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Expired warranty: liability for defects in shipbuilding sub-contract

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The High Court of the Republic of Singapore recently considered the liability of a subcontractor for welding defects discovered in portions of a vessel in *Seatrium New Energy Ltd (formerly known as Keppel FELS Ltd) v HJ Shipbuilding & Construction Co, Ltd (formerly known as Hanjin Heavy Industries and Construction Co Ltd)* [2023][1]. This judgment, although provided by the Singaporean High Court, serves as an important reminder to those entering into a shipbuilding contract under English law on the scope of the builder's warranty obligations.

This alert considers: (a) the existence of defects; (b) whether there was a breach of contractual duty; (c) the warranty provision; (d) the effect of a side letter entered into by the parties; and (e) the doctrine of promissory estoppel.

Background

Keppel FELS (now Seatrium New Energy Limited) had agreed to design, build, test and sell a semi-submersible accommodation unit (the "**Vessel**") for Floatel International Limited pursuant to a shipbuilding contract dated 17 August 2012 (the "**Main Contract**"). Keppel FELS in turn appointed Hanjin Heavy Industries (now HJ Shipbuilding & Construction Co, Ltd) as a subcontractor to fabricate, assemble and erect the pontoons and lower columns of the Vessel (the "**Works**") under an agreement dated 17 January 2013 (the "**Sub Contract**"). This provided, inter alia, that:

> *2.3. Notwithstanding any other provision in this Sub Contract, it shall be the Sub Contractor's responsibility to ensure that:*
>
> *(a) The Sub Contract Works when carried out or performed shall fully comply with such requirements of the applicable Classification Society and Regulatory Bodies as* [Keppel FELS] *may require.*
>
> *(b) The Sub Contract Works are performed with such standard of workmanship that upon performance of the Sub-Contract Works, those parts of the Vessel, insofar as pertains to or in connection with the Sub Contract Works, shall be in all respects a first class product capable of operating or functioning under the conditions in which it is intended to operate and function.*
>
> *8.1 The Sub Contract Works shall be performed in strict compliance with this Sub Contract with all due skill, care and diligence, with first class workmanship, and in accordance with good and sound engineering practice to the satisfaction of* [Keppel FELS, Floatel International Limited] *and the Classification and Regulatory Bodies.*
>
> *16.3 Irrespective of whether any designs, data or information have been provided or approved by the Builder, the Sub Contractor undertakes to maintain and keep the Sub Contract Works in proper working order and guarantees and warrants ~~the design~~, workmanship and all materials and equipment fabricated or provided by it against any and all defects for the period stated in the Works Order, or, if no such period*

[1] [2023] SGHC 264.

> *is stated, then for a period of twelve (12) months from the date of official delivery of the Vessel to the Owner ('Warranty Period'). Unless otherwise stated, any period stated to be the Warranty Period in the Works Order shall commence from the date of official delivery of the Vessel to the Owner*. (emphasis added; strikethrough in original)

The Works were delayed and Keppel FELS and Hanjin entered into a side letter dated 27 December 2013 (the "**Side Letter**") whereby it was agreed that Keppel FELS would take over and complete part of the Works, defined as the Outstanding Items, with the value of this work being deducted from the sums payable to Hanjin. It also recorded that Hanjin's liability would be limited to its warranty obligations under the Sub Contract for that part of the Works that it had performed.

Sixteen months after delivery of the Vessel, numerous welding defects on the bracing stubs of the pontoons and other parts of the Vessel were discovered during a routine inspection (the "**Defects**"). These were of sufficient severity that a Condition of Class was placed on the Vessel. Keppel undertook repair works on the Vessel for Floatel[2]. Keppel FELS and Hanjin entered into correspondence regarding the Defects in which Hanjin made an offer to pay US$2.3 million to Keppel FELS for a share of the repair costs (the "**Offer**"). This Offer was rejected by Keppel FELS who subsequently brought a claim against Hanjin.

Judgment

Were the Works defective?

Hanjin argued that the Defects were overreported as a stricter criterion was applied in assessing the Works than was required under the Sub Contract. The Court accepted that there were instances where a stricter criterion was used but, found that even if the correct criteria had been used, there would still have been defects in the Works. The Court also considered examples of inconsistencies with the inspection reports and concluded that these were "*de minimis*" which did not warrant a rejection of the inspection reports in their entirety. The Works were therefore found to be defective.

Contractual duty

Hanjin argued that Clause 2.3 of the Sub Contract required it to carry out the Works in compliance with the applicable Class standards and that it fulfilled this by exercising reasonable care and putting in place procedures and personnel to perform and test the Works. The Court rejected this and held that Hanjin was required to carry out the Works in compliance with the requirements of the Sub Contract and the Main Contract (which contained detailed technical specifications for the Vessel and the environmental conditions in which the Vessel would look to operate), as well as "*fully comply*" with the Class requirements. Hanjin had to perform the Works to a standard of workmanship where the relevant parts of the Vessel "*would be in all respects a first-class product capable of operating or functioning under its intended condition*".

The Court found the extensive and serious number of defects was strong evidence that the procedures employed by Hanjin had not been followed and the relevant parts of the Vessel were not capable of operating or functioning as intended and that Hanjin was therefore in breach of Clause 2.3(a) and (b). In addition, Hanjin were found to

[2] No further details are provided in the judgment of Floatel's claim or the contractual relationship between Floatel and Keppel FELS.

have failed to perform the Works with all due skill, care and diligence and with first class workmanship in accordance with Clause 8.1.

Warranty Clause

Keppel FELS sought to distinguish between the types of 'defects' that had been discovered on the Vessel and those that were covered by the warranty provision in Clause 16.3 of the Sub Contract suggesting that the Defects were inherent defects and therefore did not fall within the clause.

The Court considered that based on the clear wording of the Clause 16.3, the warranty obligations were for *'all materials and equipment fabricated or provided by it against any and all defects'* for a period of 12 months. There was no distinction made in the Sub Contract between the types of defects or when such defects could be discovered which meant that there was a strict 12-month time limitation for all defects.

Side Letter

Hanjin relied on the Side Letter in answer to Keppel FELS' claims. Hanjin argued that the Side Letter clearly stated that except for the warranty obligations set out in the Clause 16.3 of the Sub Contract, Hanjin did not owe any liability to Keppel FELS for any claims under the Sub Contract. Consequently, as Keppel FELS had not notified Hanjin of any Defects during the warranty period, Hanjin had no liability.

Keppel FELS argued that the Side Letter should be considered in the context where Keppel FELS had to take over outstanding tasks from Hanjin and the Side Letter related to those outstanding tasks rather than the Works generally.

In considering these arguments, the Court referred to the sophisticated nature of the contracting parties. The outstanding tasks referred to by Keppel FELS had previously been defined by the parties in the Side Letter as "Outstanding Items" and the Side Letter provided that *"save for* [Hanjin's] *warranty obligations for the Sub-Contract Work which it has carried out,* [Keppel FELS] *shall not have any claims whatsoever against [Sub-Contractor] for the works which will have to be carried out by* [Keppel FELS] *to complete/remedy the Sub-Contract Works".* The Court held that the use of the defined term "*Sub-Contract Works"* in the Side Letter was clear objective evidence that the parties were referring to the "*Sub Contract Works"* and not the *"Outstanding Items"* when addressing Hanjin's warranty obligations under Clause 16.3 of the Sub Contract (which had expired). Therefore, Keppel FELS had no claim whatsoever against Hanjin.

Promissory Estoppel

Keppel FELS also relied on the doctrine of promissory estoppel in an attempt to prevent Hanjin from relying on the Side Letter. They contended that in email correspondence, Hanjin's representatives had made clear and unequivocal admissions that there were Defects and argued that prior to the repair work undertaken by them, Hanjin had not relied to the Side Letter. The Court considered these email exchanges to determine whether Hanjin had consistently maintained their position regarding the expired warranty period and concluded that Hanjin's representatives had acknowledged the possibility of the Defects in the Works, but did not find that there was a clear and unequivocal admission of liability by Hanjin which was relied upon by Keppel FELS to their detriment. Furthermore, the Court considered that the lack of explicit reference to the Side Letter was not inconsistent with Hanjin's position at the hearing.

Keppel FELS also referred to the Offer as an admission of liability by Hanjin. The Court did not accept that this was necessarily the case. When Hanjin made the Offer, it said this was "*to cooperate with your company to solve this problem favorably*" and as a result, the Court considered this to be a goodwill gesture by Hanjin or an attempt to save the relationship between the parties. As a result, the Court held there was no estoppel arising which prevented Hanjin from relying on the Side Letter provisions.

Practical Implications

It is unusual for a warranty claim of this nature to be heard by the courts, as shipbuilding contracts are commonly subject to arbitration. Where such clauses have been considered by the English Courts (generally when an arbitral award is appealed), the courts have typically found that discovery of defects after the warranty period has expired can be fatal to a claim under the warranty[3]. This judgment is consistent with the position under English law.

Like the clause here, warranty or guarantee clauses in standard form contracts, such as the SAJ form, usually refer to '*all defects*' and impose a warranty period of 12 months. The outcome of this case may have been different if the warranty clause and Side Letter had expressly excluded fundamental or latent defects, i.e. those defects that could not have been discovered through the exercise of reasonable care during the warranty period which might have entitled Keppel FELS to claim under the warranty.

Parties should also be aware, particularly when dealing with sophisticated parties, that the courts or arbitral tribunal will interpret the parties' agreements, such as the Side Letter, objectively and as a result parties should pay close attention when drafting such agreements to ensure that they do not unintentionally forego any rights. Parties should be cautious in making any declarations in respect of defects or claims unless the parties are prepared to accept the consequences of such statements which could include a buyer finding themselves without a remedy against the builder.

[3] *See China Shipbuilding Corporation v Nippon Yusen Kabukishi Kaisha and Galaxy Shipping Pte. Ltd.* [2000] 1 Lloyd's Rep 367 and *Eagle Line Inc. v Namura Shipyard Co. Ltd (the "Elf")* (1985) 145 L.M.L.N.4.