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The Supreme Court Ruling in the "JASMINE"

TRANSLATION AND COMMENT

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TRANSLATION

Judgment of the Supreme Court of Japan
dated: March 27, 1998
Docket No.: Heisei 5th Year (O) 1492
M.V. "JASMINE"[1]

JUDGMENT

Parties

Appellant: The Oriental Fire & Marine Insurance Co., Ltd.
Appellant: Daehan Fire & Marine Insurance Co., Ltd.
Appellant: Lucky Insurance Co., Ltd.
Appellant: Ankuk Fire & Marine Insurance Co., Ltd.
Respondent: Kansai Steamship Co., Ltd.
Respondent: Ebisu Marina S.A.

The appellants have made a final appeal of the judgment delivered by the Tokyo Court of Appeal, dated February 24, 1993, Docket No.: Heisei 3rd Year (Ne) 1192, regarding a claim for damages between the above named parties. Based on this appeal, this court rules as follows:

Judgment

The final appeal made by the appellants is dismissed.
The appellants are to bear the cost of this appeal.

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1 This BULLETIN published a translation of the Tokyo District Court decision in March 1992; and a translation of the Tokyo Court of Appeal decision in December 1993.

Reasoning

Regarding the grounds for Appeal - Issue No. 1:

1. In a situation where a vessel is time chartered based on a standard form, such as the New York Produce Exchange form and where the vessel is used for carriage of cargo, so long as the bill of lading concerning the cargo is issued by the master, the shipowner can be liable for a contractual claim as set out in the bill of lading, but as for contractual liability to a third party holder of the bill of lading, in order to decide who is the liable carrier under the carriage contract it would be necessary to examine the terms of the bill of lading.

This above is true for the following reasons.

(1) Article 704, Section 1 of the Commercial Code, provides as follows:
Where the lessee of a vessel uses the vessel in navigation for the purpose of engaging in commercial acts, as to matters relating to the use of the vessel, the lessee shall have the same rights and duties as the owner of the vessel.

(2) Under a bareboat charterparty contract, the lessee receives a vessel from the shipowner and employs the master, and mans and equips the vessel, and thereby takes possession and complete control over the vessel by obtaining the ability to order and direct the master and the crew. Under such circumstances, the lessor shipowner can not be held to be a party to the carriage contract.

(3) Under the previously described time charterparty contract, the shipowner employs the master, and mans and equips the vessel. The shipowner then provides the time charterer with the vessel. The time charterer retains authority relating to commercial matters, and the shipowner maintains possession of and control over the vessel, as the shipowner maintains the authority to order and direct the captain and crew.

(4) In view of the above differences between the time charter and the bareboat charter, it should not be interpreted that the time charterer alone is always responsible for a claim based on the terms of the contract and the shipowner is not responsible at all, and only by regarding the time charterer in the same manner as the bareboat charterer and given the existence of the above time charterparty, by the application, or by analogy of Commercial Code, Article 704, section 1, regardless of the terms in the bill of lading relating to the cargo on board the vessel issued by the Captain.

Therefore, the *Daishinin* (Former Supreme Court) September 4, 1934 judgment (Docket

No.: Showa 9 nen (O) 2320, Minshu 14 Kan 1495 page) shall be overruled on this point. The Court of Appeal decision is admitted in so far as it coincides with the above.

2. We are of the opinion that the Court of Appeal's finding of facts is reasonable in view of the evidence considered in the decision. In conclusion, given these facts, we agree with the Court of Appeal's finding that refutes the liability of the respondent Kansai Steamship in relation to the claim under the carriage contract set out in the bill of lading.

We are of the opinion that the Supreme Court cases referred to by the appellants are different from the instant matter and therefore are irrelevant, and also that the Court of Appeal decision contains no illegality as claimed by the appellants. We can not accept the appellants' allegation because the appellants are challenging the choice of evidence and the finding of facts both of which exclusively belong to the Court of Appeal or challenging the Court of Appeal decision based on their own unacceptable position.

Regarding the grounds for Appeal - Issue No. 2:

We admit that the Court of Appeal decisions regarding the issues raised by the appellants are reasonable in view of the evidence chosen by the Court of Appeal, and there is no illegality in the process of decision making as alleged by the appellants. We can not accept the appellants' allegations, including their contention that there was a contravention of the Constitution, their accusation of the choice of evidence and the finding of facts, both of which exclusively belong to the Court of Appeal, nor their allegation that there was a contravention of law and order, simply based on their own unacceptable views or because they can not reasonably understand the Court of Appeal decision.

Therefore, all Judges agree on the text of this judgment.

The Supreme Court No. 2 Petit Court
Chief Judge Hiroshi Fukuda
Judge Katsuya Onishi
Judge Shigeharu Negishi
Judge Shinichi Kawai

COMMENT

The decision of the Supreme Court in the *Jasmine* was eagerly awaited by maritime lawyers the world over, for the reason that the Tokyo District Court decision which was affirmed by the Tokyo Court of Appeal, held that the demise clause in a bill of lading

was effective. The demise clause is very common on bills of lading and whether the clause is effective is one of the most important concerns of maritime lawyers.

Briefly, the basic facts of the *Jasmine* are as follows:

In April of 1986 a cargo of rice bran extraction pellets was loaded on board the "Jasmine" in Indonesia. In May of 1986 the cargo was delivered to Korea in damaged condition. The plaintiffs demanded payment for damages from the time charterer (Kansai Steamship Co., Ltd.) for breach of contract and from the shipowner (Ebisu Marina S.A.) either in tort or breach of contract.

The first issue was - Who is the carrier? Is the time charterer the carrier?

Concerning the issue of identifying the carrier, the defendants asserted that the carrier was not the time charterer but the shipowner only. The plaintiffs based their position on the idea that the legal nature of a time charter was that of a mixed contract, between a bareboat charter and a contract of manning. Also the plaintiffs alleged that the provisions of Article 704, section 1 of the Commercial Code, which apply to a bareboat charter, also apply, either directly or by analogy, to a time charter.

On the issue of the identifying the carrier, the Tokyo District Court and the Tokyo Court of Appeal both held that in general the carrier evidenced by the bill of lading should be determined by the descriptions on the bill of lading and the interpretation thereof.

As to the carrier on the instant bill of lading, the plaintiffs asserted that the carrier evidenced by the bills of lading was the time charterer because the bills of lading contained at the top the wording "KANSAI STEAMSHIP COMPANY LTD BILL OF LADING". The lower courts noted that the bills of lading were signed "For the master", and also the bills of lading contained a demise clause on the reverse side. Therefore, the lower courts held that the contractual carrier was the shipowner under the bills of lading.

The second issue raised was whether the carrier was liable for the heating damage.

Regarding the heating damage, the plaintiffs alleged that the carrier was liable for the heating damage to the rice bran.

The lower courts held that the carrier was not liable because the damage to the cargo was due to internal heating stemming from the high temperature of the rice bran before loading and therefore the damage was due to a latent defect.

Regarding other issues addressed in the lower court decisions, it is not necessary to go into detail here as several excellent commentaries on the *Jasmine* decisions (which

has often been mistakenly spelled as *Jasmin*) have been published in English.[2]

Regarding the above two issues,[3] the Supreme Court dismissed the cargo claimant's final appeal against the respondent carrier.

The Supreme Court decision is too short to be understood well. The decision has been reported in four Japanese law journals. One journal published the text only[4] and the other three journals[5] published the text and as well as a comment on the decision. The three comments are effectively identical and although the author is anonymous I assume that the comments were all written by a Judge who is very familiar with maritime law. Within these comments I noticed that regarding the demise clause the author offered the opinion that "[t]he demise clause was not directly decided by the decision of the Supreme Court in the *Jasmine* and this issue may be decided by a future legal decision".

The "who is the carrier" issue is actually the "who is the contractual carrier" issue. According to John F. Wilson,[6] the usual rule under English law is that only one party is liable as carrier under any individual carriage contract. I agree that under normal contractual conditions there is only one contractual carrier.

When I commence suit in a cargo claim against a carrier, I usually include in the writ that the bill of lading issuer is the contractual carrier and that bill of lading issuer is liable in breach of contract, and that the shipowner is the actual carrier and that the shipowner is liable in tort. In this manner the carrier can be considered to be plural, in breach of contract and in tort.

In practice when identifying a shipowner we only have access to a shipowner's registry and have no means to access information regarding the existence of a demise charterparty.

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2 Specifically, Robert Margolis, *Validity of the Demise Clause under Japanese Law and the Consequences for Enforcement abroad of Claims under Japanese Bills of Lading*, 2 LMCLQ 164 (May 1993). Takashi Aihara, *Identification of the Carrier on the Bill of Lading and Validity of the Demise Clause under Japanese Law - The Jasmin*, THE BULLETIN OF THE JAPAN SHIPPING EXCHANGE, INC., No. 28, March 1994 at 63 - 69. Hiroshi Kimura, *Recent Legal Developments and Important Issues in Japan*, THE BULLETIN OF THE JAPAN SHIPPING EXCHANGE, INC., No. 32, March 1996 at 38 - 50. Caslav Pejovic, *The Identity of the Carrier under a Time Charter in Japanese Law - (The Jasmin Case)*, THE BULLETIN OF THE JAPAN SHIPPING EXCHANGE, INC., No 33, September 1996 at 1 - 8.

3 The Supreme Court is a law examining court and the grounds for a final appeal are restricted to contravention of law. Regarding issue No. 2, the appellants alleged that the fact finding by the Court of Appeal was contrary to evidential rules, experimental rules and the reasoning was inconsistent.

4 Kaiji-ho Kenkyu Kai Shi (Maritime Law Review) (No. 144), June 1998 at p. 52.

5 Kinyu Homujijyo (No. 1517), June 15, 1998 at p. 34; Hanrei Taimuzu (No. 972), July 15, 1998 at p. 98; Hanrei Jihou (No. 1636), June 21, 1998 at p. 18.

6 JOHN F. WILSON, CARRIAGE OF GOODS BY SEA 225 (3d ed. 1998).

Therefore we do not have a means to determine whether the shipowner demise chartered the vessel, and if a demise charter exists, the identity of the demise charterer.

Under these circumstances, if there is a demise clause on the bill of lading, I usually write in the writ that the registered shipowner is also the contractual carrier pursuant to the demise clause, although no one knows the identity of the demise charterer except for the party who has taken possession of and control over the vessel. I then pursue the bill of lading issuer in breach of contract and the registered owner in tort and in breach of contract. The contractual carrier should be plural because the shipowner or the demise charterer has admitted responsibility through the inclusion of the demise clause in the bill of lading.

In a recent decision called the *Camfair*[7] the Tokyo District Court held that "[t]he demise clause does not have the effect to discharge bill of lading issuer from carrier's liability but has the effect to assume liability together with shipowner".

While the *Camfair* appears to have taken a more realistic approach to the problem of identifying the carrier when a demise clause appears on a bill of lading, still the issues involved remain to be clarified by future decisions. The decision in the *Camfair* is now on appeal before the Tokyo Court of Appeal. ■

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7 Judgment of the Tokyo District Court dated September 30, 1997. A discussion of the decision is provided by the author of this comment in *The Camfair - The Enforceability of a Demise Clause in a Bill of Lading under Japanese Law*, THE BULLETIN OF THE JAPAN SHIPPING EXCHANGE, INC., No. 36, March 1998 at 9 - 25.

THE JAPAN SHIPPING EXCHANGE, INC.
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SHIPBUILDING CONTRACTS – SOME COMMON PROBLEMS

Harvey WILLIAMS*

I. WHO IS RESPONSIBLE FOR DESIGN OF THE SHIP

This paper sets out among other things to consider the potential responsibilities of those involved in the design of ships and offshore structures under construction. It is an area of recently enhanced importance. It has not previously been examined in any real depth. The increased emphasis now placed on design responsibility results from endeavours in every major casualty to find a culprit for it.

In the first part various aspects of contractual risk are considered, principally from the builder's point of view. The scope will later be broadened to consider possible responsibilities of others and the rights of third parties affected more generally.

The Contractual Position

The starting point is nearly always that as between builder and buyer design risk and responsibility will fall on the builder unless careful contrary provision is made.

A few standard form contracts expressly impose this risk on the builder. Most standard forms of shipbuilding contract do not expressly cover design responsibility in their printed text, although the buyer's representatives frequently require an express addition to the builder's standard duties to "build, launch, equip and complete" the vessel (Shipbuilders' Association of Japan (SAJ) form Preamble) to cover design. However, because of the essential nature of the English law responsibilities as between the seller and buyer of a vessel to be constructed, silence on design responsibility in the contract is almost certain to be equivalent to a builder's acceptance of responsibility.

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It is beyond argument that an English law shipbuilding contract is to be regarded as a sale of goods, not as an agreement to provide services. That imposes duties on the seller of **reasonable fitness for purpose and of satisfactory quality**, as well as of **correspondence with description**, unless such obligations are excluded. (Sale of Goods Acts, 1979-1994, ss. 13,14).

The builder will accordingly be required to construct and deliver a vessel which can operate safely and meets her contractual description in many different respects. Seaworthiness, in its widest sense, on delivery will be an implied if not an express obligation.

Another factor leading to the same conclusion is the inevitable overlap between design and workmanship.

It will inevitably be the builder's responsibility to maintain standards of good workmanship during construction. This arises both from the general statutory obligations referred to already and also from the very common express term to build the vessel to "first class ... shipbuilding standards". Even if a lesser criterion (or none at all) is adopted in the contract, the builder will still be required to build to a sound standard of workmanship. Design and workmanship cannot easily be placed in two separate compartments. As one well-known judge said (in the rather common context of a case of leaking hatch covers!):

> *" ... the contract ... required Gotaverken to supply watertight hatch covers. This required good workmanship both in the design and the execution, and if there were design errors, I see no reason why these should not be characterised and attract liability as bad workmanship ..."*
>
> (AB Gotaverken v. Westminster Corp. [1971] 2 Lloyd's Rep.505, 512 per Donaldson, J.).

One may for these reasons safely conclude that only in cases where a successful attempt is made to transfer design risks to the buyer will the builder escape responsibility for them. The possible extent of that responsibility is considered below.

Exclusion of Design Liability

The simplest case to consider is where the parties agree in bald terms that the vessel will be built to the buyer's design, or to a design provided on behalf of the buyer. Even then it will not be enough simply so to say in the contract, because the builder will still

be likely to have obligations to deliver a functioning vessel. If the design is the buyer's, but execution and the responsibility for delivery of a working ship (or a vessel of "satisfactory quality", Sale of Goods Act, 1979, s.14) is with the builder, the result is likely to be confusion and quite possibly expensive litigation to sort it out. It will be far from clear in such cases that the builder can avoid liability for significant malfunctions of the finished vessel. As already noted, the completed vessel will need to correspond to her contractual description (Sale of Goods Act, 1979 s.13). The specification is that description and may well contain obligations which because of a defect in buyer's design cannot be met. Even though the fault would then lie squarely with the buyer he might have a right to reject the finished vessel.

In practice then, further careful checking of the contract and specification by the builder will be necessary when it is agreed that the buyer shall take the design risk. There are likely to be other undertakings which are affected by design (e.g. deadweight capacity or compliance with stability rules). Unless modified such obligations could leave the builder back where he started or, at best, having to argue that conflicting terms should be resolved in his favour.

Similar problems may arise when a yard accepts a duty to incorporate extensive buyer's supplies into a standard hull form.

In either case some further clarification of the position is desirable. A simple clause might achieve the desired result. It would need to make it clear that the vessel was built (wholly or partly) to buyer's design and that the specifications had been prepared by reference to that design.

It would also need to clarify that any statutory or contractual obligations and references to standard of the finished ship were to be read as excluding any responsibility of builder for shortcomings which could be traced back to the buyer's own design.

If one considers the case of a buyer's design incorporating novel or radical elements, or the not infrequent requirement to adopt untried technical innovations specific to a given buyer's commercial purposes, it is suggested that a good clause should protect the builder from potentially open-ended liability for trying (and perhaps failing) to make such a design work.

Of course a clause such as that referred to above has the possible disadvantage of putting the design, and consequently the vessel acceptance question, very specifically

under the spotlight. More (or less) specific alternatives with corresponding advantages and disadvantages could of course be considered.

Various different clauses have been developed recently to meet these problems. They also need to be carefully adapted to the particular contractual circumstances in which they appear.

Even where design responsibility is transferred (or similarly when a large volume of buyer's supplies is to be incorporated into a basic hull design) the builder cannot expect to get relief from a failure correctly to build to the supplied design or from a failure correctly to incorporate the supplies into the completed vessel in accordance with the supplier's directions.

"Verifying" Buyer's Design

The next variation to consider is where a buyer's design has to be "verified" or "confirmed" as "constructible" (or viable) by the builder. Expressions like these are sometimes used in contracts for construction of offshore units of various kinds. The essential characteristic of most such contracts is that highly sophisticated buyer's equipment may need to be incorporated successfully into a relatively simple basic structure. Such terms are dangerous for builders because their meaning is untested and therefore uncertain. There is an obvious risk that if the builder agrees to "verify" the design (or elements of it) he assumes responsibility for something which is not even his own original work. This would potentially make matters worse than if a builder warrants his own design work. In any event the interface between the builder's and buyer's respective areas of responsibility needs to be addressed very carefully. This care will apply not just to the design clause which, unless given paramountcy by phrases of the "notwithstanding anything elsewhere herein contained" type may merely lead to ambiguity. There are likely to be implications of some significance in various other areas of contract. For example, what if an unforeseen design defect causes performance deficiencies, or where the problem is discovered, perhaps for good reason, so late in construction that there is major cost involved in putting matters right. Should one regard this as a change order, and if so, do the modification provisions (SAJ, Article V) legislate for such a possibility. It is possible that if a buyer's design causes other deficiencies in the completed unit that will offer a defence to a claim by the buyer, but such a defence would have uncertain prospects and the arguments for getting this matter right at the outset are overwhelming.

We now turn from design for a while, although we shall come back to it later. Let

us now consider ...

2. RIGHTS OF REJECTION OF A NEWBUILDING

The most common source of disputes between builders and buyers of new ships is undoubtedly over possible rights of the buyer to refuse to take delivery of the completed ship.

In looking at these problems we first need to understand one important possible misunderstanding. A right to refuse delivery (i.e. to reject the ship) is not the same as cancelling the contract. There are some rare cases where the two things go together, but these are exceptions.

Let us look at an example. A tanker has been built and has undergone seatrials. During final inspections of ballast tanks some peeling of paint coating is noticed. The buyer thinks it important, the builder disagrees and says he will deal with the problem as a guarantee claim after delivery "if necessary". So the builder tenders the vessel for delivery. The buyer refuses to take her. This does not terminate the contract. Of course if the parties continue to argue about the point and the cancelling date arrives, then the buyer could terminate if it suits him to do so, but words in the arbitration clause may affect the situation.

In other words, the builder can, if he needs to, "have another go". In fact he can go on trying to rectify any problems (or alleged problems) there may be as many times as he likes and then retender the vessel each time until the cancelling date intervenes.

So we see that rejection of the vessel is not the same thing as cancelling the contract.

I mentioned possible although rare exceptions. If the builder's performance of the contract is so bad that it is to be regarded as legally out of the question for him to be able to correct a deficiency then the buyer could terminate the contract without waiting for the cancelling date. In practice this would be extremely unlikely to happen. In fact it is difficult to think of a convincing example. Only two such cases have arisen in the present writer's experience - if one leaves aside express clauses. One such case where the buyer was able to terminate without waiting for the cancelling date was where the yard got so far behind schedule that it became absolutely certain that the ship would be incomplete at the cancelling date, or for more than a year afterwards. When this happened it was decided by the buyer to terminate the contract at once because :

(a) the shipyard had laid off almost all its labour force and

(b) an instalment of the contract price was about to fall due

(c) there were worries about the enforceability of the refund bank guarantee.

Rather than pay money which he was afraid he might never see again, the buyer decided to accept the builder's conduct as a repudiatory breach of the contract. This terminates the contract with immediate effect. We shall discuss such breaches more specifically in Section 4 of this presentation.

In the particular case the buyer got away with this, but I cannot stress too strongly that terminating before the cancelling date is rare and extremely dangerous for the buyer.

The Basic Rules concerning Rejection

When can a buyer reject?

The starting point is that the ship must comply exactly with the contract.

Obviously with something as complex as a shipbuilding contract exact correspondence is an almost impossibly high standard. There are almost certain to be some defects.

Some problems will be so slight that no buyer could realistically claim to reject for them. Suppose for example the ship vibrated slightly while accelerating through certain speeds, or some of the fittings in the accommodation were of a different colour to what was specified.

Naturally enough the difficult cases are those where a defect is of uncertain effect and the parties genuinely disagree about it.

It also has to be said that a majority of all the disputed cases which arise do so less because of a genuinely serious difficulty than because the buyer wants to try to extract some commercial advantage from a problem situation.

As noted already, English law regards the sale of a new ship as a sale of goods by description. The description is basically the specification. Therefore to be "deliverable" the ship must conform to the specification. The real question is "how closely" or "how

accurately".

In one case which arose about 12 years ago the buyer of some high specification product tankers said he was concerned about pitting in the cargo tanks after ballasting on sea trials. The buyer was perhaps in truth more interested in getting a discount on the contract price because the market had fallen. He decided to send no less than fifty inspectors with magnifying glasses on board. The outcome was indeed a discount, but it is unlikely that a rejection would have succeeded, even though the longevity of cargo tank surfaces is a matter of wholly genuine concern to the buyer.

Various lessons can be learned from that case.

(1) To the Builder delay is costly, whatever the reason;

(2) Being a nuisance can be worth a lot of money;

(3) When the market changes, the written contract may not be as important as changed negotiating strength;

(4) Restrict the numbers of inspectors the buyer may deploy at the yard!

As a general rule we may perhaps say that: "any defect or non-conformity with the contract and specification which has a significant effect on the value, quality or fitness for purpose of the completed ship will justify her rejection."

That is not a formal legal definition but it may be of some general guidance. A rule of thumb if you want one. However, these basic rules just described are varied in many contracts by the actual words you use in the contract.

This is because the Sale of Goods Act rules as already summarised are not a compulsory code of law. They only apply in so far as no contrary intention is expressed in the contract.

So let us next look at some of the typical clauses we meet in the standard contracts and variants on them.

"The Vessel shall be built in all respects to first class shipbuilding standards."

"The Vessel and all parts of her construction shall be completed in accordance with the highest standards of international shipbuilding, but subject also to the requirements of the Specification ... which forms part of this contract."

"The Vessel when delivered shall be completed to normal quality standards in all respects. However the buyer shall not refuse delivery of the Vessel because of any minor or insubstantial defects which do not materially affect the commercial ability of the Vessel to operate. Any such defects will however be dealt with by the builder under Article IX (Warranty of Quality)."

The object of clauses like these is to provide a framework for determining difficult disputes which might otherwise arise just as the parties should be preparing to give and to take delivery. Their merit is thus obvious, even if it must be said that no clause will ever eliminate all such problems.

We must next look at two associated matters which often cause difficulties or misunderstandings.

Tender of Vessel

If we consider Article VII of the SAJ form, we see that it provides that if the buyer declines to take delivery of the vessel when she is ready for delivery, then the builder may "tender" the vessel to the buyer.

In the SAJ form this concept is clear and quite simple in its purpose. What it means is that if the buyer wrongfully rejects the vessel the builder, by formally tendering delivery, starts time running. An arbitration might in an extreme case then be needed to determine if the buyer or the builder was right about this. If the builder was right then the Warranty Period (of 12 months) will start to run from the time of the tender of delivery and any delay or cost while this dispute is sorted out will be for the buyer's account.

If on the other hand the buyer was justified in his rejection then the tender will not work. Except in a very serious and extreme case of dispute one may expect that delivery will ultimately take place, but the delay is likely to be at builder's risk and the builder might also have to rely on the arbitrators to agree to extend the time for delivery, as they would usually have the power to do.

This concept of "tender" is a special usage peculiar to the SAJ style of contract. It

normally has a less precise meaning in English law, simply referring to any offer of delivery of goods under a sale contract, whether or not accepted. This is only a terminological point however, which is mentioned in order to avoid confusion.

Construction Approved by Representation

In Article IV of the SAJ form we frequently find a clause which gives the buyer's appointed representatives the right to witness and approve any (or some) tests and trials of equipment being installed during construction.

We need to consider what happens when the buyer has this opportunity and either

(1) does not attend, or
(2) attends and does not comment, or
(3) actually approves the test in question.

Assuming of course that nothing has changed in relation to the item in question when the time comes for delivery, can the buyer reject the vessel in any of these three cases? We shall consider these specific cases. We also need to consider what to say about additional expenditure and loss of time caused by the buyer only reacting in an untimely manner if he is in principle entitled to reject.

Is it perhaps surprising that this subject is not dealt with by a specific clause. One rarely sees such clauses. Evidential difficulties make them a little less useful than one might expect. In general it is hard for the builder to succeed in an argument that the buyer is prevented from complaining simply because he had, or even utilised, an opportunity to witness a test. In principle at least, one would expect arbitrators to be unsympathetic to a buyer who had an opportunity to object to something in timely fashion but only does so late in time. However there is little practical experience of such claims being fought.

Attitude of Arbitrators

We may note that arbitrators are usually chosen in rejection cases for their commercial as well as legal and/or technical awareness. Choice of arbitrators can be important.

Good arbitrators are usually sensitive to the interplay of market and commercial factors on building contracts. Consider a buyer's likely approach to deficiencies in a rising and in a falling market. Both charter and building/S & P markets may need consideration.

In the typical case we may expect most good arbitrators to be reluctant to uphold a rejection that they think is based upon commercial grounds rather than on good faith technical ones.

3. CANCELLATION RIGHTS AND DISPUTES

The Force Majeure Clause

Obviously in any contract you need a protection clause in case things go seriously wrong. This is because basically English law contracts are enforced just as they are written and every legal system must have an answer to the philosophical question.

> "What is to happen if the situation completely changes?"

War is a very obvious example. What could we have said to buyers of ships from what are now the Croatian yards in 1990 when their country was almost destroyed by civil war?

Financial disaster is equally problematical for a shipyard, although this may in some cases be legally a self-induced problem.

Then what shall we say about strikes, especially in parts of the world where labour unrest is a recurrent theme?

Or take changes in government or in regulations. In some countries questions like this can have a very serious effect on contracts, although the SAJ form does deal (some would say rather awkwardly) with changing regulations.

These are just a few of the more obvious problems, but as you will know the extent of a Force Majeure Clause in a building contract is very great.

Have a look at this typical extract from a clause:

> *"If at any time before the delivery of the Vessel, either the construction of the Vessel or any performance required hereunder is delayed due to Acts of God; acts of princes or rulers; requirements of government authorities; war or other hostilities or preparations therefor; blockade, revolution, insurrections, mobilization, civil war, civil commotion or riots; vandalism; sabotage; strikes, lockouts or other*

labour disturbances; labour shortage; plague or other epidemics; quarantines; flood, typhoons, hurricanes, storms or other abnormal weather conditions not included in normal planning; earthquakes; tidal waves; landslides; fires, lightning, explosions, collisions or strandings; embargoes; import restrictions; defects in major forgings or castings; shortage of materials or equipment, or delay in delivery or inability to take delivery thereof (provided that such materials and equipment at the time of ordering could reasonably be expected by Builder to be delivered in time); prolonged failure, shortage or restriction of electric current, oil or gas supplies; defects in materials, machinery or equipment which could not have been detected by Builder using reasonable care (provided same did not result from Builder's failure to take the reasonable necessary measures to avoid any such delay) ..."

We should understand that in cases of doubt or ambiguity clauses like this are interpreted rather strictly against the builder. This is because it is a clause imported into the contract for the builder's benefit.

Because any such doubts are resolved "against" the builder he will want to write the force majeure clause as comprehensively as possible - and so clauses get longer and longer. There is no general concept of force majeure in English law such as there is in some other legal systems, where any unforeseen event affecting contract performance excuses the party affected. The builder therefore has to say exactly what he means. Thus "war" would not include civil disturbances and a strike does not include a lock-out - and so on.

It is important to look closely at the terms of a clause like this. Consider the particular risks which affect any given shipyard. For example some areas of the world are particularly prone to typhoons. Should this risk be excluded in those places? Likewise if a shipyard has a long history of labour problems, should you not consider modifying the "strike ..." exception.

The next difficulty is the notice clauses.

It is a real nuisance to have to tell the buyer things he is already well aware of. If there is, say, a fire at the yard, why should the builder tell the buyer when his resident inspectors know perfectly well what has happened?

Broadly speaking, these clauses are interpreted so as mean that only if the buyer is

put at a disadvantage by absence of notice is the builder penalised for not giving the notice. This might happen if the buyer was unable to investigate the facts at the time because he was not told that the builder intended to "claim force majeure".

A lot of disputes under shipbuilding contracts happen because the builder claims force majeure and the buyer disputes this. Perhaps the buyer also thinks the problem is the yard's own fault, or that with reasonable care the adverse effects could have been avoided.

So, for example, a strike may be the result of the builder's bad treatment of his labour force. There was one case where a ship nearing completion broke adrift from her moorings in a typhoon. She was swept across the bay and was badly damaged by grounding on rocks. Was this the result of "storm" or of builder's negligence? Generally speaking the builder may not claim force majeure if he could by responsible efforts have avoided the problem, but the test is not very stringent, as we shall see.

4. DEALING WITH DIFFICULT PEOPLE

Do not imagine that either side has a monopoly on being difficult. Much usually depends upon the state of the market. As we have already seen more disputes are market-orientated than many people would be prepared honestly to admit.

We must first look at a few legal technicalities.

Damages

Damages are the natural and normal remedy for a breach of contract. Many breaches of contract in shipbuilding matters are dealt with by **liquidated damages**.

This expression simply means that the level of damages for a given breach of contract is preagreed. You will be familiar with this idea in relation to late delivery, speed deficiency, excess fuel consumption and lack of deadweight capacity.

It is not difficult to see why. If a builder breaches the contract, the buyer's standard remedy is to recover damages. Damages are a calculation of the loss which is legally foreseeable at the date of the contract as resulting from the breach in question.

It is obviously very difficult to calculate the actual loss resulting from a breach of the "guaranteed" speed clause. It is hard to know how the deficiency will affect the vessel

over her career, or how this can be translated into money terms. So the parties agree a figure for each 1/10 knot of shortfall of speed and that is the end of the matter, i.e. so-called "liquidated damages".

Any of the other liquidated items are similarly dealt with together with a clause saying that the buyer gets no other remedy. However if the deficiency in question exceeds a certain given level (such as one knot in speed, or 1000 tonnes in deadweight) then a **right of termination** will arise. It does so because the contract says so, i.e. the termination (or cancellation or rescission) right comes about only because the contract says so. The right would not otherwise exist.

The contract may also provide for other express rights of termination by one party or the other. Such rights need to be distinguished from rights to terminate for a **repudiatory breach**.

This sort of breach of contract is one so serious that it justifies the other party in terminating the contract at once as well as claiming damages. Examples include going bankrupt - or unjustifiably refusing to continue construction (as we saw in Section 2 above), demanding a price increase or refusing to pay an instalment of the contract price when it falls due.

These technical terms (such as repudiation, rescission and cancellation) are difficult to follow. They are of only limited interest to us for present purposes. For those who so wish however, a memorandum regarding these terms is included as Appendix A.

5. FINANCIAL SECURITY PROVISIONS

The English law of guarantees is very technical. Expert legal advice is needed if serious risks of unenforceability are to be avoided. Again for those interested an example of a guarantee is set out at Appendix B to these notes.

A guarantee is of course a legally binding obligation. It is to be strongly contrasted with a **Comfort Letter**.

A comfort letter must be understood as binding on the date it is given only. It connotes at best some moral obligation, or, more accurately, it is an expression of present intention, not a promise of future conduct. As a matter of analysis one needs to look carefully at the wording in any particular case. For general guidance however when one sees the

word "intention" this is a warning that the document may be less than a binding guarantee. (Kleinwort Benson v. Malaysian Mining Corp. [1989] 1 Lloyd's Rep. 556).

6. WARRANTY OF QUALITY

This is the (rather misleading) title of Article IX of the SAJ form of contract. What it really involves is a post-delivery repair obligation on builder or - even more accurately - a limitation on builder's post-delivery liability.

In almost all normal building contracts you will find a clause such as the following:

> *Subject to the provisions hereinafter set out, Builder undertakes to remedy or replace, free of charge to Buyer, any defects in the Vessel which are due to defective material and/or improper workmanship on the part of Builder and/or its sub-contractors, provided that the defects shall appear or be discovered during a period of twelve months after the Actual Delivery Date (the "Warranty Period") and notice thereof is duly given to Builder. For the purpose of this Article, the Vessel includes her hull, machinery, equipment and gear, but excludes material, machinery and equipment which have been supplied by or on behalf of Buyer.*

In simple language the builder says he will make good things which go wrong as a result of his poor work if notice is given within 12 months after delivery.

It will probably be obvious to you that this is a good deal less than a buyer could expect if nothing had been said. Our opening remarks on the Sale of Goods Act provisions will have made that clear to you. In other words the clause is a partial exclusion clause.

Clause IX.2(c) makes this clear.

> *The undertakings contained in this Article replace and exclude any other liability, guarantee, warranty and/or condition imposed or implied by the law, customary, statutory or otherwise, by reason of the construction and sale of the Vessel by Builder for and to Buyer.*

In addition Article IX puts other and quite severe limitations on the builder's responsibility. These in particular exclude his liability for almost everything other than the direct cost of repair at the building yard. Responsibility for damage to property other than the ship, for loss of profit or of time is thus excluded. It is most important to notice that

these limitations will not help the builder if he cannot rectify the problems which are his duty under Article IX. One class of specified vessels built in the late 1980s was found on seatrials to have irremediable steering difficulties. They could not maintain a safe straight course. In a debate over the Warranty of Quality clause the builder tried to say his liability was limited. This argument was rejected. The limitations on builder's liability were effective only when he could remedy the problem. In this case the builder was liable to pay damages for the whole of buyer's loss.

We shall also need to look at the way in which the builder's and the buyer's insurances affect this in the next section.

7. WHO PAYS WHEN THINGS GO WRONG?

Post-Delivery Obligations

We shall now look again at the matter of design responsibility.

It is likely that the Warranty of Quality clause (SAJ, Article IX) will have a bearing on responsibility. In negotiating this there should usually have been a debate about whether the builder expressly guarantees to rectify design deficiencies as well as defective materials, construction and workmanship. That much is obvious.

If the construction is to a buyer's design the builder may need to go further and expressly exclude liability for any consequences of the deficient design. It must be remembered (as described above) that in substance (if not in form) this clause will be regarded by English lawyers as an exclusion or limitation of liability provision and thus to be construed in cases of doubt against the builder's interest (*contra proferentem*). Only the clear exclusion of responsibility of any of the consequences of design will avail the builder faced by such a claim (AB Gotaverken v. Westminster Corp. (above)).

Again as described above, and following on from the same *contra proferentem* principle, if the builder cannot rectify a defect for which he is at law responsible, then provisions limiting his liability will not help him either. As a result damages at large may well be payable, not merely the replacement of broken parts as the standard SAJ wording envisages. Diminution of value, loss of earning capacity, of time and third party liability are then likely to come into the picture. Further aspects of such a matter are also reviewed in the next section.

In short, the more advanced or innovative the design may be the more caution should be used in thinking through the potential risks involved.

Contractual Consequences of Deficient Design

It is trite law to say that the purpose of a damages award in English law is to put the innocent party in the same position as if the breach of contract had not been committed, but this will not be of much help in working out compensation for design defects in building contracts. It is not infrequently seen that some of the most cataclysmic accidents may be presented or found to be the result of design defects (see "AMOCO CADIZ" [1984] 2 Lloyd's Rep. 304, 309-310 and generally).

By its nature a design defect is much more likely to manifest itself after delivery than before. Where it does occur after delivery there is no certainty that it will do so within the contractual limitation period, almost invariably of 12 months, provided in the contract.

Where the problem is identified before delivery, then the main issue is likely to be whether a defect can be rectified. As already noted, this will most often involve the builder's responsibility. If he can make good the design defect he will be obliged to do so at his own expense and that will be an end to the matter provided that time limits for rescission or cancellation do not intervene. Where design responsibility is transferred to the buyer the duty of rectification will probably fall to be adjusted under the Modifications provision of the contract. (SAJ, Article V).

Where the builder is unable to rectify a design defect appearing before delivery difficult questions as to the deliverability of the completed ship or unit may arise. We have already discussed the likely limitations on a buyer's rights of rejection (Section 2 above).

Obviously there will be cases where rejection is appropriate. A well-known example occurred in the late 1980s when buyers were held entitled to reject a whole series of combination carriers built to an unusual design when it proved impossible to rectify defects in that design. Experience of disputed cases however still suggests that this would be the result only in a small minority of contested rejections.

Where a design defect is discovered only after delivery but within the guarantee period no question of rejection will arise, but the builder's obligation to make good the defect will be very much in issue. The probability is that the builder will retain that obligation even where he does not expressly warrant the completed vessel against defects in design.

This is because of the relationship already noted between design, materials and workmanship (AB Gotaverken v. Westminster Corp. (above)).

Provided that the design defect can successfully be rectified, the builder will usually be responsible for doing so and for making good any damage caused by the design defect subject only to limitations on the extent of his liability as we have already seen (see Section 6 above). Where however the builder cannot rectify the design defect we have seen that damages would be at large. It is easy to envisage that such damages might include a diminution in the value of the vessel with the irremediable design defects, but more important still, such damages at large might also include an obligation to indemnify the buyer if he was found liable to make good, on an indemnity basis and possibly as a matter of strict or unlimited liability, the consequences of, say, a pollution catastrophe or passengers' dependants' life claims found to have been caused by a design defect in the vessel. The well-known "AMOCO CADIZ" case (above) again provides a graphic example, although it was not ultimately decided on the basis of a design defect. It is equally easy to imagine the consequences today of a ferry casualty if it were found to be the result of a design error.

It is beyond the scope of this paper to discuss in any detail the insurance arrangements which might underlie an issue such as this in a catastrophe situation. Suffice it to say for present purposes that normal insurance terms for builder's risks will not cover this situation.

Third Parties' Design Liability

Where a third party is responsible for design he may of course be acting as agent, subcontractor or employee of either builder or buyer. Clearly in such a case there will be the possibility of considering the responsibility of the principal or employer under the contract.

However there may well be an additional option of proceeding direct against the third party. In such cases contractual exclusion provisions will have no relevance. With only unimportant exceptions contracts do not benefit those who are not parties to them. The basic underlying principle in English law is that a party cannot confer the benefit of a contract on one who is not party to it. This holds good even if the third party is an employee or agent of the contractual party who is seeking to pass on the benefits. As stated in the leading case:

> *"Although I may regret it, I find it impossible to deny the existence of the general rule that a stranger to a contract cannot in a question with either of the contracting parties take advantage of the provisions of the contract, even where it is clear from the contract that some provision in it was intended to benefit him".*
>
> (Midland Silicones Limited -v- Scruttons Ltd [1962] AC 446 at p. 473 per Lord Reid)

However there has been a growing tendency by the courts, especially in a commercial setting, to strive to bring third parties within exclusion clauses and thus to give effect to the commercial realities of a situation. Such was the approach in Metall AG -v- Ceres [1977] 1 Lloyd's Rep. 665 concerning a clause in a bill of lading exempting the shipowners' agents, servants and independent contractors. It was noted that if these parties were not to benefit from the clause, the effects could be to encourage claims against them directly, thus in effect causing an increase in freight.

These efforts to protect third parties, although forming a detectible trend in recent cases are unlikely to be of much help in the context of a construction contract. A building contractor or shipyard is unlikely to wish to use the sort of elaborate language in an exclusion clause which would be needed successfully to preclude his servants, agents or third party contractors from being sued.

In any case such an action would be unlikely to be an attractive option for a claimant unless it was known that the third party carried major insurance cover and thus became a target under what has become known as the "deepest pocket" principle.

Classification Societies

Almost inevitably where "deepest pocket" and insurance considerations come into play, the special position of a classification society in design may have to be considered.

Class societies contractual exclusions are under review generally at present in the Comité Maritime International. This may result in standardised terms of contractual liability limitation being used by most major societies.

It would usually be the builder who sought to claim in contract against class, although one could envisage the buyer also considering such a claim in some cases. The builder is likely to find (in most cases) some difficulty in establishing liability for defective design

(since class will in general be approving rather than creating design and their normal terms of contract will make it difficult to point to a breach). In almost all cases a limit of liability usually related to a modest multiple of the class society's fees will make legal action unattractive. There would be no reason to encourage a claimant to think that he would be able effectively to break this limit of liability in most of the foreseeable cases, which is likely without more to end any examination of a contractual claim against class.

Claims Outside of Contract

We have not yet considered the possibility of indemnity claims in cases where a third party succeeds in a claim for negligence against builder or buyer and that party is able under the building contract to pass on the claim, for whatever that right may be worth.

This is really one aspect of a wider question of design risk to the world at large.

It is easy to see that in a case like the "AMOCO CADIZ" (above) any number of aggrieved parties might assert that it was negligence in the design of the vessel causing the damage which was the operative cause of loss.

No amount of legal or drafting skills and no contractual time limits will avail against this risk and damages can in effect be limited only by the usually impracticable method of ensuring that there are no assets to be pursued.

Little comfort can be offered to those who are most at risk of this sort of action. It is plain that the designer of a ship or offshore structure owes a duty of care to those who use the world's waterways and to those who live and work in coastal areas likely to be affected by a casualty at sea.

The scope of this paper does not permit of a review of the legislation contained in such conventions as the Civil Liability Convention of 1969 (CLC 69) on oil pollution and other similar enactments currently in course of discussion in the international community.

Parties that are at risk from action of this kind will need to bear in mind that apart from the very high limits provided by international conventions for damages in the circumstances here under consideration, there is always a risk of "forum shopping". This expression, familiar to those regularly concerned with arrests of ships and limitation of liability for maritime claims, refers to the possibility of bringing actions in places where

limits of liability set by international conventions have no application. CLC 69 (to which France is a party) requires pollution claimants to sue in the country where the pollution occurred, but this did not stop claimants against the "AMOCO CADIZ" interests mounting an action in Chicago.

The answer in cases like this is in legal theory very straightforward indeed. The party or parties responsible for design can protect themselves only by insurance cover. It is our understanding that such cover is not by any means standard. This means, having regard to the nature of the insurance market, that it will be difficult to get truly protective cover and in such situations one's experience is that not only are terms uncertain, with possibly major exclusions of the insurer's liability, but premium levels are likely to be very costly as well. Uncertain, or inadequately understood, insurance risks usually end up with cover being disputed or denied.

Nevertheless there is an increasing ethos in maritime affairs which suggests that "there is no such thing as an accident". In other words, if an untoward incident occurs someone must be liable for it. With such thoughts in mind, and with the occurrence of high profile casualties showing no sign of abating, the final recommendation of this paper must be that those who may find themselves liable for the defective design of ships and off-shore structures need to have their insurance arrangements and their legal protections reviewed and up to date if they want to sleep peacefully on stormy nights.

April 1998 ■

APPENDIX A

MEMORANDUM CONCERNING EXPRESSIONS RELEVANT TO TERMINATION

Conditions

Some obligations under contracts, either because of the express wording of the contract or because of the very nature of the obligation, are treated as Conditions. Typical examples are

"it is a condition of the Contract that ....", "delivery of the vessel by the agreed date is an essential obligation" and "the seller guarantees that the vessel will be delivered by the agreed date".

Where one party fails to comply with an obligation which is a Condition, the other party is discharged from further performance of the contract. Another way of expressing this is that continued performance of the contract by one party is conditional upon continued performance by the other. For example, if the buyer's obligation to pay for the vessel is conditional on delivery, the buyer is not obliged to pay if the builder does not deliver. Conversely, if builder's obligation to deliver is conditional on payment, the builder is not obliged to deliver if the buyer does not pay.

Repudiation

Failure to comply with an obligation which is a Condition of the contract is a repudiatory breach or a Repudiation. This not only entitles the innocent party to treat the contract as discharged ie, to bring the contract to an end, but also to claim damages arising from the breach. Although it is rare for such damages to be assessed at a figure greater than buyer's lost expenses (if the market has risen it will be unusual for the buyer to accept any repudiation on the part of a builder) nevertheless SAJ's contract has been drafted to avoid the existence of Conditions. Therefore, although builder is obliged to deliver the vessel by the agreed contractual date, the consequence of builder not so doing is liquidated damages followed by the option to terminate, which is expressly stated to be buyer's exclusive remedy. This wording contradicts any indication that delivery by the agreed contractual date is a Condition.

In the same way, speed, deadweight etc are described in a way which avoids the obligation of a Condition. We advise deletion of the word "guaranteed" from the description of speed, deadweight etc, as this word could be taken as an indication of a Condition.

Renunciation

Repudiation does not only arise where there is a breach of an express Condition. If a builder deliberately chooses not to continue with construction of the vessel, accepts the liability to pay liquidated damages and diverts resources to work for another buyer, this may be described as "Renunciation" or "expressing an intention not to be bound by contractual obligations". A commercial way of looking at this is to say that there is the general implied obligation on each party to use reasonable endeavours to perform the contract, and that obligation is a Condition.

In negotiations, buyers often ask for the inclusion of a clause allowing termination if the builder does not proceed with due diligence or in a satisfactory manner etc. Builders are advised to resist these clauses. Builders should argue that buyers do not need such express clauses as they have a remedy in damages under English law in the event that the builder is in Renunciation.

Frustration

A frustrating event occurs when performance of contractual obligations becomes impossible, illegal or radically different from what was intended by the parties at the time of the agreement. Illegality and impossibility are obvious. "Radically different" means an event which is "so fundamental as to be regarded as striking at the root of the contract as a whole". For example, if an earthquake destroys the shipyard's facilities, it would take a very long time for the facilities to be rebuilt and for the construction of the ship to be completed. If the delay is so long that it may be commercially unrealistic to expect either party to continue with the contract under those circumstances, it may be said that the delay goes to the root of the contract as a whole.

Frustration in a legal sense only occurs when neither party is responsible for the frustrating event. If a buyer cannot pay, this is likely to be for reasons within buyer's responsibility rather than for reasons of frustration.

Termination

This is the term sometimes adopted in modern variants of the standard SAJ contract in relation to events which allow either party to bring the contract to an end. It is a neutral term which does no more than describe the cessation of parties' obligations to each other under the contract. It says nothing about whether either party has a right to claim damages from the other in relation to any breach of a contractual obligation. The fact that a buyer has a right to terminate the contract and to refuse to continue performance does not, of itself, give the buyer a right to claim damages or any other remedy from the

builder.

Cancellation

This is a non-legal term which describes a decision not to proceed with a particular transaction. It may be used to describe the buyer's decision not to proceed with the shipbuilding contract in certain circumstances, but the expression "Termination" is the more correct legal expression. However, in the context of a shipbuilding contract, there is little practical difference between cancellation and termination.

Rescission

Under English law, Rescission is a legal remedy which allows one party not only to treat the contract as discharged, but treat it as never having existed. The parties' obligations do not simply cease, but they are unravelled in order to put each party in the same position as if the contract had not been entered into. Although the refund of advance payments has the appearance of an unravelling of contractual obligations, which is perhaps why the expression Rescission was used in the SAJ form, the contract is not truly rescinded and therefore the expression ideally should be avoided.

Null and Void

This expression is used commercially as a means of emphasising that on termination of the contract, the parties have no further contractual obligations towards each other. If it is intended that the expression should also discharge either party from liabilities that may have accrued before the contract was terminated, the wording is not sufficient in all circumstances to achieve this objective. We would recommend that wording be added specifically stating that one or both parties are discharged from any claim or liability which may have arisen under the contract.

Sinclair Roche & Temperley
April 1998

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APPENDIX B

REFUNDMENT BANK GUARANTEE

[

]

Date: [ ]

Dear Sirs

Hull No. [ ]

At the request of and for the account of [ ] (the "Builder") we hereby issue to you this Refund Guarantee in connection with the shipbuilding contract dated [ ] (the "Contract") made between yourselves and the Builder for the construction and sale of a [ ] having the Builder's hull number [ ] (the "Vessel") upon the following terms:-

1. As a primary obligor and not merely as a surety, we hereby irrevocably and unconditionally guarantee that if any instalment ("Instalment") of the purchase price of the Vessel paid by you under the Contract becomes refundable to you by the Builder thereunder and such Instalment together with all interest payable thereon in accordance with the Contract is not paid to you by the Builder within [fifteen (15)] days after you have claimed payment of such amount from the Builder, we shall, upon receipt from you of a written demand accompanied by a statement to the effect that such sum and interest (if any) has become payable to you and by a copy of your claim to the Builder made at least [fifteen (15)] days before the date of your written demand to us, pay to you within [fifteen (15)] days of the receipt by us of your written demand the principal amount of each Instalment to be refunded under the Contract together with such interest thereon (if any) as provided by the Contract computed from the respective date following the date of receipt by Builder of such Instalment to the date on which you receive from us payment of the amount to be refunded PROVIDED THAT the amount payable by us under this Refund Guarantee shall not exceed the aggregate of [ ] United States Dollars (US$[ ]) plus interest on each Instalment calculated as aforesaid.

2. If prior to making any payment demanded by you hereunder we receive notice that

your claim for refundment of the Instalments together with the payment of interest (if any) thereon and which is the subject of your demand under this Refund Guarantee is being disputed by the Builder and such dispute has been referred to arbitration proceedings in accordance with Article XIII of the Contract, our obligation to make any payment hereunder shall be suspended until a final award has been made by the arbitrator(s) or the proceedings settled in which case the amount payable under this Refund Guarantee shall, without prejudice to the proviso in paragraph 1, be restricted to the amount of such award or, in the case of a settlement, the amount agreed to be paid by the Builder and shall be paid upon your further written demand accompanied by a certified true copy of the final arbitration award or (as the case may be) the settlement agreement signed by yourselves and the Builder, such demand to be made within fifteen (15) days of the date of the award or settlement agreement (as the case may be) after which no demand may be made on us hereunder and this Refund Guarantee shall expire.

3. Subject to paragraph 2, this Refund Guarantee no demand may be made on us hereunder after the date of execution by you and the Builder of the Protocol of Delivery and Acceptance of the Vessel as specified in Article VII.2 of the Contract or [ ], whichever is the earlier, whereupon this Refund Guarantee shall expire.

4. This Refund Guarantee shall be a continuing guarantee and you shall not be required to exhaust your recourse against the Builder or any other securities which you may hold in respect of its obligations under the Contract before being entitled to performance by us of our obligations hereunder or payment by us of any amount hereby guaranteed. Our liability hereunder shall not be discharged or impaired by the giving of any time or other indulgence whatsoever in respect of, nor by any variation whatsoever in the terms of, the Contract.

5. Any demand or notice to be made by you hereunder shall be made in writing in the English language and shall be delivered to us in person or sent by registered airmail or by telex addressed to us at the following address:-
[

]

Telex:

6. This Refund Guarantee shall be governed by and construed in accordance with the

laws of England and any dispute arising out of or in relation to this Refund Guarantee be determined by the High Court of England and Wales to whose [non-]exclusive jurisdiction we hereby agree to submit. For the purposes of any legal proceedings hereunder we hereby irrevocably appoint [ ] at present of [ ] as our agents for the service of process.

7. The benefit of this Refund Guarantee may be assigned by you without our consent to any lawful assignee of the Contract and shall enure for the benefit of yourselves, your successors and assigns.

Yours faithfully

.....

[INSERT NAME OF REFUND GUARANTOR]

By:
Title:

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Amendments to "Foreign Lawyers Law"

The Special Measures Law concerning the Handling of Legal Business by Foreign Lawyers ("Foreign Lawyers Law") was revised and came into force as from 13 August, 1998.

The major amendments are:

1. A gaikokuho-jimu-bengoshi is now eligible under certain requirements and restrictions to perform legal business concerning laws of the specified foreign countries in addition to designated laws (Article 5).
2. The standards for approval as a gaikokuho-jimu-bengoshi by the Minister of Justice were relaxed: the minimum requirement under Article 10(1) as regards the experience as a foreign lawyer is shortened from five years to three years. On the other hand, the period of his or her services provided to other bengoshi under Article 10(2) is regarded as experience only up to one year.
3. The object of a joint enterprise under Article 49-2 now includes legal business which requires knowledge of a law which is or was in force in a foreign country.

The "Aegean Sea" Decision and the Right of Charterers to Limit their Liability

Chris MOORE*

The concept of limiting liability in the shipping trade has a long history. Indeed the first legislation in the United Kingdom dealing with the right to limit dates back to 1733 and gave the shipowner the right to limit his liability for certain types of losses by reference to the value of the ship and the freight payable on the voyage in question. This concept of limiting liability by reference to the value of the ship still exists in certain countries but many countries have now moved towards a different method of assessing the level at which liability for losses may be capped such as by reference to the weight of the cargo concerned, in the case of the Hague or Hague Visby Rules, or by reference to the tonnage of the ship under the 1957 and 1976 Limitation Conventions.

A detailed examination of the history of limitation is outside the scope of this short article but it has been said that "*limitation of liability is not a matter of justice. It is a matter of public policy which has its origin in history and its justification in convenience.*[1]" In essence limitation was originally introduced as a concept to encourage trade and navigation without exposing the shipowner to financial ruin. It is noteworthy however that the concept of limitation of liability is more prevalent in the shipping field than perhaps any other.[2]

The English courts have had to interpret the 1957 Convention on a number of occasions. For example in the *Tojo Maru*[3] the Court was asked to decide whether a salvor could limit his liability for losses caused whilst rendering salvage assistance when working away from the salvors' tug. In the *Lady Gwendolen*[4] the question arose as to whether a shipowner loses the right to limit in the event that the loss or damage was caused due to a chain of circumstances involving fault at management level.

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* of Ince & Co., Solicitors representing the owners of the *Aegean Sea.*

1 See *The Bramley Moore* [1963] 2 Lloyd's Report 429.

2 See the article by Lord Mustill in LMCLQ [1993] 490 entitled "Ships are different – or are they?"

3 *The Tojo Maru* [1971] 1 LLLR 341.

4 *The Lady Gwendolen* [1965] 1 LLLR 335.

By contrast the English courts have seen far fewer cases in which they have been asked to construe the terms of the 1976 Convention. This may be in part due to the fact that litigation inevitably takes time to find its way into the courts and because the limits of liability under the 1957 Convention were increased substantially in the 1976 Convention such that there will be fewer cases where the sums claimed will exceed the vessel's limitation fund. Indeed the number of cases dealing with limitation of liability coming before the courts is likely to continue to decline if the protocol to the 1976 Convention, the subject of a diplomatic conference held in London in April and May of 1996, is ultimately adopted as an amendment to the 1976 Convention and which increases those limits yet further.[5]

By way of an example of the current limits of liability under the 1976 Convention for property damage claims in the case of tankers, the limit funds are as follows :-

ULCC	US$ 34.5 million
VLCC	US$ 22.2 million
AFRAMAX	US$ 11.6 million
PANAMAX	US$ 8.1 million
HANDY SIZE	US$ 5.1 million

Although steeped in history the English Admiralty Court handed down a judgment in April of this year which addressed a question which has never been put to an English Court or, it is believed, any other court. The court was asked whether charterers can also limit their liability under the 1976 Convention in respect of claims brought against them by the shipowners.

At first sight, and without the benefit of looking at the terms of the 1976 Convention, the immediate reaction might well be "no". On what basis would it be suggested that, say, a voyage charterer can limit his liability by reference to the size of a ship of which he is not the owner, but on which he may have chartered space for a two day coastal passage?

However, if one examines the text of the 1976 Convention itself the point becomes

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[5] In the case of a 30,000 ton vessel, for example, the limit of liability will more than double to approximately $9.5 million once the 1996 amendment is adopted.

more debateable. Article 1(2) of the Convention states :-

> "The term 'shipowner' shall mean the owner, charterer, manager and operator of a sea-going ship".

Thus when reading the definition in isolation one may arrive at the conclusion that if claims are made which are of the type which fall within the Limitation Convention for which a shipowner can limit his liability then, since the shipowner is defined to include the charterer, so can the charterer limit his liability. Any uncertainty on this question might be removed by an examination of Article 2(1) of the Convention which sets out the types of claim for which there is a right to limit liability "whatever the basis of liability may be".

Having read this one may be tempted to say that the answer is clear. Provided the claims fall within the category of claims which a shipowner can limit liability then so can a charterer. The Admiralty Court however decided otherwise.

To explain and understand this decision further it is necessary to look into the facts of the *Aegean Sea*. This vessel, having loaded some 79,000 tons of crude oil at Sullom Voe, was ordered pursuant to an ASBATANKVOY Charterparty to discharge the cargo at La Coruna in Spain. Whilst entering La Coruna the vessel grounded, subsequently exploded and sank spilling much of her crude oil cargo into the sea. The owners claimed that the vessel had been sent to an unsafe port and sought (in London arbitration) to recover from the charterers :-

1. Damages for loss of the ship.
2. Damages for loss of the bunkers.
3. Unpaid freight.
4. An indemnity in respect of owners' liability pursuant to the Civil Liability Convention, for property damage, clean-up expenses and the cost of preventative measures arising out of the oil spill in Spain.
5. An indemnity in respect of owners' potential liability to CRISTAL.
6. Reimbursement of Special Compensation paid to salvors pursuant to the Lloyd's Open Form of Salvage Contract.

These claims total approximately $65 million. The vessel's Limitation Fund is approximately $12 million. The claims, although very different in nature, do have one common feature. For none of these claims can the owner limit his liability pursuant to

the 1976 Limitation Convention. The first three claims of course represent the owners' own losses and thus limitation would not arise. Claims 4-6 were for reimbursement of liabilities for which the owner could not limit his liability under the 1976 Convention but which the owner sought to recover from charterers as damages. It is at this stage that the question of whether a charterer should be able to limit his liability in circumstances where the owner cannot limit requires further consideration.

It was this very issue that Mr Justice Thomas had to decide in the Admiralty Court in the case of *Aegean Sea*. In searching for an answer the Judge considered Article 9 of the Convention to be important. This provides that the limits of liability under the Convention "shall apply to the aggregate of all claims which arise on any distinct occasion". In analysing the concept of limitation of liability the Judge took the view that the fund should be available to those outside the shipowner sphere and not depleted by owners' indemnity claim. In his Judgment the Judge commented :-

> "It is the provision of Article 9(1)(a) which is in my view significant, as it provides for the aggregation of all the claims against those categorised as 'shipowner' – the owner, charterer, manager and operator for the purposes of limiting liability".

The Judge also found Article 11 to be relevant. Paragraph 3 of Article 11 reads :-

> "A fund constituted by one of the persons mentioned ....(in the Convention) shall be deemed constituted by all persons mentioned (in the Convention) respectively".

In commenting upon this section the Judge stated :-

> "The wording of Article 11(3) and the use of the word 'respectively' is significant. It indicates that the fund constituted by any of the persons within the category of the shipowner is constituted on behalf of all of them".

Having noted that only one fund needs to be established in respect of claims arising "on any distinct occasion" the Judge came to the view that the fund was not meant to be available to meet the owners' indemnity claims :-

> "As there is provision for a fund for those categorised as shipowners and that fund is to cover both charterers and owners, it is difficult to see how charterers can claim the benefit of limitation through that fund when a claim is brought against them by owners..... It cannot have been intended that either the limitation amount

> or the fund be reduced by direct claims by the owners against charterers for the loss of the ship or the freight or the bunkers; it was intended for claims by cargo interests and other third parties external to the operation of the ship against those responsible for the operation of the ship. To permit claims of the type advanced by owners against charterers for the direct losses they suffer to come within the scope of the limitation amounts or the fund would diminish what was available to others".

Conclusion

Thus on the facts of the *Aegean Sea* case the charterer could not limit his liability for the claims that owners were bringing against him. The judgment does not mean that the charterer can never limit his liability. The Judge found that :-

> "The charterer is to be treated as a shipowner and entitled to limit for the claims brought against him when he acts in the capacity of a shipowner".

The effect therefore is that if, e.g., a charterer is sued as a carrier or bill of lading issuer then the right of limitation will be available to the charterer. In circumstances, however, where the owner is seeking an indemnity from the charterer, the charterer may have no right to limit.

The Judgment therefore (and subject to any appeal), has significant consequences. In circumstances where charterers anticipate that by chartering as opposed to owning vessels they have transferred the majority of an operator's liability on to the owner they will now have to accept that where they face potential claims for reimbursement under a charter, for example where the owner alleges that the vessel was sent to an unsafe port, then if the charterer is liable, that liability may be unlimited. Whether owners would permit charterers to insert a clause into the charterparty giving them a contractual right to limit remains to be seen.

The Judgment does not adversely affect the shipowners' right to limit. In circumstances where the charterer issues bills of lading and incurs a liability to cargo interests following a casualty and then seeks an indemnity from the owner, the charterer will normally have been able to limit his liability to the cargo interests in the first place. Thus the indemnity claim which the charterer brings against the owner will already have been "limited". The judgment will, however, be of relevance to charterers and liability insurers who have an eye on charterers' exposure. ■

Japanese Sentiment, Today and Tomorrow

– Integrity –

Takao TATEISHI - *Editor*

The validity of the demise clause ("identity of carrier" clause) in a bill of lading was affirmed by the Supreme Court of Japan on 27 March, 1998. This was the *Jasmine* case, an appeal by the plaintiff insurers from a judgment of the Tokyo High Court (appeal court) rendered on 24 February, 1993 in favour of the first defendant time charterers. The gist of the Appeal Court's decisions had been that the identity of the carrier under a bill of lading must be decided in accordance with what were written on it - the bill of lading, although in the time charterers' form, had been signed "for the Master" by the sub-charterers' agent and the identity of carrier clause which nominated the owner as carrier was printed on its back. The Supreme Court did not intervene in that conclusion. It seems that the terms of the contract between such seasoned persons as charterers and shippers should be construed strictly to the letter.

While in most cases the parties' intention reflects commercial reality, it is in the interests of legal certainty to have some uniformity in the decisions of the judicial mechanism so that traders in general may be sufficiently sure what their positions are. By honouring the parties' agreement in *Jasmine*, the Court appears to have properly preserved the principle of freedom of contract. Indeed, under Japanese law it is seemingly required to abide by the terms of agreement. For example, the Japanese Civil Code provides in Article 420 for liquidated damages and purports to stick to party autonomy:[(1)The parties may determine liquidated damages payable in the event of non-performance of an obligation; in such case the Court cannot increase or reduce the amount. (2)The determination of liquidated damages shall not prejudice the obligee's right to demand performance or rescission. (3)A penalty is presumed to be a determination of liquidated damages.] Therefore, liquidated damages even if unduly excessive would not necessarily be illegal under Japanese law.

However, this should not mean that under Japanese law the parties to an agreement may exercise their rights solely invoking the terms of the agreement. The Civil Code stipulates in its very first section about the exercise of good faith: [Article 1(1)All private rights shall conform to the public welfare. (2)The exercise of rights and performance of duties shall be made in good faith and in accordance with the principles of trust. (3)No abusing of rights is permissible.] Accordingly, in determining the validity of liquidated damages, due regard should at least be had as to whether the parties properly agreed on it after they negotiated in good faith.

Looking to the other side of the contract, i.e., performance of duties, it frequently

happens that one does not comply with the terms of the contract he entered into and breaks his duty on purpose. Here, law and economics are interconnected and those should not be confused with morality, I am told. As I understand it, in Anglo-American theory a breach of contract does not constitute any moral matter, although it seems that it is intended to offset the injustice by imposing retribution on the tortfeasor as in the case of punitive damages. Hence, an efficient breach of contract where the damage incurred by the promisee does not exceed the interest gained by the promisor, is even regarded as a booster for economic growth.

In comparison, when the Japanese in general come to realise that the other party broke his promise unilaterally, they tend to feel that the basis of their trust has been shattered - a strong feeling which often makes them intolerant, although they themselves are not entirely free from breaking their own promises. This mentality is largely induced by their *bigaku*, or certain moral judgment, that one should keep one's words and also by their lack of suspicion against others. Japanese society is homogeneous and the people in general are not used to anything different or unusual. Benefiting from this moral pressure, integrity has long been the basis of trade among the Japanese and I do not imagine this to change any time soon, even though it is true that people in an advantageous position often fall into the trap of moral hazard and inflict a serious stigma on their credit.

In my view, that very factor of morality has contributed greatly to Japan's relative safeness for living. Among others to that end I can name at least two: one is the nature of endurance by which the people have managed to contain their feelings whenever necessary; another is Japan's capitalism which has not purely been driven by market economy and hence has so far successfully prevented the disparity between rich and poor from reaching a dangerous level.

Any legal system which would allow a breach of contract under the rubric of economic growth will inevitably lead one to postulate that we must thrive at any cost. After all, normal people never wish to give up the handy gadgets their economy bestowed in defiance of the certainty that it would reduce much the amount of CO_2 emissions. Besides, while an economy run strictly by the doctrine of free market surely raises morale among hard workers, it could increase social cost as well. Is it not the integrity formed on the solid relationships between persons who act in good faith and keep their promise that can eliminate the cost of security otherwise needed to protect against the revenge to wreak havoc on the promisor's assets?

The point is, however, that merchants who have *seii* or good faith will comply with their agreement, but not vice versa. In my view, justice may better be meted out if the subject of who is liable is judged not merely through technical interpretation of the contract terms but, whenever suitable, in the light of trade usage which has been established by such merchants in the particular trade. ■

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