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The English High Court Again Declines to Apply the Prevention Principle to a Shipbuilding Contract

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The "prevention principle" has been a popular argument run by shipyards in English law shipbuilding disputes in recent years. This enthusiasm for the prevention principle has not been shared by English Courts and tribunals, and prevention principle arguments rarely, if ever, succeed.

The judgment handed down last week in *Jiangsu Guoxin Corp v Precious Shipping Public Co Ltd*[1] is a further example of the English Court declining to apply the prevention principle to a shipbuilding contract.

What is the prevention principle?

In brief, the prevention principle applies where one party to a contract prevents the other party from complying with the contract timetable and the contract does not contain a mechanism for extending time in those circumstances.

If the prevention principle applies, the preventing party cannot require compliance with the contract timetable. Instead, time is "at large", meaning that the obligation to complete the work by the contractual completion date is replaced by an obligation to complete within a reasonable time.

The judicial background to Jiangsu

Adyard

As referred to in the judgment in *Jiangsu*, the application of the prevention principle to a shipbuilding contract was considered in *Adyard Abu Dhabi v SD Marine Services*[2] as follows:

a. In a basic shipbuilding contract, which simply provides for a shipyard to complete the construction of a vessel and to reach certain milestones within specific periods of time, the shipyard is entitled to the whole of that period of time to complete the contract work.

b. If the buyer interferes with the work so as to delay its completion in accordance with the agreed timetable, this amounts to an act of prevention and the shipyard is no longer bound by the strict requirements of the contract as to time for completion.

c. This interference does not have to be a breach of contract. For example, the instruction of variations to the work can amount to an act of prevention.

d. The prevention principle does not apply if the contract provides for an extension of time in respect of the relevant events, in which case, the contract completion dates are extended in accordance with the terms of the contract and the shipyard must complete the work by the new completion date.

[1] [2020] EWHC 1030 (Comm)
[2] [2011] EWHC 848 (Comm)

The Court in *Adyard* found that the extension of time clause in the shipbuilding contract applied to the events in question (a failure by the parties to agree an adjustment) and therefore the prevention principle did not apply. The judge was influenced by the following factors in reaching that conclusion:

a. It avoided the unsatisfactory consequence of the parties being in a contractual 'limbo'.

b. It was inherently unlikely that the parties would have intended there to be such a 'limbo', particularly in an obviously foreseeable situation such as a failure to agree an adjustment.

c. This was all the more so given the potentially extreme consequences of the application of the prevention principle, where a trivial variation may lead to the loss of the buyer's right to liquidated damages for a long period of culpable delay and the loss of the right to rescind as well.

d. Where there is ambiguity the Court should lean in favour of a construction which makes the contract work.

Zhoushan

Another shipbuilding case that featured significantly in the *Jiangsu* judgment was *Zhoushan Jinhaiwan Shipyard Co Ltd v Golden Exquisite Inc.*[3] This was another unsuccessful attempt by a shipyard to bring a claim for an extension of time outside the contractual extension of time provisions.

In *Zhoushan*, the shipyard argued that delays caused by the buyer's supervision team at the yard (in breach of the buyer's contractual undertaking that its supervisors would carry out inspections in accordance with usual shipbuilding practice and in a way to minimise delays) should be excluded from the calculation of the cancellation date. Such delays would therefore effectively postpone the cancellation date.

The shipyard did not rely on the prevention principle, but instead on the presumption that a contract should not be construed in such a way that a party can rely on its own breach to obtain a benefit[4].

The judge in *Zhoushan* found that the extension of time provisions in the shipbuilding contract were a complete code dealing with extensions to the contractual delivery date. There were, accordingly, only three types of delay: permissible delay, non-permissible delay and the specific causes of delay listed in the contract as not counting towards the calculation of the cancelling dates[5], which the judge referred to as "excluded delays".

The judge did not accept the shipyard's argument that there was a further type of delay, "buyer breach delay", which would postpone the cancelling date.

The approach to the Prevention Principle in Jiangsu

In *Jiangsu,* the Court was deciding an appeal against an arbitration award. One of the issues under appeal was whether there was any scope for the application of the prevention principle.

[3] [2014] EWHC 4050 (Comm)
[4] As the judgment was an appeal on a point of law from an arbitration award, the reasons why the shipyard relied on this presumption rather than the prevention principle is not apparent, although the two grounds have a number of similarities.
[5] These were delays due to arbitration, default in performance by the buyer, delay in delivery of the buyer's supplies, as well as a number of other grounds for extension of time provided for in the contract.

By way of factual background, the buyer had entered into shipbuilding contracts with the shipyard for a series of 14 bulk carriers. The first two vessels were delivered. The shipyard tendered the next four vessels for delivery, but these were rejected by the buyer on the basis that they were susceptible to stern tube bearing failures. The shipyard disputed these rejections. The appeal related to the next two vessels in the series.

The shipbuilding contracts gave the buyer the right to cancel if there had been 150 days of non-permissible delay. The buyer cancelled the shipbuilding contracts for these two vessels for delay under those provisions. The shipyard disputed the buyer's cancellations.

The shipyard argued, among other things, that the prevention principle applied. This was because the buyer's (allegedly) unlawful rejection of the four preceding vessels had resulted in those vessels continuing to occupy berths at the yard, thereby delaying the following two vessels. The shipyard therefore argued that time was set "at large".

The judge held that the prevention principle did not apply because the delay in question was covered by the extension of time clause in the contract – Article VIII (Delays and Extensions of Time for Delivery). This Article contained general "sweep up" wording providing that the shipyard was entitled to an extension of time for "other events beyond the control of the [shipyard] or of its subcontractors". The judge held that this was wide enough to include delays caused by a wrongful rejection by the buyer of the four vessels which in turn caused delay to the next two vessels for the following reasons:

1. This was the most natural meaning of the words. The clause referred to events "beyond the control of the [shipyard] or of its subcontractors", not beyond the control of the parties.

2. The clause was not called a "force majeure" clause (force majeure is normally confined to matters beyond the control of either party, "no-fault" events, rather than the fault of one of the parties).

3. The clause did, however, include "force majeure of any description" as a separate ground for an extension of time. This suggested that the "sweep up wording" referring to "other events beyond the control of the [shipyard] or of its subcontractors", must be referring to something other than conventional "no-fault" events.

4. Even if the clause was ambiguous (which in the judge's view it was not):

   "the construction to which the court should lean is that which tends to give the Seller the benefit of the extension of time provided for in the Article, in relation to matters which are not within its control. That militates in favour of giving a wide, not a narrow meaning to the phrase "other causes beyond the control of the [shipyard]*"".*[6]

5. If the delay in question did not fall within Article VIII, it would not fall within one of the three categories of delay referred to in *Zhoushan*, which, as was recognised in *Zhoushan*, was clearly intended to be exhaustive.

In deciding that buyer-induced delay outside the control of the shipyard came within Article VIII, the judge acknowledged that he was differing from the decision in *Zhoushan* on similar wording.

[6] Paragraph 34 of the judgment.

In *Zhoushan*, the words "or other causes beyond the control of the [shipyard]" in the extension of time clause in that contract (also referred to as Article VIII) was held not to apply to buyer-induced delay.

The judge in *Jiangsu* justified this on the basis that the principal reason why the judge in *Zhoushan* gave the words "or other causes beyond the control of the [shipyard]" a narrower meaning was because he considered that all buyer's breach delays which were intended to permit a postponement of delivery were dealt elsewhere in the contract. There was therefore no good reason to construe Article VIII as extending to buyer's breach delays.

The background facts in *Jiangsu* highlighted, however, that there may be other buyer's breaches which were not provided for elsewhere in the contract. On that basis, the judge in *Jiangsu* considered that the best interpretation of the contract was to apply a wider interpretation to the wording in Article VIII.

The judge in *Jiangsu* also addressed the difficulty identified in *Zhoushan* with treating buyer's breach delays as "permissible delay".

This difficulty arises because shipbuilding contracts generally grant the buyer two cancellation rights in respect of delay. The first is a right to cancel after a set number of days of non-permissible delay. The second is a right to cancel after a set number of days of permissible and non-permissible delay (often referred to as the "long stop" date).

Usually, a number of specified causes of delay for which the buyer is responsible, such as delays caused by buyer's supplies or buyer's default in performance, are excluded from this calculation (these are the "excluded delays" referred to in *Zhoushan*).

But according to the judgment in *Zhoushan*, the buyer's breach relevant in that case (delays caused by the buyer's representatives) did not come within any of the excluded delays. This was because the judge in *Zhoushan* construed delays due to "default in performance by the Buyer" as only referring to delays caused by the specific events of buyer default listed in Article XI (Buyer Default) which entitled the shipyard to cancel the contract.

As a result, a breach by the buyer of any of term of the shipbuilding contract other than Article XI would not be an "excluded delay" and would count towards the calculation of the long stop date. Consequently, the buyer could cause 180 days delay by a breach of contract and still be entitled to cancel, thereby benefiting from its own breach.

In *Jiangsu*, the judge got around this difficulty in two ways.

First, he held that the exclusion of delays "due to default in performance" from the calculation of the 180 day period in Article VIII was not just a reference to buyer defaults under Article XI. Instead, the phrase "default in performance" covered any default in performance by the Buyer, including a breach of an implied term as to non-prevention.

This was different to the conclusion reached in *Zhoushan*, as set out above. The judge in *Jiangsu* explained this difference by the fact that the finding in *Zhoushan* was in the context of the argument in that case that the only buyer's breach which might give rise to a delay, and which was not otherwise catered for by an express regime, was a breach of the buyer's obligation in respect of supervision and inspection. Once it is recognised that, as illustrated by the background facts in *Jiangsu*, there may be other buyer's breaches which may significantly delay construction but which would otherwise be included in the calculation of the long stop date, then the intent behind the reference to "due to default in performance by the Buyer" must be to refer to any default in performance by the buyer.

Second, the shipbuilding contract in *Jiangsu* contained rights to cancel the contract for 180 days of permissible and non-permissible delay in both Article III (Adjustment of the Contract Price) and in Article VIII.

Unlike the wording in Article VIII, the cancellation right in Article III did not state that delays caused by "default in performance by the Buyer" should be excluded from the calculation of the 180 day period. The shipyard therefore argued that this would mean that the buyer could cause 180 days delay through default in performance and cancel under Article III. This would result in the buyer profiting from its own breach.

The judge addressed this second difficulty by holding that the cancellation rights in Article III and Article VIII were intended to be equivalent and that Article VIII should be regarded as the primary provision relating to the right to cancel for excessive delay. The cancellation right in Article III was therefore to be read as implicitly excluding from the period of 180 days any delays caused by the Buyer's default in performance.

The theme arising from these cases

Although *Jiangsu* and *Zhoushan* differ in the way they interpret similar wording, the overall theme is clear. As illustrated in the decisions in *Adyard*, *Zhoushan* and *Jiangsu*, a Court/tribunal will try, if possible, to interpret a shipbuilding contract in such a way as to bring the delay events in question within the contractual extension of time provisions in the contract. This is to avoid the extreme consequences of applying the prevention principle.

In all three cases, as in the vast majority of shipbuilding cases where the prevention principle is argued, it was the shipyard that was arguing that the delay in question fell outside the extension of time regime, and therefore the prevention principle applied. The judge in Jiangsu summed up the Court's approach to such an argument as follows:

"Here, paradoxically, it is the Seller which is contending that a cause of delay is not covered by Article VIII.1 and is therefore not subject to the extension of time prescribed in that Article. It does so in order to argue that the relevant cause of delay is not dealt with by the contract at all, in the sense that no extension is provided for it, and therefore the 'prevention principle' is applicable. In my judgment this is not a construction which the court should favour."[7]

That is not to say that there can be no circumstances where the Court or a tribunal will apply the prevention principle in the context of a shipbuilding contract, but it is clear that the hurdle is a high one.

Other points of interest in the Jiangsu judgment

Although this article is principally focusing on the Court's approach to the prevention principle, there are other aspects of the *Jiangsu* judgment that are important to shipyards and buyers. These are summarised below.

Implied term as to prevention

The judge accepted that a term is to be implied into shipbuilding contracts that neither party should prevent the other from performing its obligations under the contract. This implied term is subject to several limitations, including:

[7] Paragraph 34 of the judgment.

i. that the term is limited to the active prevention of performance, and probably does not extend to passivity in the face of the action of a third party;

ii. the act complained of must be wrongful, either as being a breach of the express or implied terms of the contract, or wrongful independently of the contract.

Given that the judge also held that a breach of this implied term would be a default in the Buyer's obligations, and thereby any resulting delay would be excluded from the calculation of the cancellation date (subject to the shipyard complying with the required notice provisions, see below), this implied term is a potential cause of extension of time for the shipyard.

A buyer therefore needs to be careful that it does not do anything that wrongfully delays the shipyard's performance of the contract.

The requirement for the shipyard to notify the buyer of a claim for delay

The shipbuilding contract in *Jiangsu* contained the usual SAJ wording in Article VIII that the shipyard must serve various notices in respect of "any delay on account of which the [shipyard] claims that it is entitled under this contract to an extension of the time for delivery of the Vessel". As is usual, the contract provided that a failure to serve such notices precluded a claim for delay.

In *Zhoushan*, the Court held that the requirement to serve these notices only applied to claims for extension of time under Article VIII, not to claims for delay under other Articles in the contract.

The judge in *Jiangsu* held that, if (contrary to his view) the shipbuilding contract should be construed so as to allow for claims for delay that were not claimed pursuant to Article VIII or another Article with its own notification regime, then this notification requirement would apply to any such claim. A failure to serve a notice on time would therefore preclude a claim.

The judge agreed with the view stated in *Zhoushan* that:

"The parties could no doubt have made a contract which left them each to perform their own calculation and then argue about the causes of delay after a cancellation has occurred. However, they have tried to avoid such an anarchic situation. Instead, they have adopted a scheme which provides for notices to be given and agreement reached, or any dispute resolved by arbitration if necessary, whenever an event occurs which the Yard wishes to say justifies an extension of time for delivery."[8]

The judge in *Jiangsu* therefore concluded that:

"I consider that the parties have clearly attempted to provide for notification of the matters relevant to a claim for an extension of time. I consider that the court should lean in favour of a construction under which there are notification requirements in relation to any, or at least any reasonably foreseeable, causes of delay."

This again highlights a point that has been made in numerous judgments and arbitration awards relating to shipbuilding contracts - if the contract requires the shipyard to serve a notice at the time of the delay in order to be able to claim an extension of time, it is essential that the shipyard serves such a notice in respect of <u>any</u> claim

[8] Paragraph 50 of the judgment.

for delay. A Court or tribunal is likely to decide that, if the parties have agreed a notice requirement for some claims for delay, it is unlikely that the parties would have intended that other claims for delay would not require any notice. This would defeat the object of such notice requirements, which is to enable both parties to know where they stand in relation to claimed extensions of time.

Modifications

The judgment also highlighted the danger for a shipyard in carrying out extra work without an agreement as to the extension of time or, at the very least, a binding agreement that, if the parties are unable to agree an extension of time, an appropriate adjustment to the delivery date can be made by the tribunal.

The shipbuilding contract in *Jiangsu* contained the usual provision entitling the shipyard to refuse to carry out additional work unless the appropriate adjustments to the contract, including the delivery date, had been agreed. Given this right, the Court held that there was no basis for the shipyard to claim an extension of time where it had carried out additional work without any such agreement.

The judge did, however, suggest that the parties could always make an ad hoc agreement that the shipyard would carry out the additional work and if the parties failed to agree the appropriate extension of time, this could be determined by the tribunal.

It would, however, be important to document such an agreement clearly, and to ensure that it complied with any requirements in the contract for agreeing variations.

Option to extend the delivery date in the event of a delay in payment of any of the predelivery instalments

The shipbuilding contract contained the usual provisions that, if an instalment of the contract price was paid late, "the Delivery Date shall, at the [shipyard's] option, be postponed for a period of continuance of such default by the Buyer."

The Court held that, for the shipyard to claim this extension, it must communicate to the buyer that it is exercising its option to postpone the delivery date before the delivery date arises. Consequently, a shipyard cannot claim such a postponement in defence of a cancellation for delay if it did not provide such a communication to the buyer before the delivery date.[9]

[9] It is also important that the shipyard ensures that any such communication complies with any requirements of the contract in order to be effective.