THE SHIPPING LAW REVIEW

TENTH EDITION

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PREFACE

The aim of the tenth edition of this book is to provide those involved in handling shipping disputes with an overview of the key issues relevant to multiple jurisdictions. As with previous editions of *The Shipping Law Review*, we begin with cross-jurisdictional chapters looking at the latest developments in important areas for the shipping industry, including international trade sanctions, ocean logistics, offshore, piracy, shipbuilding, ports and terminals, marine insurance, environmental and regulatory issues, decommissioning and ship finance.

We have invited contributions on the law of leading maritime nations, including both major flag states and the countries in which most shipping companies are located. We also include chapters on the law of the major shipbuilding centres and a range of other jurisdictions.

Each of these jurisdictional chapters gives an overview of the procedures for handling shipping disputes, including arbitration, court litigation and any alternative dispute resolution mechanisms. Jurisdiction, enforcement and limitation periods are all covered, as are the key provisions of local law in relation to shipbuilding contracts, contracts of carriage and cargo claims.

In addition, the authors address limitation of liability, including which parties can limit, which claims are subject to limitation and the circumstances in which the limits can be broken. Ship arrest procedure, which ships may be arrested, security and counter-security requirements, and the potential for wrongful arrest claims are also included. The authors review the vessel safety regimes in force in their respective countries, along with port state control and the operation of both registration and classification locally. The applicable environmental legislation in each jurisdiction is explained, as are the local rules in respect of collisions, wreck removal, salvage and recycling. Passenger and seafarer rights are also examined. The authors have then looked ahead and commented on what they believe are likely to be the most important developments in their jurisdiction in the coming year.

The shipping industry continues to be one of the most significant sectors worldwide, with the United Nations Conference on Trade and Development estimating that the operation of merchant ships contributes about US$380 billion in freight rates to the global economy, amounting to about 5 per cent of global trade overall. The significance of maritime logistics in facilitating trade and development has become increasingly apparent in the past year. Heightened and unstable freight rates, port closures, congestion and evolving shipping requirements as a result of covid-19 and the Ukraine conflict have all had far reaching effects beyond the shipping sector itself. As the international shipping industry is responsible for the carriage of over 80 per cent of world trade, with over 50,000 merchant ships trading internationally, the elevated shipping expenses and challenges to global logistics we have experienced this year have exacerbated inflation and supply chain disruptions, adding to the ongoing global crisis and hampering the maritime industry's covid-19 recovery. We have seen

global maritime trade, which plunged by approximately 4 per cent in 2020, recover at an estimated rate of 3.2 per cent. In 2021, shipments reached 11 billion tonnes, a value slightly below pre-pandemic levels.

The disruption caused by the pandemic and the war in Ukraine have brought to the fore the importance of the maritime industry and our dependence on ships to transport supplies. The law of shipping remains as interesting as the sector itself, and the contributions to this book continue to reflect that.

We would like to thank all the contributors for their assistance in producing this edition of *The Shipping Law Review*. We hope this volume will continue to provide a useful source of information for those in the industry handling cross-jurisdictional shipping disputes.

Andrew Chamberlain, Holly Colaço and Richard Neylon
HFW
London
May 2023

Chapter 7

SHIPBUILDING

Vanessa Tattersall and Simon Blows[1]

I OVERVIEW

Shipbuilding is a cyclical business. Its patterns of boom and bust have been illustrated vividly in the past 15 years. In the heady days before the 2008 financial crash, the upward march of newbuild prices looked unstoppable as shipyards struggled to meet the seemingly insatiable appetite of shipowners for new tonnage, fuelled by the boom in world trade and soaring commodity prices. Many new shipyards sprang up too, particularly in China. The crash of 2008 and its aftermath produced a sobering market adjustment as the freight market collapsed, leading to high-profile insolvencies, and inevitably reduced demand for new tonnage. Since then, the market has remained a period of shipyard overcapacity characterised by defaults, deferrals and renegotiations. Shipyard consolidation became a major issue, especially in Korea, even among the big yards.

The covid-19 pandemic led to construction delays for newbuilds, particularly at Chinese and European yards, and seems to have dented newbuild orders (although perhaps not as much as some expected). However, the full and long-term effects of the pandemic on demand for new ships and the industry in general remain to be seen. The effect of delays resulting from the pandemic is considered in Section IV, below.

Asia continues to dominate shipbuilding. According to statistics for 2020,[2] published by the Shipbuilders' Association of Japan (SAJ), of the 1,084 worldwide recorded orders for new ships of more than 100 gross tonnage (GT) during the year, 659 (just under 61 per cent) were placed with the big three Asian shipbuilding nations: Japan, South Korea and China. China accounted for 323 of those orders, almost a third of the world total. When these statistics are analysed in terms of GT, the imbalance towards Asia remains striking. Of the world total of more than 33 million GT ordered in 2020, about 30 million GT was with shipyards in the big three Asian shipbuilding nations, with South Korea and China accounting for more than 11.8 million GT and 14.5 million GT, respectively; together, about two-thirds of the world total. (For China in particular, new orders in terms of GT remained similar to 2017, 2018 and 2019 figures, despite order numbers having fallen, showing the demand for fewer but larger ships at Chinese yards.)

Despite this shift to the East, English law and London arbitration are still crucially important for shipbuilding. International buyers remain reluctant to experiment with Chinese law and arbitration for contracts involving Chinese shipyards. Other key interests in Asia and elsewhere remain happy to use English law and London arbitration. English law

1 Vanessa Tattersall is a partner and Simon Blows is a consultant at HFW. The information in this chapter was accurate as at May 2021.

2 These are provisional figures.

gives a large degree of certainty in respect of the meaning and effect of shipbuilding contract provisions, particularly those on the commonly used forms. Furthermore, Asian shipyards are used to and comfortable with English law, making it unusual to see them push back on an English law clause. This must reflect the continuing strength and depth of the London legal market for maritime law. Of the emerging jurisdictions, only Singapore seems to present a serious alternative to London as a centre for dispute resolution, which may be a result of its similarities with English law and procedure.

II SHIPBUILDING CONTRACTS

There are a number of standard shipbuilding contracts. The most widely used remains the SAJ Form, which is used throughout Asia, including Korea and China. It is frequently adapted and the versions used in China are developing a particular character. Amended SAJ forms are used by Chinese shipyards despite the publication of the new Chinese Maritime Arbitration Commission form in 2011.[3]

The SAJ Form was drafted by an influential shipbuilders' trade association so it is not surprising that in its unamended form it is thought to favour the shipyard. Many of the amendments that are most frequently seen are made by buyers to redress this perceived imbalance. The Baltic and International Maritime Council (BIMCO) has produced its own form of shipbuilding contract, the Newbuildcon.[4] BIMCO is a shipping industry trade association with many shipowner members, so it is also perhaps not surprising that the Newbuildcon is a much more buyer-friendly contract. Although it is a more modern contract, the Newbuildcon does not seem to have caught on and it is not often encountered in practice, presumably because of shipyard resistance.

For high-value and complex projects in the offshore industry (such as for floating production storage and offloading units, and floating storage and offloading units), engineering, procurement and construction contract forms are sometimes used. These types of contracts originate from the engineering industry rather than shipbuilding and differ in a number of respects from the mainstream shipbuilding contract forms. Care should be taken when using these contract forms – they will usually need to be adapted to work for a shipbuilding project. Shipbuilding contracts are different from other types of contract in terms of the provisions required and how they are interpreted by English courts and arbitration tribunals.

III DEVELOPMENTS IN SHIPBUILDING LAW

The downturn of 2008 led to many disputed shipbuilding contract cancellations as collapses in asset values and chartering revenues forced buyers to reassess their order books and shipyards sought to hold reluctant buyers to their contracts. Because arbitration (often under the rules of the London Maritime Arbitrators Association) rather than court jurisdiction remains the most common choice for dispute resolution under shipbuilding contracts, the

3 The Chinese Maritime Arbitration Commission form is designed for use in international sales by Chinese shipyards.

4 The most recent version was issued in 2007.

details of disputes are largely confidential. However, a number of important cases have come before the courts, some as appeals from arbitration awards, which English law permits in some circumstances.

Disputes involving delays in construction remain important for both buyers and shipyards. *Adyard Abu Dhabi v. SD Marine Services Limited*[5] involved a disputed cancellation and clarified some issues concerning the relationship between claims by a shipbuilder for extensions of time under contractual *force majeure* provisions and claims for extensions of time based on allegations that delay had been caused by the buyer's breaches – the 'prevention principle'. In *Adyard*, the buyers cancelled for delay, following (among other things) a dispute about the terms for compulsory modifications. Adyard did not give notices claiming an extension of time under the contractual *force majeure* provisions, which contained general words allowing extensions for 'any other delays of a nature which under this contract permits postponement of the delivery date'. Instead, it alleged that the buyers' failure to agree terms for the modifications was a breach of the contract that prevented completion of the ship.

The judge found for the buyers and upheld their cancellation. He decided that Adyard's failure to give *force majeure* notices disqualified it from claiming any extension to the delivery date. The judge's decision seems to reflect a concern to keep the parties within the four corners of the express contractual regime for claiming extensions of time, so that where a claim for an extension to the delivery date can be made under the contract's *force majeure* provisions, those provisions must be used.

This approach makes it more difficult for shipyards to raise generalised delay claims long after the event. Requiring shipyards to use *force majeure* provisions (which almost invariably require prompt notices specifying details of the delays and what is said to have caused them) ensures that the parties know where they stand at the time they have to make difficult decisions about tender of delivery and termination.

The *Adyard* approach has been followed in a number of subsequent cases, including a decision in 2020 by the Commercial Court at the High Court of England and Wales.

Zhoushan Jinhaiwan Shipyard Co v. Golden Exquisite & ors[6] was an appeal from an arbitration award in the buyers' favour. This decision analyses in more detail the issues that are likely to arise under SAJ-type contracts.

A Chinese shipyard disputed the buyers' cancellation by alleging that delays had been caused by the buyers' breaches of the inspection and supervision regime under Article IV of the contract. They alleged that the buyers' supervisors worked unreasonably short hours so were not available to attend tests or inspections promptly. The shipyard claimed that the resulting delays should be taken into account in determining whether the buyers were entitled to cancel for excessive delay, citing the principle that a party should not profit from its own breach.

The judge (like the arbitrators) disagreed. The contract did not say that delays caused by a breach of Article IV postponed the delivery date or gave rise to permissible delays; by contrast, a breach of other provisions was expressly said to create permissible delay and postpone the delivery date. According to the judge's analysis, Article IV gave the buyers' supervisors the right to attend tests and inspections, but also allowed tests and inspections to be conducted in their absence if they did not attend. He was troubled that the shipyard's arguments, if correct, would allow them to claim for delays without giving notice to the

5 [2011] EWHC 848 (Comm).

6 [2014] EWHC 4050 (Comm).

buyers at the time. The judge thought these matters outweighed any general principle against construing the contract in a way that enabled the buyers to profit by their own breach, and for those reasons upheld the buyers' cancellation.

Jiangsu Guoxin Corporation (formerly known as Sainty Marine Corporation Ltd) v. Precious Shipping Public Co Ltd was an appeal from two partial final awards in the buyers' favour made in arbitration pursuant to shipbuilding contracts for two ships on materially identical terms.[7] The buyers had purchased a series of bulk carriers from the shipyard to be built in China. The first two ships were delivered and accepted. The buyers purported to terminate the contracts for the next four ships based on alleged defective design and construction. The buyers then purported to terminate the contracts for the next two ships when they said it became clear that the ships would not be delivered by the contractual delivery dates. The shipyard argued that the buyers' alleged wrongful termination of the contracts for ships three to six prevented it from constructing and delivering the remaining ships, as the rejected ships remained at the yard and were taking up the berths needed for others. Therefore, the shipyard argued that the buyers were not entitled to delivery of ships seven and eight by the contractual dates in line with operation of the prevention principle. The shipyard did not give notice of its prevention claims.

The judge found that a term was implied into the shipbuilding contracts that neither party should prevent the other performing its contractual obligations, although the term only applied to wrongful acts and to the active prevention of performance, and 'probably' did not extend to passivity in the face of action from a third party. However, the judge also found that neither the implied term nor the prevention principle applied in this case, again because the contract included machinery to extend time, in particular the *force majeure* provision, in Article VIII.1, which was widely drafted to include 'other causes beyond the control of the seller or its sub-contractors', and therefore included any wrongful acts of the buyers in terminating contracts three to six. The shipyard's argument failed because, among other things, it had not given notice of permissible delay claims in accordance with the requirements of Article VIII.2 of the contract.

The judge also said that, even if he was wrong to find that the situation fell within Article VIII.1, the requirement for the shipyard to give notice of *force majeure* events in Article VIII.2 was wide enough to apply to a prevention claim. He suggested that, because all the situations that entitled the shipyard to an extension of time under the contracts required timely notification, that should also be the case for claims for buyer-induced delays and prevention. This part of the judgment will inevitably be cited against shipyards claiming prevention at delivery to excuse delays as an additional rebuttal of prevention arguments.

There are also now several decisions by London arbitrators in shipbuilding cases in which there has been a marked reluctance to allow shipyards to rely on prevention, including the partial final awards in the *Precious Shipping* case, referred to above, and an anonymised award reported in summary form in 2013,[8] in which London arbitrators held that a shipyard's attempts to step outside the notice provisions of a shipbuilding contract to claim extensions for delayed approval of construction drawings by the buyers would produce uncommercial and unworkable results. This decision is based on similar reasoning to that in *Precious*

7 The appeal hearing took place via video link because of the covid-19 pandemic and the judge commented on the effectiveness of the virtual hearing in his judgment.

8 'London Arbitration 9/13', *Lloyd's Maritime Law Newsletter*, 29 May 2013.

Shipping: the tribunal observed that doing this would deprive the parties of the information needed to make an informed evaluation of their respective positions, and the buyers might have no idea that delay was being claimed until much later.

The approach to the prevention principle adopted in *Adyard* was followed in *Saga Cruises BDF Limited & Others v. Fincantieri SpA*.[9] In that case, the Commercial Court held that the principle only applied to trigger the yard's contractual liability to pay liquidated damages in the case of concurrent delays (for some of which the yard was responsible and for others the buyers were responsible) when it was the delays for which the shipyard was responsible that had caused actual delay beyond the contractual delivery date. The judgment again limited the scope of the prevention principle so that it could not be used as a get-out-of-jail-free card by shipyards whose actions have delayed delivery.[10]

The tension between the application of the express scheme of the shipbuilding contract and common law principles was a factor in *Stocznia Gdynia SA v. Gearbulk Holdings Ltd*,[11] a decision by the England and Wales Court of Appeal (EWCA) in 2009. In that case, the buyers terminated shipbuilding contracts for delay, exercising express contractual provisions entitling them to rescind. The buyers demanded and received refunds of instalments under refund guarantees given on behalf of the shipyard. However, the buyers did not limit their claims to contractual termination and refund of the instalments. They also sought to treat the shipyard's conduct as a repudiatory breach and claimed damages. In response, the shipyard argued what was then a widely held view of many practitioners and commentators – that the termination and refund provisions of the shipbuilding contracts amounted to a comprehensive code so that the buyers' exercise of these rights amounted to a waiver of their rights to treat the shipyard as being in repudiatory breach and to claim damages for loss of bargain at common law.

The EWCA found in favour of the buyers, deciding that the contracts did not clearly exclude their common law rights and that the buyers' words and conduct when terminating the contracts did not amount to a binding election to exercise only their contractual rights. As a result, the buyers were free to exercise their common law rights. The familiar provisions in shipbuilding contracts for liquidated damages to be paid by the shipyard in the event of delay and specified shortfalls in performance by the ship as built, which only came into effect if the ship was delivered, did not exclude the buyers' right to claim damages if the ship was never delivered.

Although the decision of the EWCA gives some buyers potentially valuable additional rights against shipyards, in practice its scope may be limited. This is because, unlike the contract in *Stocznia Gdynia*, many shipbuilding contracts contain an express stipulation that refund of instalments discharges the obligations of all parties.[12] A clause of this kind should prevent a claim for damages for repudiation. Even where there is no clause of this nature,

9 [2016] EWHC 1875 (Comm).

10 Judge Cockerill QC concluded: 'Unless there is a concurrency actually affecting the completion date as then scheduled the [shipyard] cannot claim the benefit of it.'

11 [2009] EWCA Civ 75, CA. This was an appeal from an arbitration award on a number of preliminary issues.

12 Article X 3 of the SAJ Form provides: 'Upon such refund by the builder to the buyer, all obligations, duties and liabilities of each of the parties hereto to the other under this Contract shall be forthwith completely discharged.'

great care will be needed to formulate the notice in a way that both exercises contractual rights of termination and accepts a repudiation, giving rise to the right to recover damages for breach.[13]

It is not unknown for shipbuilding contracts, or for events occurring under them,[14] to be backdated to avoid the effect (and cost) of new regulatory requirements. One of the issues in *Crescendo Maritime Co and Alpha Bank AE v. Bank of Communications Company Ltd & Ors*[15] was that the underlying shipbuilding contract was backdated to circumvent the application of the amendments to the International Convention for the Safety of Life at Sea 1974 (SOLAS) concerning tank coatings that applied to vessels built under shipbuilding contracts signed after 8 December 2006. The shipbuilding contract was cancelled and there was a demand under the refund guarantees. In concurrent London arbitrations under the shipbuilding contract and the refund guarantee, Bank of Communications Company (BOCC), the respondent refund guarantors, alleged that the backdating of the shipbuilding contract was a fraud on it, and that the fraud had induced it to issue the refund guarantees. After a procedural decision by the London tribunal to allow Alpha Bank (which had a security assignment of the shipbuilding contract from the buyer) to join the arbitration, BOCC stopped its participation in the arbitrations and commenced proceedings in China, seeking declarations that the conduct of the other parties in the arbitrations had been fraudulent. The buyers won the arbitrations and applied to the London court for anti-suit injunctions restraining BOCC from pursuing the proceedings in China. These complicated circumstances gave rise to a number of legal and procedural issues on which the buyers and Alpha broadly succeeded. Although the judge was not able to grant Alpha the anti-suit injunction it sought, he made a declaration of non-liability in Alpha's favour.

Both the London arbitrators and the judge found that BOCC was aware of the backdating of the shipbuilding contract. The judge also found that there was no concealment or non-disclosure of its true date by Alpha Bank to BOCC. So the question of whether this kind of backdating gives rise to rights to avoid a contract or a refund guarantee must wait for another day.

In most shipbuilding contracts, it is the shipyard's responsibility to use reasonable skill and care to design the ship. There can be disputes about design liability when the ship complies with the technical specification in the contract but fails to meet the required performance criteria. Whether (1) the shipyard's compliance with the contract specification or (2) the buyers' right to receive a ship capable of achieving the performance criteria prevails is always a matter of construction of the contract terms, but the approach of the English courts has been that compliance with specification does not excuse failures to comply with performance criteria.

This principle has been restated in a Supreme Court case involving wind farm foundations.[16] The contractor agreed to build to specified standards, which incorporated class-approved calculations that were later found to be incorrect. As a result, the wind farm was constructed with foundations incapable of lasting for 20 years, which was an express

13 For an example of a contractual termination where this was not done and a helpful and thorough review of the relevant authorities, albeit in a different commercial context, see the Judgment of Baker J in *Phones 4U Limited (in administration) v. EE Limited* [2018] EWHC 49 (Comm).

14 For example, the date of keel laying.

15 [2015] EWHC 3364 (Comm).

16 *MT HØJGAARD A/S v. Renewables Robin Rig East Ltd and Another* [2017] UKSC 59.

contractual requirement. The contractor argued that it had exercised reasonable skill and care and had complied with the specification. The court disagreed, on the basis that even if the requirement to build in accordance with the specified standards and for the foundations to last 20 years were inconsistent, the balance of authorities favoured the specified performance criteria over compliance with the specification.

How the specification and required performance criteria interact will vary from contract to contract. In the final analysis, this will always be a matter of construction.

IV COVID-19

There are currently no reported covid-19-related shipbuilding cases – shipbuilding disputes tend to be legally, factually and technically complex and take time to reach trial or a hearing. Furthermore, delay disputes usually fully manifest upon delivery because it is often only then that delay to delivery can be properly assessed. It is safe to say, however, that covid-19 has had a significant effect on shipbuilding projects, most notably in terms of delay. Numerous sub-contractors and suppliers are involved in these projects and equipment and personnel are required to attend shipyards from overseas. Travel and transport restrictions have therefore been felt. In addition, increased hygiene and sanitation requirements at some yards, introduced to limit the spread of covid-19, have created extra work and distractions for shipyard workers.

It has been widely accepted that the pandemic can be a *force majeure* event when *force majeure* clauses include (1) 'pandemic' or 'epidemic' as defined *force majeure* events or (2) catch-all wording to include events beyond a shipyard's control. *Force majeure* events will usually entitle a shipyard to permissible delay, which extends the contractual delivery date. However, shipyards will need to prove more than that if they are to succeed with covid-related permissible delay claims to avoid liquidated damages or buyer termination for delay.

Covid delay disputes have so far tended to focus on the more factual issues of causation and mitigation; that is to say, whether the actual cause of delay is covid-19 or another event that does not give rise to permissible delay, and whether the shipyard could have, but failed to, take steps to mitigate any resulting delay. Therefore, it is important for buyers and shipyards to keep up to date with relevant covid-19 rules and restrictions, to discuss the consequences of any such rules and restrictions and whether delays can be reduced or avoided with their site teams, sub-contractors and suppliers, and to keep written evidence and proper records of construction delays to ensure that they have evidence to support their position in a later dispute.

Shipyards will also need to take care to properly notify buyers of *force majeure* or permissible delay claims resulting from covid-19. Subject to the terms of the contract, as the permissible delay and prevention cases referred to in Section III emphasise, the right to claim can be lost if notice is not given in time.

V POST-DELIVERY WARRANTIES

Commercial shipbuilding contracts almost invariably contain a guarantee or warranty provision, warranting the condition of the ship on delivery and providing a limited remedial regime under which the shipyard agrees to repair specified types of defects in design and construction that manifest themselves within (usually) a year of delivery. Many contracts are designed to make the one-year warranty the buyers' sole remedy for post-delivery problems.

The restrictive nature of this regime is entrenched within the industry and is usually justified by the need to strike a balance between the parties' respective interests so that the buyers obtain rights to have repair work done (or paid for) by the shipyard and the shipyard can limit its potential liability, both as to the type of defects covered and the period for which it is exposed to the risk of remedying them.

The court's willingness to construe warranty provisions in a strict way is illustrated by *Star Polaris LLC v. HHIC-PHIL Inc*.[17] About eight months into the warranty period, *Star Polaris*, a capesize bulker, suffered a serious engine breakdown, which was caused in part by a breach by the yard and in part by negligence by the ship's chief engineer. The question that arose on appeal to the Commercial Court from an arbitration award was whether the exclusion of 'consequential or special losses, damages or expenses' in the warranty provision excluded all financial losses caused by the defects, above and beyond the cost of replacement and repair of physical damage. The court upheld the arbitrators' decision that the wording of the warranty provision[18] covered the cost of repair or replacement of the main engine damage caused by the shipyard, but excluded the broader financial consequences that the remedial work entailed.

VI REFUND GUARANTEES

Commercial shipbuilding contracts generally require the shipyard to procure refund guarantees for buyers. These guarantees are usually provided by banks and ensure that if a buyer becomes entitled to terminate, there is a solvent guarantor from whom they can recover refunds of instalments paid to the shipyard. Given the concerns about many shipyards' solvency and the difficulties and delays encountered in enforcing awards and judgments in some jurisdictions, refund guarantees are an important element in the shipbuilding contract package, and are invariably required by the providers of pre-delivery finance to buyers.

There were virtually no reported decisions involving shipbuilding contract refund guarantees until 2002, when the EWCA considered whether refund guarantees given on behalf of a Spanish shipyard were payable on demand or only after the shipyard's liability (if any) had been decided in arbitration under the shipbuilding contract.[19] In contrast, in recent years, there have been several important decisions concerning refund guarantees, which could reflect the fact that buyers are having to claim under them more frequently (or that banks are more willing to take points to resist demands).

An extreme example is the case of *Sea Emerald SA v. Prominvestmentbank*,[20] in which the buyers paid some US$17 million to a Ukrainian shipyard in respect of one of a number of ships being built there. The Ukrainian government eventually withdrew financial support to the shipyard, the shipbuilding contract was rescinded and the buyers claimed a refund of instalments under the refund guarantee. The Ukrainian refund guarantor bank alleged that, as a matter of Ukrainian law, the bank official who signed the refund guarantee lacked the

17 [2015] EWHC 2941 (Comm).

18 A bespoke modification of the SAJ warranty clause.

19 *Caja de Ahorros del Mediterraneo and others v. Gold Coast Limited* [2002] 1 LLR 617 – in the event, the Court of Appeal determined that the guarantees were payable on demand.

20 [2008] EWHC 1979 (Comm).

authority to do so, that the bank had not subsequently ratified the refund guarantee, and was not bound by it so had no liability to pay. The Commercial Court in London (reluctantly) agreed with them and the buyer was left with no remedy.

The decision of the Supreme Court of the United Kingdom in *Rainy Sky SA and others v. Kookmin Bank*[21] concerned refund guarantees and has broad general significance for English law principles of contract interpretation.

Most shipbuilding contracts give buyers the express right to terminate and to a refund of instalments on the happening of defined events, almost invariably including excessive delay in construction and specified shortfalls in performance (for example, if the ship's speed measured on sea trials falls below a set minimum). The buyer often also negotiates a right to cancel and receive a refund if there is an insolvency event affecting the shipyard. The refund guarantees should correspond with the shipbuilding contract, and respond to the contractual termination events and refund rights (although refund guarantees very rarely extend to cover common law rights).

Rainy Sky concerned the interpretation of refund guarantees[22] given in respect of six shipbuilding contracts and whether an insolvency event affecting a shipyard entitled buyers to refunds under them. The shipbuilding contracts permitted the buyers to terminate and to recover refunds of instalments for delay and for specified shortfalls in performance. They also provided that the buyers were entitled to refunds on an insolvency event although, curiously, the buyers had no right to terminate the contracts for insolvency. The buyers contended that an insolvency event had occurred and demanded refunds of instalments under the guarantees, but the bank refused to pay.

The refund guarantees promised to pay on demand 'all such sums due to [the buyers] under the contract'. The question the Supreme Court had to decide was what the words 'such sums' meant. On the basis of Paragraph 2 of the guarantees, the buyers argued that all pre-delivery instalments were covered. However, on the basis of Paragraph 3, the bank argued that these words were to be construed more narrowly and covered only refunds payable following a termination, not refunds triggered by insolvency (for which the contracts gave the buyers no termination rights). The guarantees were ambiguous and both constructions were arguable.

The Supreme Court decided that when the commercial purpose of the guarantees was taken into account, the buyers' construction was correct. It concluded that there were no credible commercial reasons for the bank's more restrictive analysis of the scope of the guarantees and gave judgment for the buyers.

Many commercially minded people would agree with the Supreme Court's conclusion. The bank had the opportunity to adduce evidence of any commercial rationale for the refund guarantee wording (for example, if they had intended to exclude insolvency-related refunds because the shipyard was not prepared to pay any extra charges to the refund guarantors to cover insolvency risks) but did not do so. The Court seemed happy to infer from this that no such rationale existed and, in this case, the inference was probably well-founded. However, there are obvious dangers in judges seeking to apply their own (necessarily subjective) 'commercial common sense' to resolve questions of this kind, except perhaps on those very rare occasions when ordinary legal analysis cannot provide the answer.

21 [2011] UKSC 50.

22 Described in the judgment as advance payment bonds, although nothing seems to turn on this distinction.

We have already seen an example of refund guarantors commencing defensive proceedings in their home jurisdiction, notwithstanding English law and London arbitration provisions in the refund guarantee itself in the *Crescendo Maritime Co* case mentioned in Section III, above. Similar events occurred in *Spliethoff's Bevrachtingskantoor BV v. Bank of China Limited*,[23] another anti-suit injunction case involving ships being built in China and a Chinese refund guarantor bank.

In this case, buyers cancelled two shipbuilding contracts for delay, won the resulting London arbitrations and claimed under refund guarantees. The bank resisted the demands for payment, relying on judgments obtained in China by the shipyard and, later, the sellers of the ships restraining payment under the refund guarantees based on allegations that the buyers and the engine manufacturers had fraudulently supplied defective second-hand engines and concealed from the shipyard that the engines were not new.[24] The Chinese judgments were enforceable in China.[25]

The refund guarantor was in a difficult position. It had never been a party to the Chinese proceedings, but orders had been made restraining payment of the refunds that buyers were demanding. The Chinese judgment had been obtained in breach of English law and London arbitration provisions in the shipbuilding contracts and in breach of an anti-suit injunction granted by the English court restraining the sellers from continuing with the proceedings in China. Nonetheless, the refund guarantor was a Chinese bank. At the same time, the refund guarantor was being sued to judgment in London under the express terms of its refund guarantees based on London arbitration awards obtained under the shipbuilding contracts.

The EWCA gave judgment for the buyers requiring payment under the refund guarantees and refused the bank's application to enforce in England the Chinese judgment restraining payment. The EWCA plainly wished to give effect to the contract jurisdiction provisions and took full account of the breaches of the London anti-suit injunction. It also doubted that the bank was at any real risk of criminal prosecution in China, and reasoned that because of its judgment compelling payment under the refund guarantees, the bank would be making payment under compulsion, so would not be acting voluntarily, which would be contrary to the Chinese judgment.

Chinese shipyards frequently require buyers' payments of future instalments to be secured by a performance guarantee. A dispute under a payment guarantee of this kind following cancellation of a shipbuilding contract has been considered by the English courts,[26] which first had to decide whether the guarantee was payable on demand or only after the buyers' liability had been determined in arbitration. The payment guarantee had similar features to the wording of the refund guarantees in *Caja de Ahorros* and, although the first instance judge found for the guarantor bank, the EWCA determined that it was payable on demand.

The potentially far-reaching consequences of on-demand guarantees are illustrated by a subsequent decision of the EWCA in the same case.[27] The shipyard was entitled to retain substantial sums paid under the payment guarantee even though the arbitration tribunal

23 [2015] EWHC 999 (Comm).

24 The buyers unsuccessfully challenged Chinese jurisdiction, citing the shipbuilding contract arbitration clause.

25 This was common ground, although an application for a retrial was under way in China.

26 *Wuhan Guoyu Logistics Group & anr v. Emporiki Bank of Greece SA* [2012] EWCA Civ 1692.

27 *Wuhan Guoyu Logistics Group & anr v. Emporiki Bank of Greece SA* [2013] EWCA Civ 1679.

appointed under the shipbuilding contract subsequently ruled that the shipyard had no right to receive the instalment in respect of which it had made its demand. This was because the demand was made in good faith and was valid when made, and there were no grounds to say that the payment was subject to a trust in favour of the guarantor bank if the instalment was found later not to be due.

This decision is consistent with well-established authorities concerning payment under performance bonds. However, the dangers it illustrates should alert parties negotiating refund and performance guarantee wordings under shipbuilding contracts to the consequences that may flow from what they agree.

As a footnote, structured finance mechanisms such as interest rate and currency swaps are increasingly a feature of newbuild finance. As with many derivative-type contracts, they have generated disputes.[28]

28 See, for example, *Sixteenth Ocean GMBH & Co v. Société Générale* [2018] EWHC 1731 (Comm).