

# English Law Covid-19 Q&A Series: Shipbuilding Contracts

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PRACTICES Shipping

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## **Does the Covid-19 pandemic (or actions taken to counter the spread of Covid-19) constitute a Force Majeure in a shipbuilding contract? Is there any implied right of relief for Builder or Buyer?**

Under English law, unlike civil law systems, a force majeure is neither defined nor automatically applicable to commercial contracts.

In order for a party to be excused for non-performance of a contractual obligation by relying on the force majeure principle, the contract must explicitly incorporate a force majeure clause which can either have a closed list providing for specific events that would constitute force majeure events, or a wider definition such as “events outside the parties’ control”.<sup>1</sup>

The COVID-19 outbreak may potentially fall under multiple force majeure categories. It will almost certainly be covered in a shipbuilding contract that includes a “pandemic” or “epidemic” as a force majeure event (which became common practice following the SARS and MERS outbreaks). Though “pandemic” is the most obvious option in the current scenario, it may also be possible to rely on other force majeure events, provided these are included in the pertinent clause of the contract, such as “quarantine,” “entry and exit restrictions,” “restraint of princes, rulers or people” or “requirements of government authorities,” especially in cases where the builder’s employees’, builder’s suppliers’ and/or builder’s sub-contractors’ performance has been hindered due to a measure imposed to curb the spread of COVID-19.

As an alternative to the force majeure principle, a party may seek to rely upon the English law doctrine of frustration. Frustration requires the presence of a supervening unforeseen event through no fault of the parties that has occurred after the formation of the contract. For an event to be a frustrating event, it must make performance of the contract illegal, impossible or radically different from what was anticipated by the parties. If a party establishes that its performance of the contract has been frustrated, then the contract is automatically terminated, and parties discharged from any future performance. The threshold to establish frustration is typically very high as it provides for the existence of strenuous circumstances and severe events that undermine the purpose of the contract.

In the context of a shipbuilding contract that anticipates pandemics as a possible force majeure event and legislates for how any associated delay is dealt with, it is unlikely that frustration will be an available remedy. However, it is possible that supply contracts could be frustrated which in turn would have an impact on any force majeure claim by the builder.

## **If the Covid-19 pandemic (or actions taken to counter the spread of Covid-19) constitutes Force Majeure what might that mean for:**

### **A) The Builder?**

For the builder to trigger a force majeure clause, depending of course on the specific wording of the contractual provision, the following requirements need to be satisfied: a) there is a force majeure event within the meaning of the contract; and ii) the force majeure event is preventing or delaying the builder from performing the contractual obligation, i.e. any delay claimed must be due to/ caused by the force majeure event. It is also important in clauses where giving notice of the force majeure is a condition precedent to claiming an extension of time that the notice requirements have been fully complied with (the force majeure notice provision should be carefully reviewed to determine if the notice is in fact a pre-condition to claiming an extension of time).

The builder should also be aware of any provisions imposing an obligation on the party seeking to invoke a force majeure event to mitigate losses and effects of the force majeure event.

Additionally, the builder who is successful in invoking a force majeure event is usually entitled to an extension of the contractual delivery date, subject to any duties to mitigate such delay. However, the builder should be mindful that if the aggregate number of days of delay due to force majeure event and/or certain of the delays exceed a prescribed number of days, the buyer maybe entitled to cancel the contract and receive a refund of the pre-delivery instalments paid.

## **B) The Buyer?**

Shipbuilding contract force majeure clauses primarily benefit the builder as they do not typically confer any rights to the buyer. Accordingly, even if the COVID-19 pandemic falls within the scope of the force majeure clause and prevents (or delays) the buyer performing certain of its contractual obligations or exercising certain of its contractual rights (for example the delivery of “buyers’ supplies” to the shipyard, supervision of construction or attendance of trials), the force majeure clause is unlikely to afford the buyer any rights or benefits.

As a result, the buyer could find itself in breach of contract or unable to exercise its rights and will need to carefully consider the relevant clauses in the contract to determine the consequences this could have with respect to the construction of the Vessel and the builder’s rights.

In certain situations, the buyer may find that the COVID-19 pandemic impacts the ability of the buyer to make instalment payments (for example if the buyer is unable to drawdown on its intended source of funding). Any difficulties in paying an instalment is of particular significance as non-payment of instalments is likely to trigger a contractual termination right for the builder. Whilst contractual cure periods may provide some leeway to the buyer, if there is a concern that this may happen, it may be prudent for the buyer to take early steps to ensure that payment can be made and, if not, reach out to the builder to see if an extension of time for payment can be agreed (noting that the builder may also be concerned with issues relating to its ability to perform its own contractual obligations).

## **Are there wider practical considerations for a builder in the face of the Covid-19 pandemic?**

As the COVID-19 pandemic is likely to have wide reaching global economic repercussions, the builder should closely monitor the solvency of the buyer, any guarantor and if applicable, any project the vessel is intended to service after delivery.

The builder’s supply chain may well be disrupted, impacting the ability of the builder to source material and equipment. The builder may wish to review the extent to which its contracts afford it rights to substitute materials and/or equipment with/without the buyer’s consent, and whether the contract provides for a closed “makers’ list”. In circumstances where the builder is being delayed

because the contract limits the ability to make substitutions, the builder should further consider its obligations under the force majeure clause, which may provide that the builder shall take reasonable steps to overcome or mitigate any delay. In some circumstances, this may potentially extend to using different suppliers or materials. In the event this creates a tension between the mitigation obligation and the makers list, it may be necessary to seek legal advice and/or seek to reach an agreement with the buyer.

Additionally due to governmental travel restrictions and national “lockdowns”, service of a notice may become a more complicated process, for example if the contract provides for hand-delivery of notices (although English law typically, in the absence of contrary provisions in the contract, treats courier delivery as hand-delivery) and the buyer is not maintaining a representative on site). Accordingly, the builder should, so far as possible, consider any requirement to give a notice well in advance so that the builder complies with any notice related time limits.

### **Are there wider practical considerations for a buyer in the face of the Covid-19 pandemic?**

As the COVID-19 pandemic continues, the buyer should closely monitor the solvency of the builder. If the builder goes into liquidation/ becomes insolvent, then the builder may be in default under the shipbuilding contract so as to give rise to a right for the buyer to terminate. Most shipbuilding contracts require the builder to provide a refund guarantee or refund guarantees (usually issued by a bank and of an aggregate value at any one time at least equal to the value of the total instalment the buyer has paid the builder at such time). In order for a builder to be able to make a claim under the refund guarantee, it is usually a condition that the buyer must have terminated the shipbuilding contract in accordance with its terms, and therefore any decision by the buyer to terminate the contract shall be carefully considered to ensure it does not prejudice the buyer’s security and the refund guarantee.

Another practical difficulty that the buyer may well face is mobilising or maintaining its supervision team and/or crew at the shipyard. With multiple countries operating “lockdown” policies, the buyer may struggle to position its representatives, and as a result, its ability to supervise construction, attend trials and inspections could be severely impacted. It would be prudent to check the extent to which the contract allows the builder to proceed with construction absent such buyer’s supervision and attendance at trials and inspections. If the contract provides (as they usually do) that the builder is able to proceed with construction, then it may be worth the buyer exploring different ways in which the builder can evidence/report construction, trial results, etc., to the buyer. It may be possibly useful in those circumstances for the builder to provide more detailed reports to the buyer and consider whether use of photographs and video footage can be used to update the buyer and demonstrate the construction of the vessel is in accordance with the terms of the contract.

If a vessel is close to delivery, lack of crew onboard the vessel will severely restrict the buyer’s ability, inter alia, to remove the vessel from the shipyard after delivery. The buyer should carefully review its contractual obligation to remove the vessel and the consequences of failing to do so as it may be necessary for the buyer to negotiate arrangements with the builder whereby the delivered vessel can remain at the shipyard with minimal or no crew onboard.

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The buyer should also review the vessel's employment arrangements ex-yard. Ideally, the delivery of the vessel under a charter party or other form of employment will be tied to the actual delivery of the vessel under the shipbuilding contract. If not, the buyer should review the relevant contracts and their late /non-delivery arrangements.

**If a shipbuilding contract is entered into now, will any of the contracting parties have an immediate right to postpone the “Delivery Date” as a result of the ongoing Covid-19 pandemic?**

One of the central elements of the drafting of most force majeure clauses is the “un-foreseeability” of the occurrence of the force majeure event when the contract is signed. Given the obvious impact the ongoing COVID-19 pandemic is already having around the world, it may well be difficult for the builder to establish that COVID-19 pandemic related disruptions and/or delays constitute a force majeure event entitling the builder to postpone the “Delivery Date” of the vessel unless the parties amend/waive the requirement for a force majeure event to be unforeseeable. As having a fixed delivery date is a key element of most shipbuilding contracts (and of particular importance to a buyer), it would be prudent for a builder to factor in any likely delays in the construction (including those it considers may arise from the COVID-19 pandemic) in the time for delivery at the outset, rather than relying on potential extensions of time under the contract when it is signed.

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<sup>1</sup> Although such clauses still often include a list of events by way of example.