

T H O M A S
C O O P E R

Builders' Warranties and Guarantees in Yacht Building Contracts

Superyacht Claims Adjusters Association

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Outline

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 - a) Express warranties
 - b) Implied warranties
 - c) Limit of the Builder's warranty

2. Refund guarantees
 - a) The history of the refund guarantee
 - b) The guarantee spectrum
 - c) Surety guarantee
 - d) Performance bond

Example of a Builder's warranty

IX.1 Guarantee of Material and Workmanship

- *The Builder, for a period of 12 months following acceptance by the Buyer of the vessel, guarantees the vessel, her hull and machinerywhich are manufactured, furnished or supplied by the Builder... against all defects in materials and/or workmanship on the part of the Builder ...*

Limitation of warranties

The Builder's warranty is also likely to contain terms such as:

- *The Guarantee provided in this Article and the liabilities of the [Builder] are **in lieu of all other warranties** and the Buyer waives all other remedies...*

The Sale of Goods Act 1979

As a matter of English law, the traditional view is that yacht building contracts are in fact agreements to sell future goods by description.

A superyacht will come within the definition of “goods” under the Sale of Goods Act 1979.

The SGA 1979 implies conditions into the contract of sale when goods are sold in the course of a business:

- Section 13: where the goods are sold by description, the goods must correspond to their description
- Section 14(2): the goods must be of satisfactory quality
- Section 14(3): the goods must be fit for their purpose

The Consumer Rights Act 2015

The CRA 2015 is only applicable to business to consumer transactions.

- “Consumer” means an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession.

Where applicable, the CRA 2015 will include terms in the contract.

Those with significance to yacht building are:

- Pre-contractual information provided by the yacht builder will be included in the contract.
- Installation will be included as part of conformity of the goods in the contract.

Remedies: *The five R’s*

- Right to Reject within 30 days - *which if not exercised leads onto*
- the Right to Repair or Replacement - *if this isn't satisfactory then*
- the Right to a Price Reduction or a final Right to Reject

Example of a limit to the Builder's warranty

IX.3 Extent of the Builder's warranty

- *(a) The Builder shall have no obligation under this guarantee for any defect discovered after the expiration of the guarantee period for any defects whatsoever. . .other than the defects specified in Section 1 of this Article. Nor shall the Builder, in any circumstances, be liable for any indirect, consequential or special losses, damages or expensesoccasioned to the Buyer by reason of the defects specified.*

Limit of the Builder's warranty

The contract will often state that it expressly excludes liability for:

- Defective design
- Consequential damages, such as loss of hire or image

The contract may state that it expressly excludes liability for:

- “any other defect of any kind whatsoever”
- “any term implied by contract and law, including sections 13 and 14 of the Sale of Goods Act 1979”

Provided the contract is concluded on a business to business basis and is an international sale within the meaning of sections 26 and 27 of the Unfair Contract Terms Act 1977, these exclusion clauses are perfectly enforceable under English law.

Recommendations and checklists

Notification: any defects must be notified to the yacht builder in strict compliance with the terms of the warranty, for example:

- Sent to a named representative, sent by post not email.

Evidence of breach: any breach of the builder's duties to properly perform the construction of the vessel in accordance with the terms of the contract and the specifications should be recorded.

- Reports should be taken from owners' attending representatives during the newbuilding phase.

Repairs: Any warranty repairs notified and rectified by the yacht builder will not be complete or "closed out" until a survey or assessment has been carried out that confirms that this is the case.

THE REFUND GUARANTEE

The history of the refund guarantee in shipbuilding

Historically, shipbuilding contracts provided that as the vessel was being built, ownership in the steel used in construction would pass to the buyer as each installment was paid.

In theory

- During the build the yard held the money but the buyer would own the steel, i.e. the partly completed vessel.
- In the event of a problem, theoretically, the buyer could hire someone else to finish the build.

In practice

- If the yard became insolvent and/or there was a dispute over the build, it was very difficult for the buyer to exercise its rights and gain access to its partly completed vessel.

The result

- The commercial bargaining strength between yards and buyers lay firmly in favour of the yards.

The refund guarantee today

The old position reversed

- Ownership in the steel, i.e. the partly completed vessel, remains with the yard until delivery of the finished vessel.
- In return for the paid installments, the yard undertakes that, in the event of a dispute during the build, it will immediately return the installments to the buyer.

The credit risk

- To cover the credit risk of the yard being unable to pay or becoming insolvent, buyers often request that the yard's undertaking to return the installments is supported by the yard's bank in the form of a refund guarantee.

A better credit risk

- The buyer has supplemented the credit risk of the yard with what they hope is a better one – that of the yard's bank.

The guarantee spectrum

There are not discrete types of guarantee. It is far more accurate to think of guarantees as being on a spectrum.

The guarantee spectrum

Performance bond
(more favourable for the buyer)

Surety guarantee
(less favourable for the buyer)

Where a guarantee falls on the spectrum is dependent on its wording and the commercial context of the transaction - not merely the title of the document.

Surety guarantee

The yard's bank promises that it will pay back the installments to the buyer in the event that the yard defaults.

- The buyer can only enforce the guarantee against the bank in the event of the yard failing to perform its obligations under the yacht building contract.

Secondary obligation

- The bank's obligation to pay is contingent on the yard's failure to perform under the yacht building contract.

Surety guarantee: protection for the guarantor

Where the contract is one of surety, the guarantor is legally entitled to certain protections which can limit or extinguish his liability.

Material variation

- If the risk of the builder not completing his obligations under the contract is in any way enhanced, then the variation will be material and the guarantor will be released.
- A very strict test

The Case of *General Steam-Navigation Co v Rolt* [1859]

- The buyer paid earlier than due under the contract to help the shipbuilder who was in financial difficulty, with the result that the guarantor was held released!

A well drafted suretyship guarantee will normally exclude this protection.

The performance bond

Also known as a demand guarantee or performance guarantee

An irrevocable undertaking from the yard's bank to pay a specific amount (i.e. deposit and installments paid plus interest) upon receipt of the buyer's demand.

- The buyer can enforce it irrespective of the yard's performance or non-performance of the contract.

Primary obligation

- The bank's obligation to pay is entirely independent of the original yacht building contract
- Not a "guarantee" in the technical sense at all

Surety guarantee or performance bond?

Wuhan Guoyu v Emporiki Bank of Greece [2014]

Whilst not endorsing a “box ticking” exercise, the judge concluded that there would be a presumption that, if certain elements were present in a document, it should “almost always” be treated as a performance bond. The elements are:

1. The underlying transactions are cross-border
2. The guarantor is a bank
3. The document contains an undertaking to “pay on demand” (with or without the words “first” and/or “written”)
4. The document does not contain typical clauses excluding or limiting the defences normally available to a surety

How to make sure your refund guarantee is not worthless!

The performance bond

- There is less room for the guarantor to avoid liability under a performance bond than a surety guarantee.

Identity of the refund guarantor

- Take special care when the refund guarantor is not a bank or other financial institution.
 - normally, no other type of body will issue a performance bond.

Expiry

- Ship deliveries can often be delayed. The expiry date of the guarantee should extend automatically to match and cover any alterations to the shipbuilding contract.

How to make sure your refund guarantee is not worthless!

Practical

- Can you assign the refund guarantee to your bank if you are looking for finance?
- Ensure there are no practical hurdles to making a demand
- Check the governing law and jurisdiction provisions
 - Can you enforce it easily? Is it validly executed?

Remember

- The refund guarantee is only as good as the credit of the issuing bank!

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