be assigned to the buyer if there is no express restriction on such assignment. There is no legislation that entitles the buyer to make a direct claim under the subcontractor's or manufacturer's warranty. In practice, such warranties are usually for one year and construction of the vessel can take longer than one year after delivery of the equipment to the shipyard. It is more common to rely on the contractual warranties between builder and buyer.

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

There is no legal requirement under Singaporean law to put the builder in default by sending an official notice if there is no such requirement under the terms of the shipbuilding contract.

The usual remedy will be a claim for damages. Specific performance may be ordered where the buyer can prove that damages will not be an adequate remedy. All this will also depend on the shipbuilding contract. The buyer may also seek to remove the vessel to another yard (if the buyer has title to the vessel under construction), and complete the construction.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

A protracted failure to construct or continue construction by the shipbuilder may entitle the buyer to claim that the contract has been frustrated by breach. If successful in this claim, the buyer can recover monies paid to the builder on the basis of a total failure of consideration.

A protracted failure to construct or continue construction can also be a fundamental breach of contract by the builder that will entitle the buyer to terminate the construction and claim damages from the builder for breach of contract.

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

Yes, a buyer's contractual right to terminate the shipbuilding contract for the builder's insolvency would be enforceable in Singapore.

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

The Singapore Chamber of Maritime Arbitration and the Singapore International Arbitration Centre are commonly agreed on. The Singapore High Court also has specialised judges to deal with shipbuilding contract disputes.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

This question has not yet been determined by a Singaporean court. Where an insolvency proceeding or a moratorium of proceedings is in place, further proceedings against the Singapore builder may be restrained or stayed by the court and hence cannot be proceeded with except with the leave of court. The enforceability of the buyer's contractual right to take possession of the vessel under construction will usually take into account the exact wording of the contractual term. Generally, where the buyer has title to the partly constructed vessel, it is arguable that the buyer's right to take possession of the uncompleted vessel survives the insolvency or moratorium of creditors of the Singapore builder and an application can be made to the Singapore court for leave to commence or continue legal proceedings against the Singapore builder to enforce its rights under the shipbuilding contract. On the contrary, if the title to the uncompleted vessel vests in the builder, which is commonly the case, it can be expected that it will be more difficult for leave of the Singapore court to be obtained for the buyer to enforce its right to take possession of the uncompleted vessel as the buyer is an unsecured creditor, unless a valid admiralty writ in rem has been issued by the buyer in respect of the uncompleted vessel before the insolvency proceeding or moratorium are in place, such that the buyer thereby qualifies as a secured creditor against the Singapore builder. If the builder is subject to insolvency or restructuring proceedings in other jurisdictions, the Singapore court may restrain or stay Singapore legal proceedings against the builder on application of the builder, pending the outcome of the foreign insolvency or restructuring proceedings as Singapore has adopted the UNCITRAL Model Law on Cross Border Insolvency.

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

Yes, parties do tend to incorporate an ADR clause in shipbuilding contracts.

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

The remedies would usually be specified in the shipbuilding contract. These would include the right of the builder to rescind the shipbuilding contract, to sell the vessel by public auction or by private treaty and, in the event of a shortfall between the sale price recovered by the builder and the construction cost under the shipbuilding contract, to recover the shortfall from the buyer.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

The Shipbuilders' Association of Japan and the Association of European Shipbuilders and Shiprepairers forms are predominantly used.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

Under Singaporean law, only rights and benefits can be assigned, not liabilities and obligations. There are no statutory requirements for assignment of a contract to a third party. In the event of a contractual prohibition against assignment, the consent of each counterparty to the contract must be obtained prior to the assignment. There is no requirement for an assignment to be in the form of a tripartite agreement – it can be in the form of a deed entered into by the assignor in favour of the assignee. Such an assignment is perfected by the service of the notice of assignment on the other contracting parties. The original contract is not discharged by the assignment and the assignee does not assume all rights and obligations ab initio.

If the rights, benefits, liabilities and obligations under a contract are to be transferred by one party to another, this transfer can be effected by way of a novation agreement, to be executed by all the original parties to the contract and the new transferee. The new transferee can assume all rights and obligations under the contract ab initio if the novation agreement expressly provides for it.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

The upcoming merger (scheduled in 2023) of the shipyard operations of Sembcorp Industries Limited and Keppel Corporation Limited.

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Summary

PARTICIPATION AND OWNERSHIP

Restrictions on foreign participation and investment

1 Is the shipbuilding industry in your country open to foreign participation and investment? If it is open, please specify any restrictions on foreign participation.

The Turkish shipbuilding industry is open to foreign participation and investment and there are no restrictions on foreign participation in the shipbuilding industry.

Furthermore, as per article 935/2(c) of the Turkish Commercial Code (TCC) and the provisions referred to therein, newbuilding vessels can be registered with the Newbuilding Registry, regardless of whether their owners are foreign persons or entities.

Government ownership of shipbuilding facilities

2 Does government retain ownership or control of any shipbuilding facilities and, if so, why? Are there any plans for the government divesting itself of that participation or control?

The Constitution of the Republic of Turkey and Coastal Law No. 3621 stipulate that the coasts are under the authority and at the disposal of the state, and the public (national) interest shall have priority in benefiting from the coasts. Therefore, the state retains ownership of the coastal areas in which shipbuilding facilities are established under the permission granted by the state through a contract for usufruct and servitude rights. The state only retains the ownership of the allocated land and does not interfere with the business or the management of the shipyard, while keeping the right to monitor and supervise compliance issues. There is no announced plan for the government to divest itself of such control. Nevertheless, there are some exceptions, such as instances where the shipyard is directly owned by private entities, or the rent or usufruct right is granted by free-zone authorities.

In addition, with the Regulation on the Environmental Management of Shipyards, Boat Manufacturing and Boatyards published in the Official Gazette of 7 December 2022, it has become mandatory to construct the necessary infrastructure, determine the measures and create the procedures related to them to prevent, minimise or eliminate the negative effects on the environment caused by the facilities. Within the framework of the same Regulation, sanctions for non-compliance with these obligations have been regulated.

Furthermore, the Environmental Impact Assessment Regulation has been published in the Official Gazette of 29 July 2022. In this context, the list attached to the amended Regulation has been updated and the preparation of environmental impact assessment has become mandatory for the following projects listed in the annex of said Regulation:

- construction of intra-continental waterways;
- commercial ports, piers, docks, dolphins (except sunbathing, sports piers and buoys);
- shipyards;
- facilities performing one or more of the modifications, manufacturing, maintenance and repair services for yachts or boats over 24 metres facing the sea;
- ship dismantling and (or) ship recycling facilities; and
- marinas.

KEY CONTRACTUAL CONSIDERATIONS

Statutory formalities

3 Are there any statutory formalities in your jurisdiction that must be complied with in entering into a shipbuilding contract?

Entering into a shipbuilding contract is not subject to any statutory formalities. General provisions of the Turkish Code of Obligations (TCO) and the Turkish Commercial Code (TCC) are applicable to the signing and execution of shipbuilding contracts; however, the permissions stipulated under the Regulation on the Construction, Refit and Maintenance-Repair of Ships and Watercraft should be obtained to commence such works under the relevant contract.

Choice of law

4 May the parties to a shipbuilding contract select the law to apply to the contract, and is this choice of law upheld by the courts?

The parties to a shipbuilding contract are free to agree on the law to be applied to the shipbuilding contract as per article 24/1 of the Code on International Private and Procedural Law (IIPL). According to article 2/1 of the IIPL, the courts shall apply ex officio the law agreed by the parties. Pursuant to the aforementioned article 24/1 of the IIPL, the choice of law that is clearly understood under the provisions of the contract or under the present conditions of the case shall also be deemed valid and binding. If the parties to the contract have not expressly chosen a governing law, then the contract shall be governed by the law of the country with which it is most closely connected pursuant to the conflict of laws rule as set out in article 24/4 of the IIPL, which shall be the law of the jurisdiction where the shipyard is

located and incorporated and wherein the vessel is constructed. In any case, as per article 31 of the IIPL, the court may also choose to apply the overriding mandatory provisions of a state that is most closely connected with the contract. Furthermore, if a foreign law is chosen under the contract, the exceptions based on public policy (article 5 of the IIPL) and overriding mandatory provisions (article 6 of the IIPL) may apply.

Nature of shipbuilding contracts

5 Is a shipbuilding contract regarded as a contract for the sale of goods, as a contract for the supply of workmanship and materials, or as a contract sui generis?

The nature of shipbuilding contracts is not statutorily defined in Turkish law. However, according to the precedents of the Supreme Court and scholarly opinion, in principle, shipbuilding contracts are regarded as contracts for works and services, which fall within the scope of the general provisions of the TCO. Having said that, there may be different interpretations according to the provisions of the relevant shipbuilding contract, such as being a sui generis contract bearing obligations on the sale of both goods and services.

However, if making an evaluation is required within the scope of Turkish law, according to certain scholars' opinions, those contracts, the subjects of which are the construction of a specific ship based on an order, and in which the obligation to work stands out, are in the nature of work contracts.

Hull number

6 Is the hull number stated in the contract essential to the vessel's description or is it a mere label?

The hull number is one of the key elements to distinguish a vessel from others. Therefore, the reference made to the hull number in a shipbuilding contract shall serve the ease of identification and proof. The hull number is one of the alternatives (including its name and any other identification mark) required for the registration of a hull with the Newbuilding Registry (NBR) as set out in article 988/1(a) of the TCC. Thus, the hull number can be considered an essential element of the contract from registration and identification points of view.

Deviation from description

7 Do 'approximate' dimensions and description of the vessel allow the builder to deviate from the figure stated? If so, what latitude does the builder have?

Unless otherwise agreed by the parties in the shipbuilding contract, the builder, in principle, does not have the right to deviate from the figures specified in the contract. Any deviation from the figures and descriptions stipulated in the contract shall be deemed as a defect. Having said that, approximate dimensions and descriptions stipulated in a contract might provide certain flexibility to the builder, as long as the result is reasonably close to the contracted figure and does not contravene the principle of good faith (article 2 of the Turkish Civil Code). However, if a specific figure is stipulated in the specifications or plans and drawings, this will supersede the approximate figure stipulated in the contract.

Read this article on Lexology

Guaranteed standards of performance

8 May parties incorporate guaranteed standards of performance whose breach entitles the buyer to liquidated damages or rescission? Are there any trade standards in your jurisdiction for coating, noise, vibration, etc?

As per the principle of freedom of contract, the parties can freely incorporate guaranteed standards of performance in a shipbuilding contract. In the case of a breach of the guaranteed standards of performance, as per article 475 of the TCO, the buyer may:

- request a reduction in the contract price;
- request the elimination of the defect, if possible; or
- use its rescission rights, provided that the acceptance of the vessel cannot be expected from the buyer under the breach of such standards of performance.

The parties may also agree on a clause in the contract regarding liquidated damages or penalties in the case of a breach of certain performance or remedies, as they deem appropriate. Currently, there are no trade standards applicable in Turkey for coating, noise and vibration. Therefore, it is recommended that the parties to a shipbuilding contract mutually agree upon the benchmark levels regarding these standards.

Quality standards

9 Do statutory provisions or previous cases in your jurisdiction give greater definition to contractual quality standards?

Under Turkish law, there are no statutory provisions or court precedents that give greater definition to contractual quality standards. Articles 471/1 and 471/2 of the TCO state that the duty of care of the contractor (namely, the builder) shall be determined on the basis of acts of a prudent businessperson in the relevant area.

Classification society

10 Where the builder contracts with the classification society to ensure that construction of the vessel leads to the buyer's desired class notation, does the society owe a duty of care to the buyer, or can the buyer successfully sue the classification society, if certain defects in the vessel escape the attention of the class surveyors?

The classification society's liability against the parties with whom they do not have a contractual relationship is not yet finally settled under Turkish law. There are no statutory provisions clearly establishing the liability of the classification society against third parties (eg, the buyer). Among scholars, it has been suggested that a classification society may be held liable by a third-party buyer on the basis of the breach of the trust that is created by the class certificate; such liability is based directly on the general duty of good faith as set out in article 2 of the Turkish Civil Code. Another scholarly opinion goes to the effect that a classification society may be held liable in tort by a third-party buyer.

There have been only a few cases decided by the Istanbul Maritime Court where the liability of the classification societies has been discussed. The Supreme Court recently upheld a Regional Administrative Court judgment stating that classification societies can be held liable towards the buyer in tort based on breach of duty of care only if they have established such a care, for instance by way of delivering a classification certificate to the buyer upon the seller's request.

Flag-state authorities

11 Have the flag-state authorities of your jurisdiction outsourced compliance with flag-state legislation to the classification societies? If so, to what extent?

Yes, the flag-state authorities may delegate their powers to classification societies in accordance with the provisions of the Regulation on Institutions Authorised for Vessels. The powers may be wholly or partially delegated and include the performance of surveys and inspections and the issuance of certifications.

Registration in the name of the builder or the buyer

12 Does your jurisdiction allow for registration of the vessel under construction in the local ships register in the name of the builder or the buyer? If this possibility exists, what are the legal consequences of this registration?

As per article 986/1 of the TCC, the vessel or yacht under construction (VUC) can be registered in the NBR upon request of the buyer, the builder, the creditor having a precautionary injunction over the vessel, or the mortgagee (if any). The registration can be made in the name of the builder or the buyer, which can be agreed upon in the contract. Upon the mentioned registration, the registered title and encumbrances (if any) become public.

Title to the vessel

13 May the parties contract that title will pass from the builder to the buyer during construction? Will title pass gradually, upon the progress of the vessel's construction, or at a certain stage? What is the earliest stage a buyer can obtain title to the vessel?

The parties are free to agree upon whom the title will belong during construction. In the event that the parties have not clearly agreed on this issue in the contract, it is disputed under Turkish legal doctrine whether the buyer or the builder shall be entitled to the title of the VUC until delivery. The matter was discussed during the drafting of the new TCC (which is currently in force), where some legal scholars opined that the title should belong to the buyer until delivery, whereas the builder should have a statutory mortgage right over the VUC. Ultimately, this view was upheld in the TCC, where articles 986/1 and 987/1 of the TCC clearly distinguish between the 'owner of the VUC' and the 'owner of the shipyard who is granted a statutory mortgage over the VUC'. In practice, however, it is usually the builder who obtains in his or her own name the building licence for the VUC from the harbour master. If so, the title of the VUC would be deemed to be held by the builder. It is strongly recommended that the parties register the VUC with the NBR to clarify the title issue. The parties are also free to agree on the gradual passing of the title, upon the progress of the

vessel's construction, or at a certain stage. The buyer can obtain title to the vessel by means of registering the vessel in the NBR when the construction level of the vessel is sufficient to distinguish the vessel from the other vessels; whereby, this is a condition for the registration of the vessel and not the ship mortgage.

Passing of risk

14 Will risk pass to the buyer with title, or will the risk remain with the builder until delivery and acceptance?

In a shipbuilding contract, the risk shall remain with the builder until delivery of the vessel in cases where the VUC is registered in the buyer's name. As per article 477/1 of the TCO, the risk shall pass to the buyer upon the delivery and acceptance of the vessel, save for hidden defects and defects concealed on purpose by the builder.

Subcontracting

15 May a shipbuilder subcontract part or all of the contract and, if so, will this have a bearing on the builder's liability towards the buyer? Is there a custom to include a maker's list of major suppliers and subcontractors in the contract?

As per article 471/3 of the TCO, the builder is obliged to construct the vessel either itself or have it constructed by others under its own supervision, unless the builder's own qualifications are important in the building of the relevant vessel. It is important to stipulate in the contract whether the buyer allows the builder to subcontract the whole or a part of the works or not. The builder will be responsible for the works carried out by its subcontractors as if these were carried out by the builder itself, unless otherwise agreed upon in the contract. Even though including a maker's list in the contract completely depends on the negotiation between the parties, it is very frequently used.

Extraterritorial construction

16 Must the builder inform the buyer of any intention to have certain main items constructed in another country than that where the builder is located, or is it immaterial where and by whom certain performance of the contract is made?

In general practice, the parties are free to decide on the place where the vessel will be wholly or partially constructed, as well as on the qualifications and origin of the materials that will be used. In the event that there is no such provision in the contract, it is important to check whether the builder is allowed under the contract to construct the vessel in a different country than the country of the shipyard. If there are no such provisions in the contract, then article 471/3 of the TCO shall apply, according to which the builder will be obliged to construct the vessel itself or have it constructed by others under its supervision.

PRICING, PAYMENT AND FINANCING

Fixed-price and labour-and-cost-plus contracts

17 Does the law in your country have different provisions for 'fixed-price' contracts and 'labour-and-cost-plus' contracts?

The general principle in vessel and yacht construction agreements is the turnkey practice, thus fixed price. Needless to say, the parties may choose to include an adjustment clause to determine situations when the fixed price will be altered, such as a change in material and class requirements. According to article 480 of the Turkish Code of Obligations (TCO), if a contract includes a fixed-price provision, the builder will then be obliged to carry out the construction against the determined price and cannot request an increase in price even if the construction requires more cost and effort. However, in the event that certain conditions that could not be foreseen or were not considered in the beginning by the parties prevent or significantly hinder the performance of the builder, then the builder may ask the court to adapt the agreement to new conditions or, if this is not possible or cannot be expected from the buyer, the builder may rescind the contract. The builder may only be entitled to use its termination right in cases where this is required under the principle of good faith.

As per article 481 of the TCO, in the event that the price is not predetermined or determined approximately in the contract (which is unlikely in practice), the price shall be determined in accordance with the value of the vessel at the place and date of construction, as well as the costs suffered by the builder.

Price increases

18 Does the builder have any statutory remedies available to charge the buyer for price increases of labour and materials despite the contract having a fixed price?

According to article 480/1 of the TCO, if a fixed price is determined in the contract, there will be no statutory remedies for the builder to charge the buyer for price increases of labour and materials unless otherwise agreed in the contract. However, in unforeseeable or foreseeable but unconsidered circumstances, the builder may request the court to adjust the price in accordance with the new conditions. In such cases, general principles, such as contract provisions, good faith and prudent merchant rules, shall be taken into consideration.

Retracting consent to a price increase

19 Can a buyer retract consent to an increase in price by arguing that consent was induced by economic duress?

Article 480 of the TCO entitles the court to adjust the price of a contract provided that the circumstances envisaged under the law have arisen. In cases where the parties have already entered into a contract with free will, it will be difficult to challenge the price thereafter based on the claim that their consent was impaired due to economic duress. Having said that, this will require a case-by-case analysis taking into account the specific claims of the parties regarding economic duress.

Exclusions of buyers' rights

20 May the builder and the buyer agree to exclude the buyer's right to set off, suspend payment or deduct certain amounts?

The parties to a shipbuilding contract are free to agree on the buyer's right to set off, suspend payment or deduct certain amounts, unless this falls against public policy.

Refund guarantees

21 If the contract price is payable by the buyer in pre-delivery instalments, are there any rules in regard to the form and wording of refund guarantees? Is permission from any authority required for the builder to have the refund guarantees issued?

In practice, refund guarantees are issued by banks in the form of bank letters of guarantee. In this respect, the response to this question is provided on the assumption that the refund guarantee is provided by a bank. There is no standard form or wording for refund guarantees under Turkish law, and the content is subject to negotiation between the parties and the bank. However, the guaranteed amount, the beneficiary, the party whose obligation is being guaranteed and the conditions under which the refund will be made shall be included in the relevant refund guarantee. Under Turkish law, guarantee agreements (including refund guarantees) do not have any statutory validity condition, and a simple written agreement is sufficient to prove its existence and validity (provided that such an agreement does not violate any mandatory provision of Turkish law). Refund guarantees are not subject to any permission from any governmental authority; however, there is an obligation of the Turkish guarantor to provide a notice upon providing guarantees to third parties located outside of Turkey.

This response does not extend to or cover personal guarantees or surety or any other similar forms of security provided by real persons.

Advance payment and parent company guarantees

22 What formalities govern the issuance of advance payment guarantees and parent company guarantees?

Under Turkish law, guarantee agreements, including advance payment guarantees and parent company guarantees, do not have any statutory validity conditions, and a simple written agreement is sufficient to prove their existence and validity, provided that such an agreement does not violate any mandatory provision of Turkish law. In practice, advance payment guarantees are issued by banks in the form of letters of guarantee.

This response does not extend to or cover personal guarantees or surety or any other similar forms of security provided by real persons.

Financing of construction with a mortgage

23 Can the builder or buyer create and register a mortgage over the vessel under construction to secure construction financing?

As per article 1054/1 of the Turkish Commercial Code (TCC), either the buyer or the builder, together with the creditor, may apply to create and register a mortgage over a vessel or yacht under construction (VUC) provided that the VUC is registered in their name. As per the provisions of article 1054 of the TCC, a mortgage can be established on a VUC from the date of its keel-laying until the date of its launching, beginning from the time of the vessel becoming clearly and permanently distinguishable by placement of its name and number on a visible spot thereon. Article 1055 of the TCC stipulates that the mortgage on a VUC shall be established upon written agreement of the owner and the creditor, which should be certified by a notary public and by registration of the mortgage with the Newbuilding Registry. Alternatively, an agreement may also be made before the registrar.

In accordance with article 1056 of the TCC, a ship under construction is deemed within the scope of the mortgage at every stage of the construction if and once the ship mortgage is established over her.

DEFAULT, LIABILITY AND REMEDIES

Liability for defective design (after delivery)

24 Do courts consider defective design to fall within the scope of poor workmanship for which the shipbuilder is liable under the warranty clause of the contract?

It is important to determine which party is liable for the design under the contract. If the design liability is on the buyer, then the builder cannot be held liable in this respect, unless it has acted in fault or non-compliance with the design requirements set out in the contract. However, if the design liability rests on the builder, then the provisions of article 474 et seq of the Turkish Code of Obligations (TCO) concerning the buyer's alternative rights in the case of defect become applicable.

Remedies for defectiveness (after delivery)

25 Are there any remedies available to third parties against the shipbuilder for defectiveness?

If it is determined in the contract that the builder's warranty liability shall continue within the warranty period against third parties (eg, buyers), then the builder can be held liable against the new buyers (thus third parties) under the determined conditions. There are no other statutory remedies for this purpose. In the event that a mortgage is established over the vessel or yacht under construction (VUC), then the mortgagee may file a lawsuit requesting the court to prevent the builder's act or failure to act that causes the deterioration of its physical condition or decrease in its value. Otherwise, the only option for a third

party would be to raise a tort claim against the builder under the relevant provisions of the TCO, provided that the required conditions are met.

Liquidated damages clauses

26 If the contract contains a liquidated damages clause or a penalty provision for late delivery or not meeting guaranteed performance criteria, must the agreed level of compensation represent a genuine link with the damage suffered? Can courts mitigate liquidated damages or penalties agreed in the contract, and for what reasons?

If the contract bears any provisions regarding liquidated damages or penalties for late delivery or failure to meet the guaranteed performance criteria, these will be applicable and binding on the parties. The liquidated damages claim is not related to damages suffered. The parties are free to determine the amount of the liquidated damages or penalties and can determine a cap for liquidated damages or penalties payable.

Accordingly, it is recommended that a liquidated damages or penalty clause be determined by the parties whereby it shall be explicitly stated that any party's right to claim damages shall be reserved if damages exceed the amount of mutually agreed penalty or liquidated damage amount.

As provided under article 22 of the Turkish Commercial Code (TCC), Turkish law does not accept the intervention of the court to the amount of penalties set out in the contracts between merchants, save for certain limited exceptions such as the penalty amount being possible to lead to economic destruction of the merchant (as worded by the Supreme Court). However, these are determined on a case-by-case basis taking into consideration the actual circumstances and that the builders of vessel construction agreements are mostly merchants (namely, companies), they will not be entitled to request a decrease in a penalty from the court by alleging that it is excessive unless they provide sufficient documents and information evidencing that the penalty will cause irreversible damage.

Preclusion from claiming higher actual damages

27 If the building contract contains a liquidated damages provision, for example, for late delivery, is the buyer then precluded from claiming proven higher damages?

If the contract bears any provisions regarding liquidated damages or penalties for late delivery or failure to meet the guaranteed performance criteria, these will be applicable and binding on the parties. The liquidated damages claim is not related to damages suffered. The parties are free to determine the amount of the liquidated damages or penalties and can determine a cap for liquidated damages or penalties payable.

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Force majeure

28 Are the parties free to design the force majeure clause of the contract?

The parties to the contract are free to design the force majeure clause, as long as this is in line with public policy.

Umbrella insurance

29 Is certain 'umbrella' insurance available in the market covering the builder and all subcontractors of a particular project for the builder's risks?

Yes, construction all-risks insurance, covering the builder and all the subcontractors of all tiers or each of the named subcontractors of a particular project, is available.

Disagreement on modifications

30 Will courts or arbitration tribunals in your jurisdiction be prepared to set terms if the parties are unable to reach agreement on alteration to key terms of the contract or a modification to the specification?

Theoretically, one of the parties may request the alteration of the key terms of the contract from the court or an arbitral tribunal, although this is very unlikely in practice. In such cases, in practice, courts tend to refer the case to expert panels upon hearing the statements of the other party, while arbitral tribunals or the technical experts appointed under the contract (if this is the case) may render a decision directly at the party's request.

Acceptance of the vessel

31 Does the buyer's signature of a protocol of delivery and acceptance, stating that the buyer's acceptance of the vessel shall be final and binding so far as conformity of the vessel to the contract and specifications is concerned, preclude a subsequent claim for breach of performance warranties or for defects latent at the time of delivery?

The buyer's signature of a protocol of delivery and acceptance constitutes a statement that the buyer has accepted the apparent defects at the time of signing. However, latent defects are not deemed to fall within this scope, and thus will not be deemed as accepted by the buyer. Therefore, in such cases, the remedies stipulated in the mandatory provisions of law

and the builder's warranty liability shall remain valid. If the buyer notices any defect after the delivery of the vessel, then it shall notify the builder within a reasonable period, unless otherwise agreed in the contract. Furthermore, if a latent defect or any defect within the scope of the warranty clause appears after delivery, the buyer shall also notify the builder of this defect as soon as possible; otherwise, the buyer will be deemed to have accepted the vessel with such defect. Needless to say, specific provisions of the contract regarding the warranty liability shall also be taken into account, such as whether a notice requirement is determined to call the builder's warranty liability.

Repair location and associated costs

32 When repairs or replacements covered under the warranty must be carried out, may the buyer insist they be carried out at a shipyard or facility not operated by the builder? Must the buyer bear all costs associated with moving the vessel to the location selected for the repair and replacement work and any sea trials? If the remedial work requires the vessel to be docked, will the costs be covered under the warranty, or will the buyer have to pay?

There is no explicit provision in the TCO dealing with these questions and therefore, in practice, it is generally regulated contractually. However, in the absence of any contractual agreement, given that article 471/3 of the TCO requires the builder to complete all works personally or under its own management, it could be held that the buyer does not have the right to request that the works for repair or replacement are undertaken elsewhere, except where it could be proven that the specific repair or replacement cannot be carried out at the builder's shipyard. On the other hand, article 475/1(3) of the TCO requires the builder to carry 'all costs' of repair or replacement, unless such costs are excessive. As such, it will have to be determined in each specific case whether dry-docking expenses could be deemed as reasonable or excessive.

Liens and encumbrances

33 Can suppliers or subcontractors of the shipbuilder exercise a lien over the vessel or work or equipment ready to be incorporated in the vessel for any unpaid invoices? Is there an implied term or statutory provision that at the time of delivery the vessel shall be free from all liens, charges and encumbrances?

The TCC explicitly grants the statutory lien right to the builder (shipyard) over the VUC for its receivables arising from the building and repair of the vessel, which shall be registered in the relevant Newbuilding Registry (article 1013 of the TCC). Subcontractors and suppliers are left outside the scope of this statutory lien right. However, the supplier or subcontractor may apply the right of retention if they have possession of the relevant equipment, while the title thereof belongs to the buyer. There is no explicit statutory provision to the effect that the vessel shall, at the time of delivery, be free from all liens, charges and encumbrances. However, it may be assumed that the general provision of article 475/1 of the TCO regarding the builder's liability for defects would apply in such cases as well.

Reservation of title in materials and equipment

34 Does a reservation of title by a subcontractor or supplier of materials and equipment survive affixing to or incorporation in the vessel under construction?

The validity of the reservation of title in materials and equipment is subject to its compliance with the official form stipulated in article 764/1 of the TCC, which is required to be entered into and registered with a special registry before a notary public. If the materials and equipment are delivered without such registration and are installed on the VUC, then they fall within the scope of the buyer's ownership over the VUC, as these materials and equipment become an integral part, or a supplement, of the VUC upon their installation.

Third-party creditors' security

35 Assuming title to the vessel under construction vests with the builder, can third-party creditors of the builder obtain a security attachment or enforcement lien over the vessel or equipment to be incorporated in the vessel to secure their claim against the builder?

As long as the title of the VUC is with the builder, the third-party creditors of the builder can obtain a precautionary attachment or an enforcement lien over the vessel or equipment to be incorporated in the vessel or start an enforcement process. However, if the vessel is under construction within a free zone, all materials, machinery and equipment enter into free zones in the name of the shipyard. In practice, there are cases where third-party creditors have applied arrest over the machinery and equipment even though the VUC was registered in the name of the buyer.

Subcontractor's and manufacturer's warranties

36 Can a subcontractor's or manufacturer's warranty be assigned to the buyer? Does legislation entitle the buyer to make a direct claim under the subcontractor's or manufacturer's warranty?

The subcontractor's or manufacturer's warranty can be assigned to the buyer under the shipbuilding contract or otherwise. In the event that no assignment is made, the buyer may only be entitled to claim tort liability of the subcontractor or the manufacturer in cases where the criteria sought under articles 49 et seq of the TCO are present.

Default of the builder

37 Where a builder defaults in the performance of the contract, is there a legal requirement to put the builder in default by sending an official notice before the buyer's remedies begin to accrue? What remedies will be open to the buyer?

The parties are free to determine a specific date for performance and a cure period for default, as well as the buyer's rights and remedies in cases of delay in performance. If the parties have already agreed on a specific date for the performance, there is no legal

requirement to serve an official notice to put the builder in default; if not, then an official notice requesting the performance will be necessary to determine the date when the buyer's remedies begin to accrue. In the event that both parties are merchants, such notice should be served:

- through a notary;
- by registered return-receipt mail;
- by telegraph; or
- by a registered electronic mail system using a secured e-signature, as per article 18/3 of the TCC.

As per article 124 of the TCO, there is no need to grant a period for remedy of defaults if:

- the current status or behaviour of the debtor proves that granting a period will be ineffective (and will not yield the requested result);
- owing to the default of the builder, the performance of the obligation has become useless; or
- it is understood from the contract that due to non-performance of the obligation at a certain time or within a certain period, its performance will no longer be acceptable.

If the builder defaults in the performance of the shipbuilding contract, then the buyer may:

- request the performance of the contract and compensation for delay; or
- request the compensation of damages arising from non-performance of the contractual obligation, or rescind the contract, by notifying that it waives its right to request the performance and the compensation for delay (article 125 of the TCO), unless otherwise agreed under the contract.

In the event of rescission of the contract, the parties are discharged from their contractual obligations, and the buyer may request compensation for damages caused due to the invalidation of the contract, unless the defaulting builder proves that it had no fault.

Furthermore, article 473 of the TCO stipulates that, if it is clearly determined that there is no longer any prospect of completing the work on time owing to the builder's failure to commence the works on time, or delay in the works in contradiction with the contractual terms, or delays not attributable to the buyer, then the buyer may rescind the contract without waiting for the delivery date. This provision grants the buyer the right to rescind the contract. During the course of the work, if it becomes apparent that the work is going to be defective or not in compliance with the contractual specifications due to the builder's fault, to recover such, the buyer may serve a warning to the builder by which it grants an adequate period for remedying the defect or non-compliance and warns the builder that such remedy works shall otherwise be contracted to a third person while all the damage and expenses will be borne by the builder.

The buyer's alternative rights provided under article 475 of the TCO may also apply.

Remedies for protracted non-performance

38 Are there any remedies available to the shipowner in the event of protracted failure to construct or continue construction by the shipbuilder apart from the contractual provisions?

The shipowner can request a precautionary injunction order for the delivery or relocation of the vessel when the builder fails to construct it. The court, while granting such an order, may request the claimant to lodge sufficient security in consideration of the losses or damage of the opponent if such request of the claimant is found unjust. In very rare cases, the court may grant a precautionary injunction for the delivery or relocation of the vessel for further construction by a different builder, the cost of which will be borne by the previous builder.

Builder's insolvency

39 Would a buyer's contractual right to terminate for the builder's insolvency be enforceable in your jurisdiction?

It is recommended to include a clause in the contract that would enable the buyer to terminate the contract if the builder becomes insolvent, or if it loses its right of disposition over its property, or if its right to freely dispose is restricted. Furthermore, provisions stating that the contract may be terminated not only due to bankruptcy, but in the case of a concordat or other similar arrangements for the composition of bankruptcy or insolvency situations, may be included within the shipbuilding contract.

Judicial proceedings or arbitration

40 What institution will most commonly be agreed on by the parties to decide disputes?

Foreign arbitration, such as by the London Maritime Arbitrators Association, is the most common agreement reached by the parties in this regard, whereas the jurisdiction of Turkish courts is also preferred occasionally. If the jurisdiction of Turkish courts is chosen, then the admiralty courts of the relevant province shall be competent to resolve these disputes, as set out in the recent decisions of the Supreme Court. Furthermore, domestic arbitration is becoming more widespread in practice.

Buyer's right to complete construction

41 Would a buyer's contractual right to take possession of the vessel under construction and continue construction survive the bankruptcy or moratorium of creditors of the builder?

As per article 473/2 of the TCO, the buyer may exercise its contractual right to take possession of the vessel against the bankrupt's estate, provided that the VUC is registered in the name of the buyer. In such a case, the VUC can be recovered from the bankrupt's estate by claiming the recovery of property. However, if ownership of the VUC is with the builder, then the buyer will not be able to claim the return of the possession of the VUC.

Read this article on Lexology

ADR/mediation

42 In your jurisdiction, do parties tend to incorporate an ADR clause in shipbuilding contracts?

The parties to a shipbuilding contract usually prefer to insert an arbitration clause rather than a mediation clause. If there is no arbitration clause in the contract and the parties have agreed on the jurisdiction of Turkish courts and the application of Turkish law, and the conditions stipulated in the legislation are fulfilled, then the parties shall apply to mediation before filing a lawsuit in the courts as a precondition (mandatory mediation).

Default of the buyer

43 Where the buyer defaults in the performance of the contract, what remedies will be available to the builder? What are the consequences of the builder's cancellation of the contract?

If the buyer defaults in the performance of the shipbuilding contract (namely, in the payment terms), then the builder may:

- request the performance of the contract and interest and compensation for delay;
- request the compensation of damages arising from non-performance of the contractual obligation; or
- rescind the contract, by notifying that it waives its right to request the performance and the compensation for delay.

In the event of rescission of the contract, the parties are discharged from their contractual obligations, and the builder may request compensation for damage caused due to the invalidation of the contract, unless the defaulting buyer proves that it has no fault. The builder may claim interest for monetary debts and request damages exceeding the interest amount.

Whether the title of the VUC will be on the buyer or the builder determines the consequences of the builder's cancellation of the contract. It is also important to agree in the contract the remedies of the builder in cases of the buyer's default, whether the default of the buyer will grant the builder the right to sell the VUC to a new buyer or to enforce its statutory lien right under the law. In cases of the buyer's default in the performance of the contract, the outstanding receivables under the contract constitute a maritime claim under article 1352/1(m) of the TCC, and the shipbuilder has the right to request precautionary attachment (arrest) over the VUC.

CONTRACT FORMS AND ASSIGNMENT

Standard contract forms

44 Are any standard forms predominantly used in your jurisdiction as a starting point for drafting a shipbuilding contract?

All international standard forms are recognised and used in Turkish shipbuilding practice; however, shipyards usually prefer to use their own forms, which are mostly drafted taking the standard forms as a basis. For this reason, it is difficult to say that any one of the standard forms is predominantly used.

Assignment of the contract

45 What are the statutory requirements for assigning the contract to a third party?

The parties to a shipbuilding contract may assign the contract to a third party in accordance with article 205 of the Turkish Code of Obligations, which stipulates that assignment of an agreement is a tripartite agreement between the assignor, assignee and the other contracting party to the shipbuilding contract. With the assignment agreement, the assignor transfers all rights and obligations arising from the shipbuilding contract to the assignee, together with the capacity of being a party to the agreement. The assignment may also be made by way of notifying the shipbuilder and obtaining its acknowledgement. If the shipbuilding contract allows its assignment, then no prior consent from the other party is necessary. However, if the assignment is subject to the prior consent of the other party, this consent should either be obtained in advance or be ratified by the other contracting party after its signature.

The validity of the assignment agreement is subject to the same form requirements as the original contract. There is no statutory requirement for shipbuilding contracts under Turkish law. Therefore, the assignment of shipbuilding contracts is also free of any statutory form requirements. However, if the parties agree on any form requirements on the shipbuilding contract, these will also apply to the relevant assignment agreement. The parties may freely decide whether the original contract will be discharged by the assignment, or whether the new contracting party will assume all rights and obligations ab initio.

UPDATE AND TRENDS

Recent developments

46 Are there any emerging trends or hot topics in shipbuilding law in your jurisdiction?

In the Ship and Yacht Export Assessment report, published by the Ship, Yacht and Services Exporters' Association in December 2022, it is observed that ship and yacht exports have decreased by 10.58 per cent in 2022 compared to 2021, whereas the superyacht building market is growing significantly. From the number of new clients, who requested our services

for the purchase or the construction of super yachts, we observe that the demand for luxury yachts that was rising before the covid 19 pandemic, is continuing. Consequentially, the shipyards specially designed for building superyachts are also increasing in number.

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