Cecil and Dracoulis in Maritime Magazine: Lessons Learned from M/V Dali

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The recent lawsuit filed by the owners and managers of the M/V Dali, the vessel that struck and destroyed Baltimore's Francis Scott Key Bridge, against Hyundai Heavy Industries raises significant questions about shipbuilders' post-delivery liability. If successful, the case could challenge long-standing industry norms and reshape the legal landscape for shipbuilding contracts governed by English law. Haynes Boone Partners William Cecil and Andreas Dracoulis authored an article for *Maritime Reporter and Engineering News* to discuss the lessons that can be learned from this lawsuit and these shipbuilding contracts.

Read the full article below.

The owners and managers of the M/V Dali, the ship that destroyed Baltimore's Francis Scott Key Bridge, have brought a claim in the Pennsylvania Court against the vessel's shipbuilder, Hyundai Heavy Industries Co. Ltd. The M/V Dali was completed and delivered by HHI in 2015, so is 10 years old.

The owners/managers allege strict products liability for defective design and manufacturing, breach of implied warranties, negligent misrepresentation, negligence and an indemnity and/or a contribution. The owners/managers are claiming the cost of damage to the vessel, a contribution/indemnity for any damages sustained by the owners/managers in claims by third parties in respect of personal injury/death or damage to property (referred to as the Limitation Action) and other damages. These claims have not been quantified, but are likely to be very substantial. Perhaps not surprisingly in view of the issues discussed in this article, the owners/managers' claims say almost nothing about the underlying shipbuilding contract concluded with the builder.

If successful, these claims would break open shipbuilders' normal limited liability for defects in the vessel after delivery, as provided for in most international shipbuilding contracts (at least those subject to English law) and which form an integral part of the shipbuilding bargain. Given the recent focus on increasing US shipbuilding and ship ownership, this could be of extra significance to builders.

This article explores the normal post-delivery defects regime in shipbuilding contracts and considers examples of attempts by shipowners to get around this regime and claim additional liability from the builder. The issues are approached from an English law perspective, which is a common choice of governing law under shipbuilding contracts.

The Post-delivery Defects Regime

In all shipbuilding projects there is a tension following delivery of the vessel. The builder will want to limit its ongoing liability in respect of defects discovered post delivery; whereas the buyer will want to be covered for unknown defects that expose it to unforeseen future costs or liabilities.

This tension is usually resolved by the builder providing an express warranty or guarantee for 12 – 24 months from delivery. If a defect is discovered before the expiry of the warranty period, the builder is obliged to rectify at its own cost. Importantly, the builder is not liable for defects that arise (or are discovered) after the warranty period expires. This arrangement has value to both parties. The buyer can have the builder fix defects, albeit limited to those arising during the warranty period, without the need to engage another contractor. For the builder, not only is it obliged to rectify any defect, it also has the right to do so – which is likely to be less costly than compensating the buyer for the costs of another contractor rectifying.

Additionally, it is commonplace for shipbuilding contracts to specify that, post-delivery of the vessel, the builder is not liable beyond its obligation to rectify defects discovered during the warranty period. That means the builder will not be liable for the buyer's losses arising from loss of use of the vessel, or for the buyer's losses in the event of a casualty and arising from claims by third parties in respect of personal injury/death or damage to property, i.e. precisely the types of claims being advanced by the M/V Dali owners against HHI in the Limitation Action. Furthermore, the warranty will normally operate to the exclusion of any other contractual or statutory warranty related to the vessel's condition or performance. The builder's sole obligation, post-delivery, is to rectify defects that arise during the warranty period.

Contractual provisions reflecting this arrangement can be seen in the most commonly used standard form shipbuilding contracts – see for example Article IX of the SAJ form and Articles 35-37 of Newbuildcon.

The inclusion of what is a wide ranging exclusion of liability in favour of the builder might seem on its face surprising. However, it is precisely because of the potential costs and liabilities that might arise from defects in the vessel post delivery that the builder's liability is limited in this way. Builder's generally operate under tight margins and particularly so in the context of the more standardised trading vessels (such as a container vessel like the M/V Dali), the construction of which can be likened to a sophisticated factory production line. The vessels are produced in the most (cost) efficient way possible to meet the demands of the shipping market. Most builders simply could not operate on this basis if they had potentially unlimited exposure for defects in the vessel post-delivery.

The wider characteristics of shipbuilding projects are also relevant. The vessel will be required to meet standards defined by a recognised classification society (Class) and the requirements of a number of national and international regulatory authorities (including the vessel's chosen flag state) who will regulate the vessel's operations following delivery. In practice, this means that Class will supervise construction of the vessel, signing off on various elements of the vessel on a day-to-day basis. Additionally, buyers' representatives will review and approve work as it is undertaken. None of this affects the builder's fundamental obligation to construct and deliver a vessel according to the requirements of the contract; but what it does mean is that, upon delivery, the vessel, and its various machinery and equipment, should have undergone thorough examination by the various stakeholders, thus limiting the prospect of unknown defects slipping through the net. Additionally, and in order to maintain the vessel's ability to operate post delivery, the buyer will have to adhere an ongoing inspection and testing regime mandated by Class and the relevant regulatory authorities.

Attempts by Owners to Circumvent the Regime

Despite this well-established contractual arrangement for post-delivery defects, the extent to which a builder will compensate a buyer for its associated losses is often in practice disputed. Most

disputes are resolved through negotiations or confidential arbitration proceedings, but there are examples where these disputes have come before the English courts. Three recent examples are considered below, one concerning an attempt by a buyer to circumvent the time limit on discovery of defects; and the second and third concerning the scope of the usual exclusions contained in the builder's warranty.

In Neon Shipping v Foreign Economic & Technical Corporation Co of China [2016] EWHC 399 (Comm), the relevant builder's warranty provided that the vessel and its parts would be both "seaworthy" and free from defects due to "defective design, construction, calculation, material or workmanship". The builder's liability was conditional upon the buyer giving notice of defects within 30 days of the expiry of the 12-month warranty period, which the buyer failed to satisfy in relation to alleged defects in the vessel's cranes. The buyer argued that it was only the builder's warranty against defective design that depended upon timely notice, and that claims related to the vessel's seaworthiness were not subject to any notice requirement. The argument was rejected by both the arbitration tribunal and by the English High Court on appeal. The court considered that a distinct category of post-delivery defect claims, for which notice was not required to be given, would be "wholly artificial" and without "commercial or other justification".

China Shipbuilding v Nippon [2000] 1 Lloyd's Rep. 367 concerned welding defects discovered in a series of vessels after expiry of the relevant warranty periods. Two issues arose, both of which related to the usual practice of excluding the builder for liability in respect of any contractual or statutory warranties related to the vessel's condition or performance. First, based on the particular wording of the builder's warranty, which had been amended from the standard wording found in the SAJ form, the buyer argued (to get around the timing issue) that the builder was not excluded from liability for alleged failures to comply with express contractual obligations related to build quality and compliance with Class rules. While the arbitration tribunal found for the buyer, on appeal the English High Court was clear that the builder's warranty was comprehensive and effective to exclude all liability for breach of express terms following delivery. Second, the buyer also sought to argue that the builder's warranty could only apply to "inadvertent" breaches of the builder's quality obligations, and not where the breaches were made knowingly or deliberately. This point was not resolved by the High Court (it was remitted back to the arbitration tribunal), however commercial common sense would dictate that a builder's warranty should be interpreted as protecting the builder in all cases short of actual fraud. If not, there would be great uncertainty caused by the need to determine, in each case, whether a breach was sufficiently serious or deliberate to overcome the express exclusion of liability.

In Star Polaris LLC v HHIC-PHIL Inc [2016] EWHC 2941 (Comm), a vessel had suffered a serious engine failure within the (12 month) warranty period. The builder broadly accepted responsibility for the cost of the repairs, but the buyer also claimed damages for its loss of income and for a diminution in value of the vessel as a result of the engine failure. The builder's warranty excluded "consequential or special losses", and the buyer argued that its losses of income and value were not "consequential" in nature and were therefore not affected by the exclusionary wording. There was some considerable force in the buyer's argument, because a long line of English case law has, in general terms, interpreted references in exclusion clauses to "consequential loss" restrictively. However, both the arbitration tribunal and the English High Court rejected this argument. The builder's warranty was a "complete code" for the builder's post-delivery obligations in relation to defects. The intent of the warranty provisions was to limit the builder's liability to the cost of repairing the warranty defect and any related damage caused to the vessel. In this context, claims for loss of income and value as a result of the repairs were claims for "consequential or special losses" and were therefore excluded.