English Contract Law in Practice
Case study: Shipbuilding arbitration

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Introduction

• About the lecturers

• About Thommessen
  – One of Norway’s largest law firms
  – Specialist Shipping & Offshore department

• English law in a Norwegian practice
  – Especially relevant in shipping, offshore, oil and gas and financing transactions
  – English law is a ”neutral” and ”familiar” choice of law in contracts, also regarded by many international businesses as “commercial” with highly experienced and qualified judges and arbitrators
  – ”London arbitration” for dispute resolution is an established concept
  – The London market is key to brokerage, insurance, financing etc.
  – Many of the biggest global law firms have their HQs there

• Our view: a basic knowledge of English law concepts – even if you do not formally advise in it – is essential in practice in a department like ours
Today’s topic: a shipbuilding arbitration case study

• Confidential London arbitration, so we have had to change a few facts around - but the issues remain:
  1. Interpretation of a performance standard
  2. Quantification of an (uncertain) loss

• Briefly about a typical arbitration procedure
  1. Appointment of arbitrators
  2. Written submissions
  3. Evidence/witness statements and disclosure
  4. Expert evidence
  5. Oral hearing
  6. Arbitral award

• Questions before we begin?
Case Study: Main Facts

• Parties
  – Claimant: Buyers of a specialist oil services vessel
  – Defendant: Norwegian shipyard, with Ukrainian subsidiary yard

• Vessel ordered 2006 for delivery in 2008 – cost USD 150m

• Construction of hull/steelwork took place at the Ukrainian subsidiary’s yard, with the hull then transported to Norway for outfitting and finalisation

• Buyers had active supervisors at the Ukrainian yard, who complained about the quality of the welding and steelwork generally

• Yard took extensive corrective action during the build phase, rectifying and reinforcing poor welding seams, “forcing” steel plates into alignment etc
Illustration of steelwork (NB not our vessel)
Case Study: Main Facts (cont.)

- Vessel was eventually delivered, after outfitting, from the yard in Norway, and met classification society requirements

- Buyers accepted delivery, as they wanted to trade the vessel, but did so under a reservation of rights with respect to any claims for defective delivery quality

- The vessel was chartered out at a normal market rate and no issue was raised by charterers concerning any defects

- Buyers initiated arbitration in 2010 after unfruitful settlement attempts, claiming breach of contract and about USD 20m in damages

- Basis: breach of performance standard set out in the contract
Case study Issue I: Interpretation
Wording of the clause

1. Description and Standard
   The Vessel shall be built at the Builder’s yard at XXX, Norway … The Vessel shall be designed and built in accordance with first class shipbuilding practice in Western Europe for new vessels of similar type and characteristics …

3. Classification, Rules and Regulations
   The Vessel, including its machinery equipment and outfittings shall be designed and constructed in accordance with the rules and regulations of the Det Norske Veritas (the Classification Society) …

4. Subcontracting
   The hull and major sections thereof are to be built by the Builder at the Yard set out in Article II [the Norwegian yard], except for the steel hull which can be built at a Related Shipyards [the Ukrainian yard fell within this definition]

The parties agreed that the Builders were entitled to sub-contract construction of the hull to the Ukrainian yard, so the issue in question was the interpretation of and relationship between the two sets of wording highlighted above.

NB Sale of Goods legislation had been excluded.
Case study Issue I: Interpretation
The opposing arguments

• Buyer’s case – in brief:
  The Buyer submits that the Tribunal simply has to evaluate, using the evidence before it on the construction of the Vessel, whether the picture which emerges is one which conforms to the phrase “built in accordance with first class shipbuilding practice in Western Europe for new vessels of a similar type and characteristics as the Vessel”

• Builder’s case – in brief:
  The Builder submits that the words relied on by the Buyers add nothing to the other terms of the Building Contract since “first class shipbuilding practice in Western Europe” is not a definitive written standard and it is difficult to see how it can be capable of enforcement. Further, the Builder says that the scheme of the Building Contract is for the standards to be those of Class rules … as long as the Vessel is in class on delivery, it has been constructed to the required contractual standard.

• Discussion: Which view “feels right” in your opinion?
Case study Issue I: Interpretation
Basic principles of contractual interpretation to keep in mind

• The point of departure: words are to be given their ordinary and natural meaning, but:
  – "A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in colour and content according to the circumstances and the time in which it is used." (Holmes J., in Towne v Eisner (1918) 245 U.S. 416)

• Interpretation of commercial contracts should have regard to the custom in the trade and "business common sense":
  – "If a detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must yield to business commonsense" (Lord Diplock in The Antaios [1984] AC 191)
  – "where a term of contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense" (Lord Clarke in Rainy Sky SA and ors v Kookmin Bank [2011] UKSC 50)
Case study Issue I: Interpretation
How did the arbitrators resolve the issue?

- They rejected the argument that the absence of a definitive written standard for "first class Western European shipbuilding practice" should prevent enforcement.
  
  "It may be that such standards are difficult to apply but whether such terms are agreed expressly or implied into a contract, they are nevertheless contractual terms which any court or tribunal must do its best to apply."

- However, they acknowledged that the significance of the term must be placed in its appropriate factual context.
  
  "Trading vessels are purchased to earn a return not to impress the friends of the owner as, for instance, a luxury yacht may be. Does it matter whether the welds look neat and steelwork smooth?"

Or, as put by counsel for Builders: "Did you buy a work horse or a show horse?"
Case study Issue I: Interpretation
How did the arbitrators resolve the issue? (cont.)

• Was there any case law which had considered the wording?
  – Not the specific wording here, but similar wording in Rolls Royce v Ricardo Consulting [2004] All E.R. (Comm) 129: "If services are provided of "first class quality" it seems to me that they are provided to a standard which would not be exceeded by anyone else who might actually have been engaged to provide them."

• The arbitrators took the view that the “first class” wording was not cancelled out by wording such as the requirement of meeting DNV standards
  – As a rule, words incorporated in their contract are intended to have meaning, with very limited exceptions - from Chitty (2008): “If there is in a contract a word or phrase to which no sensible meaning can be given or which is mere surplusage, it may be rejected to carry out the intention of the parties.”
Case study Issue I – Interpretation

Conclusion

• The arbitrators found on the facts that the obligation to build to “first class Western European shipbuilding practice” had been breached

• Whether or not rectification “remedied breach”: “the Tribunal does not accept that the fact that all defects that were not initially acceptable to class were repaired to class satisfaction means that there was no breach”

• The “gap” between “Class” and “first class”: “the gap between class standards and first class standards is a narrow one but it is, in our view, a real one and one to which a monetary value can be attached.”

• The show horse/work horse argument: “we are satisfied that these matters do have an effect on the benefit an owner might expect to derive from ownership of the Vessels since they can affect longevity, cost of maintenance, freedom from steelwork failure and value on resale.”
Case study Issue I – Interpretation

Conclusion

• Discussion: do you agree? And what would the result have been under Norwegian law?

• Meland in Skipsbygging – kommentarer til norsk standard skipsbyggingskontrakt (2006) suggests, with reference to the arbitral award in ND.1999.369, that "first class shipbuilding practice” can have independent meaning, beyond the Class requirements

• After the break we will consider the next issue: Quantum
Case study Issue II – Quantum
Basic legal principles

• Remedies (the basics)
  – damages
  – action for an agreed sum
  – specific performance/injunction etc.
  – restitution

• Damages
  – Award of damages
    • damages
      – compensatory
      – compensation for what?
        » loss or bargain / “loss of expectations”: the injured party claims to be put “so far as money can do it...in the same situation...as if the contract had been performed.” Robinson v Harman (1848) 1 Ex. 850 at 855
        » reliance loss
        » restitution
        » incidental and consequential loss
Case study Issue II – Quantum
Basic legal principles (cont.)

• Measure of damages (aka ”quantum”, ”quantification”, ”assessment” etc.)
  – Reliance/restitution
  – Loss of bargain
    • Difference in value
      – actual or market values?
      – if there is a market
      – if there is no market
      – other?
Case study Issue II – Quantum
How did the arbitrators resolve the issue?

• Common ground: the measure of the buyers’ loss was the difference between the value of the vessel as delivered and the value of the vessel had the builders complied with the contract

• No direct evidence on market value could be submitted (basically because the brokers did not want to commit)

• Buyer’s approach: presenting a calculation of cost savings to be expected from building the hull in a low cost European country, compared to costs involved in a W European yard

• Builder’s approach: quality of the hull steelwork was normally not a consideration for a buyer of tonnage of this type, provided the vessel was "in class”, therefore had no effect on market price
Case study Issue II – Quantum
How did the arbitrators resolve the issue? (cont.)

• The arbitrators found the issue "very difficult"
  – main problem was that there was only a "general" market for vessels of this type, not a separate geographical one for the sub-category "Eastern European"
  – arbitrators had to do their best with the material that was provided, asking
    • "what discount would a buyer require and the seller be willing to offer to make up for any perceived difference in value?"

• The arbitrators did not find the expert evidence very helpful
  – Buyers' expert "carried out the wrong calculation"
  – Builders' expert "had a tendency to hyperbole" (exaggerate)

• Conclusion
  "Having regard to all the evidence, the Tribunal is satisfied that the value of the vessel as constructed is lower by a considerable margin than it would have been had it been constructed in accordance with first class Western European practices"
  BUT BY HOW MUCH?
Case study Issue II – Quantum

How did the arbitrators resolve the issue? (cont.)

• Arbitrators applied buyer’s expert’s methodology – i.e. cost savings – but changed an important parameter
  – from comparing cost for hull construction in Ukraine. vs. Norway
  – to comparing cost of a ”first class” vs.”less than first class” hull, both built in Ukraine
  – because hulls of this type are simply not constructed in Norway or in the rest of Western Europe

• The burden of proving loss is on Buyers and to the extent the buyers fail to prove their loss, the claim must fail
  – arbitrators therefore adopted a conservative approach, given the state of the evidence

"Doing the best it can … the Tribunal is satisfied and finds that the Buyers have established that they have suffered a loss, being a reduction in the market value of the Vessel on delivery … in the amount of X %"

• The X was significantly lower than the applicable percentage had the claims succeeded in full
Concluding remarks
A Pyrrhic victory?
Concluding remarks: did the arbitrators get it right?

• Issue I: There was a breach of the performance standard – ”Class” is not the same as ”first class”

• Issue II: The market value was lower, even though there was no ”proper market” to benchmark against - forcing the arbitrators to be very conservative

• Moral of the story: a seemingly good case on liability must always be evaluated against the prospects of documenting and succeeding on quantum

• This case was ”big enough” to be worth the gamble – not all cases will be
THANK YOU FOR YOUR ATTENTION