
THE NUCLEAR OPTION SHIPBUILDING CONTRACTS: CAN I CANCEL? SHOULD I CANCEL?

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There are many circumstances in which a buyer of a newbuild vessel might want to terminate or cancel their contract with the yard. Perhaps the building work has been delayed. Maybe the market has dropped and the deal which looked like a good one a couple of years ago, when the contract was signed, no longer looks so favourable. Maybe the yard's performance is lacking and another instalment is about to fall due, which means the buyer will have to decide between paying up and hoping the problems can be put right, or terminating and attempting to recover instalments that have already been paid.

Cancelling contracts isn't straightforward; there are many traps for the unwary buyer who attempts to bring the contract to an end. If you get it wrong, you might lose the instalments you have already paid or you might face a claim from the yard for damages. Even if you get it right, you might find yourself having to deal with expensive and long running court or arbitration proceedings. This article aims to help you understand some of the pitfalls which face buyers who want to cancel shipbuilding contracts.

Termination, cancellation and rescission – what's the difference?

Termination

'Termination' is a common law right. If a party breaches a condition of a contract or unequivocally communicates (by words or conduct) an intention not to perform, this is called a repudiatory breach. The innocent party can accept the repudiatory breach as terminating the contract and can claim damages. They also have the option of affirming the contract and continuing to perform, provided they have a legitimate interest in doing so.

But watch out! A condition is an important contractual term. If a party breaches a warranty – a less important term and not to be confused with the yard's warranties regarding the quality of the build – the innocent party can only claim damages. They do not have the right to terminate. If the breach is of an innominate term (neither a condition nor a warranty) then the innocent party can claim damages but may only terminate if the breach goes to the root of the contract.

The contract may also explicitly allow a party to terminate in certain situations.

Cancellation

'Cancellation' is a contractual right. The contract may provide that a party may cancel in certain situations which means they can bring the contract to an end. The contract might also set out the consequences of that cancellation.

Rescission

Most standard-form shipbuilding contracts give both parties the right to 'rescind' in certain circumstances. Rescind means to bring the contract to an end and revert the parties back to the position they were in before the contract was signed. For example, a shipbuilding contract might provide that if the yard exceed their permissible and non-permissible delays to the delivery date, you can rescind the contract and you will therefore be put back in your original position by the yard, who will refund the installments you have already paid or allow you to claim under the refund guarantees.

Can I rescind?

Many shipbuilding contracts define a number of events which entitle the buyer to rescind. The most common are:

- Delays in delivery beyond a certain number of permissible and/or non permissible delays.
- Failure of the vessel to meet the technical requirements of the contract.
- Insolvency of the yard.
- Total loss of the vessel before delivery.
- Failure to meet certain milestones.

But watch out! If you wish to terminate for the yard's repudiatory breach, you must be confident that you can prove the yard has breached a condition or has indicated an intention not to perform. This is not always obvious. You also need to be very careful and strictly follow any procedure for rescission or cancellation. If you get it wrong (because, for example, the contract says that you must give ten working days written notice sent by courier to a particular address, and you give five days' notice and send it by fax), you might find that the yard terminates the contract for your repudiatory breach and brings a damages claim against you!

What are the consequences of rescinding the contract?

Often, shipbuilding contracts provide that if the buyer rescinds, the yard must refund their instalments 'promptly' or otherwise start arbitration to suspend that obligation until an award has been published. Once the refund is made, all of the parties' obligations to each other under the contract come to an end. If the refund is not paid and the yard does not start arbitration, the buyer can claim from the yard's bank under the refund guarantees.

Can I claim under the refund guarantee?

There are two broad types of guarantee. Under an 'on demand' guarantee, the guarantor is the primary debtor and payment is made against a written demand by the buyer certifying that they are entitled to a refund. Provided the documents are in order and the demand is made in good faith, the bank must pay. Under a 'performance' or 'see to it' guarantee however, the guarantor's liability is secondary. This means that you must first prove that the yard is liable under the shipbuilding contract before you can claim from the bank.

But watch out! Refund guarantees will not always respond to every event by which the contract is brought to an end. For example, if the refund guarantees require a valid rescission under a particular provision of the contract that does not necessarily mean that the bank must pay if you terminate for the yard's unrelated repudiatory breach. If you can't claim under the refund guarantees, think carefully about how you will enforce your claim against the yard.

Can I recover other losses?

Even if you get your instalments back, you might have also suffered other losses such as expenditure thrown away as a consequence of the ending of the project (called 'reliance loss') or, if you need to find an alternative vessel and the market has risen, the difference between the contract price and the market price of an equivalent newbuilding (called 'loss of bargain').

But watch out! It is usual for shipbuilding contracts to exclude such losses and limit the yard's obligation to repayment of the pre-delivery instalments plus interest.

It is possible to terminate for the yard's repudiatory breach and claim damages as well as exercising your contractual right to rescind and claim repayment of your instalments of the contract price. This was decided by the Court of Appeal in *Stocznia Gdynia S.A. v. Gearbulk Holdings Ltd (2009)*. However, this decision has been criticised and the relationship between contractual and common law rights is a complicated and developing one.

Should I rescind or terminate?

Ultimately, the decision to bring the contract to an end is the nuclear option. As well as irreparably damaging your commercial relationship with the yard, you might find yourself on the receiving end of expensive litigation if you get it wrong, and sometimes even if you get it right. As well as working out whether a right to rescind or terminate has arisen, you also need to consider carefully whether you can claim under the refund guarantees to recover your instalments and whether you can obtain the evidence needed to prove your other losses. For example, you might need expert evidence on market prices if you want to claim for loss of bargain.

Sometimes, terminating a contract is the best, or only, option. However, the law of shipbuilding is complex and fraught with ambiguities and the sums at stake are often large. Ending the contract is a drastic step and good legal advice is essential before you make the decision to terminate or rescind.

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