

## Andreas Dracoulis, Rahul Kumar in LNG Shipping & Terminals: Does COVID-19 Offer an Opportunity for Shipowners with Newbuild Orders'

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**PRACTICES** Shipping, Ship Construction and Conversion, Energy, Power and Natural Resources, Ship Sale and Purchase, Liquefied Natural Gas (LNG)

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The ongoing COVID-19 pandemic has had a severe impact on the maritime and offshore oil and gas sectors. Any recovery in the low LNG prices seen at the start of the year is likely to be curtailed as a consequence of weakening demand following the outbreak.

Allied with the uncertain sentiment for the year, this is likely to result in delays or scrapping of LNG projects at least in the short to medium term. This leaves shipowners without firm commitments for newbuildings and no clarity as to how long the ripples of this pandemic will continue to affect demand.

In these uncertain times, commercially prudent buyers will be looking closely at the options available under their shipbuilding contracts. However, buyers should exercise caution when taking decisions in respect of the rights under those contracts – a premature or misconceived step could open the door to significant negative financial consequences.

### **To delay or to cancel?**

A fundamental question for buyers amidst the current climate, is whether they wish to proceed with accepting delivery of the vessel as planned, or at all.

Delaying delivery can be an attractive option for buyers who are keen to continue growing their fleet as part of a long-term strategy, but wish to wait until the market recovers before paying the delivery instalment. This will allow buyers to save on incurring significant financing and maintenance costs while there is no charter for the vessel. However, and unsurprisingly, shipyards will seek favourable terms before agreeing to any delay, given their significant cost outlay during construction.

There are additional considerations, such as the risk and cost of properly maintaining and preserving the vessel pending delivery and the impact on the yard-wide schedule of other projects.

It may be possible for buyers to reach a commercial deal with the shipyard and pay a premium in return for a postponed delivery. Any such negotiations, however, will solely depend on the appetite of the shipbuilder.

If the shipowner decides not to take delivery of the vessel, it will need to cancel under one of the contractual termination provisions in order to recover pre-delivery instalments under the refund guarantee. A right to terminate may also arise outside of the contract at common law, but the refund guarantee will not usually respond in these circumstances.

The shipbuilding contract will normally give a buyer the right to cancel in certain specific circumstances. In very simple terms, these circumstances can include where the vessel fails to

meet any of the defined contractual guarantees, where there is excessive (builder-responsible) delay in delivery, or where delivery of the vessel is delayed beyond a later "drop dead" date.

If a buyer validly terminates under one of these provisions, it is normally entitled to a refund of the pre-delivery instalments plus contractual interest. Recovery of any further losses, such as site team costs, are normally excluded but the contract's wording should be carefully reviewed.

However, there can be serious financial consequences for an unjustified termination. If a buyer purports to terminate, but a court or arbitration tribunal subsequently determines that it was not entitled to do so, the buyer will lose its pre-delivery instalments and the vessel.

To make an informed decision, the buyer must consider whether the contractual delivery date has been postponed by "permissible delays" such as change orders, claims for force majeure or other permitted means, such as rule changes or adverse weather during sea trials. Whichever of these are relevant, buyers should also keep in mind the contractual formalities necessary to trigger a postponement of the delivery date.

For example, if the shipyard has not given notice in respect of force majeure, the buyer may be able to challenge any purported postponement if notice was a condition precedent.

The wording of the specification may also assist if it contains strict wording, for example, in relation to the manner in which the vessel is constructed or the required condition of the vessel prior to sea trials. If it is open to the buyer, on the correct interpretation of the contract, to hold the shipyard to these requirements, that may necessitate re-work and re-testing and therefore introduce additional steps in to the construction schedule, with the ultimate consequence that the delivery date of the vessel is pushed out.

However, this can be a risky strategy as the shipyard may be able to claim an extension of time if it is required to carry out work beyond what is necessary to comply with the contract. In the present climate, such an approach may also present difficulties to buyers who have had to reduce, or even remove, their site supervision teams. Most shipbuilding contracts provide that non-attendance at inspection/tests, including sea trials, means that a buyer is deemed to have waived its right to attend the inspection/test.

Buyers must also satisfy themselves that the refund guarantee is operative in the event of termination. Difficulties may arise because of defective wording in the guarantee or an expiry date that is too early. In some cases, variations to the shipbuilding contract without the consent of the refund guarantor may have discharged the refund guarantee. Without recourse to the refund guarantee, the buyer will rank along with other unsecured creditors of the shipyard.

### **COVID-19: a hidden opportunity?**

As countries start to recover from the impact of COVID-19, news is circulating of shipyards (no doubt concerned about a dearth of new orders) offering substantial discounts in an attempt to attract buyers. This may present a commercial opportunity for buyers willing to use future orders (at favourable prices) as a bargaining tool in agreeing extensions to existing newbuild orders with otherwise reluctant shipyards. Clearly there are risks with "on spec" orders made at this time; however, the current climate may yet represent an opportunity given that the medium- to long-term outlook for the LNG market remains positive in light of the continued push for cleaner fuels.

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