UK DEFENCE CLUB

CONSIDERATIONS WHEN BUYING OR SELLING A SHIP

UKDC
IS MANAGED
BY **THOMAS MILLER**

INTRODUCTION

The current state of the market has resulted in an increased focus on the sale and purchase of second-hand ships. These transactions can, however, be fraught with potential pitfalls for both buyer and seller alike. This publication takes a look at some of the issues that Members commonly encounter and suggests ways in which parties can seek to minimise risk and ensure that transactions proceed smoothly.

WHICH STANDARD FORM SHOULD PARTIES CONTRACT ON?

The utmost care needs to be taken at the outset of negotiations to ensure that the MOA is properly concluded on suitable terms.

There are various standard forms available to choose from. Some are more comprehensive than others. Some favour buyers, while others favour sellers. The most commonly used standard forms are probably the Norwegian Sale Forms ("NSF") 1993 or 2012; the Japan Shipping Exchange Form; Nipponsale 1999 ("Nipponsale"), and the Singapore Ship Sale Form 2011 ("SSF"). In addition, BIMCO released its SHIPSALE 22 form ("SHIPSALE") in April 2022.

Although the provisions of most standard forms are broadly similar, there are some variations which can have significant impacts on the rights and liabilities of the parties if things go wrong. So it is worth giving careful thought at the outset to which form is most suitable or provides most protection. Some of the key differences between the main forms are highlighted in this publication.

Although the provisions of most standard forms are broadly similar, there are some variations which can have significant impacts on the rights and liabilities of the parties if things go wrong.

WHEN DOES THE CONTRACT BECOME BINDING?

Negotiations on the terms may go back and forth for some time before all the terms are finally agreed. Parties should be aware that it is possible for a contract to become binding before it is signed. So a party who tries to walk away from a deal late in the day, before the contract has been signed, perhaps due to a change in market or other circumstances, might find that it has inadvertently become bound to the terms and thereby exposed itself to a claim for breach of contract.

In determining whether a contract has become binding, the question is whether the essential terms have been agreed and whether the parties intended to become bound by the contract. The courts will consider this question from an objective perspective and in the context of the individual circumstances of the case.

Parties often seek to make it clear that they do not intend the contract to be binding yet by using express wording such as "subject to contract" or "subject to confirmation in writing". This can certainly help and is recommended. However, parties should still be wary when relying on standard wording as the intentions of the parties, their actions and the surrounding facts may still lead the courts to conclude that the contract had nevertheless become binding.

By way of illustration, in one case before the English courts, an agreement for the sale of a number of ships provided that the sale was to take place "under the MOA to be finalised as per terms and conditions stated herein above". The Court of Appeal rejected the argument that this wording showed that the parties did not consider that their agreement was binding, saying that the words "to be finalised" did not relate to leaving anything to be agreed but related to questions of formalisation (*Global Container Lines v State Black Sea Shipping* [1999] 1 Lloyd's Rep. 127 (C.A.)).

In another case, the parties expressly agreed during negotiations that a contract for the installation of new production lines at a factory would "not become effective until each party has executed a counterpart and exchanged it with the other". Meanwhile, work was started on the construction. It was held that the 'subject to contract' agreement of the parties had been waived. As the parties had reached agreement on the essential terms, including the price for the work, it was thought to be unlikely that one party was agreeing to proceed with performance of the deal on a non-contractual basis (*RTS v Müller* [2010] UKSC 14). Ultimately, every case will need to be considered on its own facts.

WHAT CONDITION SHOULD THE SHIP BE IN?

Recent case law has unsettled what was previously thought to be an established point. Section 14 of the Sale of Goods Act 1979 ("SOGA") provides that terms should be implied into sale contracts that are subject to English law to the effect that the goods being sold are fit for purpose and of a satisfactory quality. However, most standard form sale terms require the seller to provide the ship "as she was at the time of inspection", "as is" or "as is where is" (e.g. clause 11 of the NSF 2012). The commercial understanding of such provisions is that the buyer takes the ship at its own risk in the condition that she is in at the stated time, without any warranties being implied as to condition or quality (*Hirstenstein v Hill Dickinson LLP* [2014] EWHC 2711(Comm)). However, the English courts have indicated that the SOGA conditions may nevertheless be implied (see *Dalmare SpA v Union Maritime Limited and Valor Shipping Limited ("Union Power")* [2012] EWHC 3537 (Comm.)).

The current legal position is therefore uncertain. Until this issue is settled by the courts, the lack of clarity poses risks for both sellers and buyers alike and the parties should take steps to protect their respective interests.

Sellers should be sure to include robust exclusion clauses to exclude the implication of unintended provisions. Such clauses need to be carefully drafted to ensure they are effective. There is uncertainty arising from a couple of English court decisions as to the extent to which it is possible to exclude the conditions that are implied into a contract by the SOGA (see *The Mercini Lady* [2011] 1 Lloyd's Rep 442 and *Air Transworld Ltd v Bombardier Inc* [2012] EWHC 243 (Comm)). To be on the safe side, at the very least, exclusion clauses should expressly refer to the "conditions" that they are intended to exclude. Legal advice may be necessary to confirm the adequacy of any exclusion clauses.

Sellers should be sure to include robust exclusion clauses to exclude the implication of unintended provisions.

Buyers, on the other hand, should make it clear in the agreement if they expect to purchase the ship in a certain condition or with certain warranties. They should also, in any event, verify the condition of the ship before purchase with a thorough physical survey and inspection of documents relating to the ship's condition and maintenance (e.g. class records, ship's logs, port state authority records, etc). Buyers should, in addition, ensure that the contract contains extensive rights of inspection, including underwater dive inspections, and access to documentation.

The contract will usually make provision for repairs to be effected in the event that an inspection reveals deficiencies, by extending the cancelling date. It is worth noting that the Nipponsale form gives the seller more time (up to 30 days) to effect repairs than the SHIPSALE (up to 21 days) and the SSF and the NSF 2012 (both 14 days), so the former may be preferable for sellers.

It is also important that buyers ensure that the ship is free from encumbrances. Claims against a previous shipowner can follow the ship, so an unwary buyer may be forced to deal with an arrest in relation to a claim that was incurred under the previous ownership. Buyers are recommended to include an express warranty in the contract to the effect that the ship is free of encumbrances (e.g. Clause 9 of the NSF 2012).

However, this alone may not prevent a claim, since the seller may not be aware of or have control over all potential claims. Buyers are therefore advised to carry out their own background checks by inspecting the mortgage and the flag state register before agreeing to buy the ship.

In addition, buyers should try to obtain an indemnity from the seller in respect of any potential claims, backed by a guarantee, or retain a percentage of the sale proceeds as security for a period (a suitable clause will need to be included in the contract to this effect). For added protection, buyers may consider purchasing maritime lien insurance such as that available via the Club.

WHAT IF THERE IS DELAY OR DEFAULT?

Buyers should ensure that they are fully protected in case the seller delivers the ship late, since this may have severe financial consequences if the delay causes the ship to miss a fixture. Equally, sellers should be aware of the potential risks of the buyer delaying in its own duties, such as making payment or taking delivery of the ship. Sale contracts may contain liquidated damages provisions to compensate the parties for delay and/or rights of cancellation. Parties should pay careful attention to such clauses to ensure they are adequately protected in the event of their counterparty's default.

Careful consideration needs to be given to the level of liquidated damages that is agreed. Such clauses may be unenforceable as a matter of English law if the rate of damages is too high and, therefore, deemed to be a "penalty". Having said that, the courts have recently tended towards upholding more onerous clauses. In a recent case, an individual sought to argue that the £85 parking charge imposed on him by ParkingEye for overstaying in a car park was an unenforceable penalty because it was not a "genuine pre-estimate of the damage", this being the principle relied on by the English courts for the last 100 years. However, the Supreme Court held that the £85 charge was not a penalty and set out a new test: the question is now whether the liquidated damages clause is out of proportion to the legitimate interest of the innocent party in the enforcement of the clause (see *ParkingEye Ltd v Beavis* [2015] UKSC 67). Parties should accordingly consider the need for proportionality when drafting such clauses.

By way of example, albeit prior to the ParkingEye case, the courts upheld a penalty clause in a contract for the sale of a luxury yacht which provided for the builder to recover 20% of the contract price in the event of termination upon the buyer's default (see *Azimut-Benetti SpA v Healey* [2010] EWHC 2234).

Careful consideration needs to be given to the level of liquidated damages that is agreed.

A contract may only be terminated in the event of delay if it contains an express provision permitting this. The main standard forms all contain rights of cancellation for the seller, in the event of the buyer's failure to pay the deposit or purchase price or to take delivery, and for the buyer, in the event of the seller's failure to deliver the ship on time. Some clauses provide for liquidated damages to be payable for the first few days of the buyer's delay in taking delivery, with the cancellation right only arising thereafter (e.g. clause 7 of the Nipponsale and clause 2 of the SSF). This may be more attractive to buyers in that they are given a chance to rectify their default and take delivery before the seller can exercise its option to cancel.

As an alternative to cancellation in the event of late delivery, the contract may include an option to extend the cancelling date, which can perhaps be seen as a less draconian reaction to delay. The NSF 2012, SHIPSALE and Nipponsale forms make provision for this (clauses 5(c), 12 and 4(c) respectively), whilst the SSF does not.

A contract may only be terminated in the event of delay if it contains an express provision permitting this.

WHAT DOCUMENTS SHOULD BE PROVIDED ON DELIVERY?

Buyers should ensure that the list of delivery documents is as comprehensive as possible and, in particular, enables them to receive sufficient documentation to be able to register the ship in her new flag on delivery. The NSF 2012 contains a more comprehensive list than its 1993 predecessor. The SSF and SHIPSALE forms also contain a detailed list of delivery documents, whereas the list contained in the Nipponsale is relatively minimal.

It is common practice for parties to delete the standard clause relating to delivery documents and replace it with an addendum detailing the documents. The risk with this is that in the rush to complete the transaction, the parties may end up with an executed contract but no agreed list of delivery documentation.

Sellers should of course always ensure, before agreeing to the document list, that they are able to provide all the documents in the agreed form at the agreed time.

WHAT HAPPENS TO THE DEPOSIT IF THE CONTRACT IS CANCELLED?

The buyer is usually required to pay a deposit up front (often 10%), which will be forfeited to the seller in the event of non-payment of the balance.

If the buyer does not lodge the deposit, then the seller usually has the right to cancel the contract. In such cases, the seller may also be able to claim payment of the deposit, even though this may be greater than the seller's actual losses due to the buyer's breach. The Nipponsale form (clause 14) and the SHIPSALE form (clause 18(b)) make this clear. The position has been less clear under the NSF 2012, but the English Court of Appeal confirmed that the deposit is indeed recoverable by the seller if the buyer fails to pay the deposit and the seller cancels the contract as a result (see Griffon Shipping LLC v Firodi Shipping Ltd [2014] 1 Lloyds Rep. 478). The SSF, however, seeks to adjust the position in favour of the buyer, by providing that the deposit is not automatically recoverable, though the seller can claim due compensation for their proven losses. This point could have significant ramifications for the parties, so this provision should be borne in mind when negotiating the terms of the contract.

WHAT HAPPENS IN THE EVENT OF A DISPUTE?

As with all contracts, consideration should always be given to a suitable law and jurisdiction clause to determine any disputes. It may not be convenient or appropriate in every case to adopt the standard form clause.

The NSF 2012 provides three options: English law and London arbitration (the default option); New York law and arbitration; or law and venue to be agreed. The SHIPSALE allows the parties to choose the applicable law and jurisdiction but, if no alternative is stipulated, English law/London arbitration will apply by default. The SSF provides for a choice of either arbitration in Singapore or an alternative forum. The Nipponsale form provides for arbitration in Tokyo. There is no choice of law clause but it is understood that a Japanese tribunal would apply Japanese law.

These are all respectable forums for dispute resolution, but if an alternative option is chosen, then careful thought should be given to its suitability in the context of the transaction. For example, it may not be appropriate to choose English Court jurisdiction where one party is based in China because English Court judgments are not readily enforceable in China. The clause will also need to be suitably amended and parties should ensure that any arbitration agreement will be recognised by the particular forum that they choose.

As with all contracts, consideration should always be given to a suitable law and jurisdiction clause to determine any disputes.

CONCLUSION

As can be seen from this publication, many of the common pitfalls in ship sale and purchase agreements can be avoided or minimised at the drafting stage. Where disputes do develop, they can be costly and complicated for all involved, so Members are advised to seek legal advice and guidance from the Club at an early stage to minimise and mitigate any losses.

ukdefence.com

The UK Defence Club
c/o Thomas Miller Defence Ltd,
90 Fenchurch Street, London EC3M 4ST
+44 207 283 4646

tmDefence@thomasmiller.com
ukdefence.com

The UK Defence Club (Europe)
c/o Thomas Miller B.V. Cyprus Branch
2nd Floor, Office 202, Gemini House
37 Theklas Lysioti Street, Limassol, CY3030
+00 357 25 375020

Registered in England: No. 501877
UKDC is regulated in the UK by the PRA and the FCA.
Company number: 00501877