

Early planning protects against delay

Simon Williams, a barrister in the Maritime, Trade and Energy dispute resolution group at Norton Rose, takes a look at minimising the financial impact of delay in newbuilding contracts

Late delivery under a shipbuilding contract can have serious financial consequences for a Buyer which are rarely fully compensated by the standard form contracts favoured by Builders.

A properly advised and represented Buyer should, however, be able to negotiate changes to the standard wording to improve its position. The aim for the Buyer should be to maximise the right to claim liquidated damages for delay, to minimise the Builder's opportunities to claim so-called permissible delay, which does not entitle the Buyer to liquidated damages (such as delay arising out of events of force majeure), and to provide clear rights of termination to avoid being locked into an excessively delayed contract.

Liquidated Damages

Most shipbuilding contracts provide the Buyer with a limited right to liquidated damages for delay, paid at a daily rate for a set period of time (often 150 days) commencing after a short grace period (often 30 days) where delay does not lead to liquidated damages.

In considering the extent of liquidated damages, it is important to note that, where the Buyer is taking delivery of a vessel for the purposes of an onward contract such as a long term charterparty, it is likely that the Buyer will itself be liable for liquidated damages for delay in fulfilling its obligations under that contract. In such circumstances, the Buyer should ensure that the liquidated damages provided in the shipbuilding contract are matched to the Buyer's onward exposure. The Buyer should consider both the daily amount, so that it is not receiving less than it is paying out (ideally receiving sufficient to provide some margin to cover financing costs), and the time period (including the grace period and total number of days) for which the liquidated damages are payable.

At the end of the grace period and 150 day damages period (or such other period for which liquidated damages are payable), the Buyer will ordinarily have an option to terminate the contract or to agree to take delivery at a specified future date. Two important points arise out of this right.

First, if the Buyer elects to terminate the contract, can it retain the damages for delay? In most shipbuilding contracts, liquidated damages for delay take effect as a reduction in the purchase price. The usual answer to this question, therefore, is a clear "no" as no purchase price is payable by the Buyer if the contract is terminated. The Buyer is however still likely to suffer loss and, whilst it may be very difficult to persuade a Builder that the Buyer should keep the entirety of liquidated damages for delay payable but for the termination, a Builder may be persuaded to include some compensatory payment in the event of termination by the Buyer for delay. As a matter of practicality, a provision of this nature will usually feature in a clause dealing with the parties' rights and liabilities on termination rather than in a provision dealing with liquidated damages for delay.

Secondly, where the Buyer chooses not to terminate but agrees a future delivery date, what are the consequences if that date is also missed? Most standard form wordings are very unclear on this point and, in particular, on the question whether the Buyer will have an immediate right to terminate if the agreed future date is missed or whether the Buyer must wait a further period (for example 30 plus 150 days) before the right to terminate accrues. A Buyer should ensure that the contract contains clear wording identifying an immediate right to terminate in the event that the vessel

is further delayed, as an obligation to wait for 180 days is unnecessarily generous to the Builder in circumstances where it is already significantly delayed. The Buyer may also wish to consider whether further liquidated damages should be payable in the event that it elects not to terminate but to take delivery at an agreed future date and that further date is not achieved. The standard forms are usually very clear in that the maximum reduction in the contract price permitted by reason of delay in delivery is for the period of 150 days (or whatever period it may be) following the grace period but before the right to terminate accrues. The Buyer may, however, be able to persuade a Builder to include a further right to liquidated damages for delay in the event that the future agreed date is missed. If a further right to liquidated damages is negotiated, the Buyer must be careful that any overall limit on liquidated damages (limiting the aggregate of liquidated damages for delay and for performance defects), found in most standard forms, is high enough to pay out not only the further delay liquidated damages but also to leave sufficient to compensate for any performance deficiencies.

Apart from termination after 180 days, the Buyer should also consider whether to include a further right of termination permitting the Buyer to terminate the contract at any time if the Builder fails to proceed with a sufficient rate of progress. Such clauses are often drafted in terms of reasonableness, for example "a failure to proceed with the construction with all reasonable despatch", which can lead to uncertainty as to whether the right to terminate has arisen and can be disputed by the Builder. An alternative is to provide a right of termination by reference to a failure by the Builder to meet planned milestone dates by a specified number of days, which is less susceptible to dispute.

A clause of this nature (seldom seen in the standard forms) provides the Buyer with a valuable additional right without which it could be tied into a delayed contract until such time as the delivery date is missed by, for example, 180 days.

Force Majeure

The Buyer's first concern in relation to force majeure clauses is to ensure that the list of force majeure events is not too generous. For example, many standard forms include all strikes as force majeure, whereas there is little justification for including strikes that are confined only to the Builder's shipyard or those of the Builder's subcontractors, since in these cases the Builder has a degree of control over whether strikes take place. If this type of clause cannot be limited, it may be possible to agree a graduated approach where the Builder is able to claim strikes as force majeure in the early part of the contract but not as the delivery date grows closer. The standard forms also often include as force majeure events a number of matters of historical relevance only (for example casting or forging rejects) which, given the modern technology available to a Builder, should be deleted.

In the present political climate, the Buyer should also give careful consideration to whether it will permit acts of terrorism to constitute force majeure. The usual standard clauses do not include terrorism, but it is an addition which Builders may seek but which is not in the Buyer's interest.

Once again, if a vessel is being constructed for an onward contractual arrangement, the Buyer should ensure that the force majeure clauses in both contracts are drafted in identical terms. The Buyer can be exposed to significant losses in the event that an incident constitutes force majeure under the shipbuilding contract (and the Builder pays no damages) but does not constitute force majeure under the onward contract, leaving the Buyer liable for damages down the chain.

Force majeure clauses are often drafted to provide the Builder with an extension of time for delivery of the vessel equal to the duration of the force majeure event. Whilst at first glance this may seem reasonable, such an extension renders the clause over-generous to the Builder. Although a force majeure event (say a typhoon) may last five days, the actual impact on the construction may be less, perhaps only

delaying the delivery by one or two days. Such clauses should make clear that the extension to the delivery date as a result of a force majeure event will be equal to the actual amount of delay caused by the force majeure event (often determined by reference to the critical path in the Builder's plan) rather than the duration of the force majeure event itself.

Most standard forms include a right to terminate in the event of an excessive amount of force majeure delay (often also 180 days) with an option to elect to continue the contract. As with the liquidated damages provision above, the Buyer's rights in the event of further delay after an election to continue should be made clear.

Finally, an important termination right often excluded from the standard forms is a right of termination in the event that the aggregate of all delay (excluding delay caused by the Buyer) exceeds a set number of days. Without this right the delivery date might be delayed by 179 days under the liquidated damages clause and by 179 days of force majeure amounting to a total delay of 358 days with no right of termination. Accordingly, it is advisable to seek a clause allowing termination in the event of delay from any cause (excluding Buyer delay) amounting to a mid-point of, say, 270 days.

Conclusion

In the world of increasingly complex vessels, the possibility of delay to shipbuilding contracts is ever present. Since delay in the completion of such complex vessels can lose the Buyer a great deal of revenue, detailed consideration of the terms of the contract at the outset of negotiations rather than when delay occurs will ensure the Buyer is given the best available protection from the financial consequences of delay.

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