Mid-2018

upright & afloat

PRE-CONTRACT AGREEMENTS MAY BE BINDING

Practical Insights to Managing Their Impacts

Owner's Rep: *"You are supposed to be applying green paint to the accommodation bulkheads, not that blue stuff."*

Shipyard Rep: *"You said we could use blue paint when we asked during the bidding phase. Besides, the specs don't mention any particular color."*

Owner's Rep: *"I wasn't involved during the bidding phase, so I could never have approved blue paint. You were supposed to have asked me before you ordered the paint."*

Shipyard Rep: *"We did ask. We sent an email to your predecessor, and he replied that blue was acceptable. We can show you the emails and there is nothing in the contract about asking you before ordering the paint."*

Owner's Rep: *"The contract clearly says that pre-contract agreements have no role in defining the work; so stop applying blue paint and give us the green paint we want."*

Similar exchanges over interpretation of the contract requirements are quite common in the marine industry. One party refers to pre-contract communications; and the other party refers to the contract that appears to exclude reliance on such pre-contract communications. Under what circumstances, if any, can pre-contract communications be binding on the parties? The following discussion provides guidelines that alert project managers to the possible need to conform to pre-contract communications even when the contract appears to exclude them from consideration.

The development of a major ship construction or conversion contract often involves multiple meetings, many written or email communications and numerous telephone calls or video conferences. Eventually, a formal, written contract evolves that typically consists of multiple components: (i) the contract agreement; (ii) terms and conditions; (iii) technical contract specifications; (iv) contract plans; (v) standards of workmanship and materials; (vi) classification and regulatory requirements; and (vii) numerous reference documents.

It is important to appreciate that each of those components are part of the contract; none of them is less important than any other. If there are inconsistencies between any of them, the inconsistency is resolved in accordance with the hierarchy clause in the contract agreement.

Assuming that all those components are consistent with one another, immediately after contract execution, the parties commence fulfilling their duties, obligations and responsibilities while exercising their rights in accordance with the entire contract. Both parties are happy to finally have the contract signed and to see the project off to a good start.

After a while, however, the parties begin to have diverging opinions on how to interpret a contractual obligation that, upon objective review, is somewhat ambiguous. The ship owner's team (Purchaser) interprets it one way, and the shipbuilder (Contractor) reads it to be implemented in a different manner. Then, to add strength to its argument over the meaning of the ambiguous contract requirement, one of the parties refers to written pre-contract communications that addressed that same issue. However, the other party quickly dismisses the significance of the pre-contract communications by citing the contract's "exclusion clause" that may read equivalent to the following.

"All prior understandings and agreements that developed or existed between Purchaser and the Contractor, whether written or oral, including but not limited to all solicitations by Purchaser and all bid or proposal information provided by Contractor in connection with this project and communications between the parties pertaining to the Purchaser's solicitation and to Contractor's bid or proposal are hereby superseded and incorporated into this Contract which alone fully and completely expresses the entire agreement between Purchaser and Contractor."

Before discussing the meaning and applicability of such an exclusion clause, consider this: it is obvious that no reliance can be given to orally expressed understandings and agreements. The reason for disregarding prior oral communication

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A newsletter for the Maritime Industries from:

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is that, invariably, at the time a dispute is developing, there will never be clear agreement as to what was expressed orally by each party and what was remembered of such conversation. In other words, from this point forward, focus is given only to written pre-contract communications, including emails, text messages, faxes, formal letters and meeting notes.

When a dispute develops over interpretation of a contractual obligation, the parties have to consider all of the written information about the subject of that dispute. Such disputes arise because the wording within the relevant element of the contract can be interpreted in more than one obvious manner. Taken to an extreme, if the parties cannot resolve the dispute they may end up going to litigation or arbitration (per the contract's disputes clause). The essence of going to a judge or arbitrator is to ask: whose interpretation is binding on the parties? Now comes the central point of this discussion.

If the parties had some written pre-contract communications regarding that subject, they may have agreed then as to how to address an issue or subject that was not completely addressed by any part of the contract documents. Merely having executed the imperfect contract does not suddenly make that pre-contract agreement void or invalid. Rather, if the dispute went to litigation or arbitration, the judge or arbitrator likely will make an observation consistent with the following.

"Prior to contract execution the parties agreed as to how to interpret the ambiguity. The contract itself does not resolve that ambiguity. The pre-contract agreement can be implemented without changing a single word in the contract. Accordingly, that pre-contract agreement interpreting what later became a contractual ambiguity is a binding interpretation of how the parties already agreed to interpret the ambiguity, which representation was relied upon for contract formation."

That is, if a written pre-contract agreement can be implemented without changing a single word in the contract documents, that agreement almost certainly becomes a binding interpretation of the silence or ambiguity in the contract. That agreement will never be considered to be part of the contract, but will be a binding interpretation of the silence or ambiguity of that issue within the contract.

Note, however, that if one or more words in the contract have to be altered or ignored in order to implement that written pre-contract agreement, then the entirety of that pre-contract agreement is, per the exclusion clause, rendered meaningless.

Using this principle, the described dispute over bulkhead colors can be resolved. Normally, it would be standard practice for the Contractor to ask what color is wanted, but such inquiry became unnecessary when the Purchaser accepted the Contractor's written pre-contract request to use blue paint. Accordingly, the bulkheads can be blue, not green, because: (a) the contract documents do not identify the intended color of the bulkheads; (b) that ambiguity in the then-anticipated contract documents was not resolved although the Contractor had raised the subject before contract execution; (c) the contract documents do not require that the Contractor ask the Purchaser what color is intended; (d) the written pre-contract communication from the predecessor of the current Owner's Representative specifically allowed the use of blue paint on the bulkheads; and (e) that written pre-contract communication created a mutually achieved interpretation of the ambiguity that could be implemented without changing a single word in the contract documents.

Another example involved the availability of detail drawings that were needed to modify a cruise ship. The Owner sought bids for the intended modification through the issuance of a bid package that included a set of drawings that later became the contract drawings. During negotiations with the selected shipyard the Owner offered in writing to provide the detail drawings, relieving the shipyard from having to produce them, if the Contractor eliminated related engineering costs from its bid. The Owner and its consultants negotiated the number and content of the proposed detail drawings with the shipyard. A few days later, the Owner sent the shipyard a detailed list and description of the drawings that would become Owner-furnished after execution of the contract provided the Contractor reduced its bid price.

Contractor agreed to reduce its price based on that written representation. The contract was executed soon thereafter. The contract identified as the contract drawings the same ones that had been in the bid package. No other drawings were mentioned in the contract documents. The ones the Owner was going to provide were not mentioned or described within the contract in any manner.

In due course, the structural detail drawings did arrive from the Owner. The shipyard was able to use them to prefabricate much of the structural alterations before the ship arrived to be modified. However, none of the other detail drawings were ever made available to the shipyard (piping, electrical, joiner, HVAC, etc.). In order to finish the modification, the shipyard undertook to have such necessary drawings created by its own subcontractors under very stressful conditions. The work was completed with a two-week delay in re-delivery of the cruise ship. Both parties sought considerable damages from the other.

In the ensuing arbitration, the shipyard alleged that it was entitled to receive from the Owner all of those "missing" detail drawings. The Owner's alleged failure to supply of them was the cause of extra costs and delay, leading to the shipyard's claim. The Owner pointed out that the contract was completely silent on the issue of which party was going to prepare the detail drawings. Accordingly, the Owner argued, the contract required that the shipyard prepare all drawings necessary to accomplish the modification since the contract did not assign that responsibility to the Owner.

The shipyard's response was: Read the written pre-contract communications that commit the Owner to providing the

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drawings, in return for which the shipyard reduced its price. Further, the shipyard pointed out, those written pre-contract communications created an agreement that could be implemented without changing a single word in the contract.

Subsequently, the arbitration award was favorable to the shipyard. The Owner asked the US District Court that had jurisdiction to overturn the arbitration award because the award was based on consideration of a written agreement that was outside of the contract, which action allegedly was contrary to the contract's exclusion clause. The District Court disagreed, and let the arbitration award stand. The Owner then went to a US Court of Appeals on the basis that the District Court had not properly considered prior court interpretations of the same issue of reliance on written pre-contract agreements. The Court of Appeals also upheld the arbitration award.

This provides a lesson for all project managers in the marine industry. Namely, be aware of all written pre-contract agreements that can be implemented without changing a single word in the contract documents for this reason: it is likely that, if such a pre-contract agreement is central to a dispute, the court or arbitrator likely will consider it to be a binding interpretation of the contract's ambiguity or silence with respect to that issue, upon which interpretation both parties relied during contract formation.

Resolving Disputes Quickly and Cost-Effectively

When ship owners' inspectors examine the work accomplished, materials supplied and schedule achieved by a contracting shipyard, disputes may arise focusing on the issue of whether the contractual obligations have been satisfied. The most cost-effective resolution of such disputes is a management-to-management discussion, but sometimes that is not sufficient. At that point, a quick, cost-effective non-binding mechanism can be used to perhaps get the parties to come to an appropriate resolution. The mechanism is to bring in a third party whose opinion can be respected by both parties, but is not binding on either. Following joint discussions with both parties and a review of the contract, the independent third party advises that, if a recommendation had to be made, it would be in favor of [shipyard or owner] for reasons that are then explained strictly relative to the contract. (This also applies to subcontract situations.) While that recommendation is not binding, it forecasts the more-likely outcome if the issue went to trial or arbitration. At that point, the parties may be able to come to an agreement that may not meet the initial demands of the parties.

Because he is an internationally recognized authority on contracts for shipyard projects as well as a trained naval architect and marine engineer, Dr. Kenneth Fisher has been called in to be such a mediator on many occasions. His insights, gained from many years of comparable experience, gives him the ability to explain why his recommendation is likely to be an accurate forecast of outcome in trial or arbitration.

If, in the alternative, the parties are already going to arbitration, consideration of Dr. Fisher as an arbitrator would be appropriate. As an Arbitrator for the American Arbitration Association and for private parties, Dr. Fisher has conducted over 160 days of arbitration hearings between ship owners, shipyards and subcontractors involving over 70 vessels in which claims exceeded $20 million. He can be contacted at: email@fishermaritime.com with "arbitration" or "mediation" in the subject line.

Planning and Contracting for Shipyard Projects

Defining Contractual Rights, Responsibilities and Obligations

"We have all heard of disasters involving ships, ships that have run aground, broken in half in severe storms, impacted vehicular bridges in fog, or even experienced fires. But there is another form of disaster involving ships; namely, contractual disasters, situations in which the shipyard and shipowner are both terribly harmed due to mismanagement of the shipbuilding contract."
Trevor Blakeley, CEO, RINA

When ship owning organizations begin planning a major shipyard project (construction, conversion, mid-life refit), the planning process should commence by initially focusing on the pre-contract elements of the project. An excellent technical plan will not guarantee a successful project if the rights, responsibilities and obligations of the parties are not well defined and effectively managed. Fisher Maritime has been called upon on numerous occasions to prepare the bid packages and contract packages that incorporate the specifications and drawings drafted by other consultancies. The special skills that Fisher Maritime brings to those projects is the comprehensive definition and smooth integration of the contractual rights, obligations and responsibilities of both parties. Fisher Maritime also prepares a quality assurance review of parts of the technical specifications, using its knowledge of past contractual problems to "tighten" the specifications, minimize ambiguities, and eliminate internally conflicting language.

If your organization is embarking on a major shipyard project, send an email to Fisher Maritime inquiring how we can assist in setting up the project so that there is smooth integration of the bid, contract, and technical elements of the entire package. Send an email to: email@fishermaritime.com.

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a newsletter for the Maritime Industry
Mid-2018

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The Management of Shipyard Projects

Any project at a shipyard is certain to involve a complex relationship between the Owner's and Yard's organizations, as well as multiple supporting organizations. Cost controls, schedule impacts, changes, unexpected conditions aboard the vessel, engineering problems, and supplier delays, among many other factors, create a very challenging situation for all parties. To obtain more insights into the management of these many types of problems, consider reading the on-line articles and papers that are available at the Publications section of the Fisher Maritime website: www.fishermaritime.com

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www.fishermaritime.com/projecttraining/projecttraining.html

Contract and Change Management for Ship Construction, Repair and Design. This 3-day course is designed for all members of the contract management team for ship owners, shipyards, design firms, vendors, subcontractors and regulatory agencies, whether commercial or government. Senior and middle management of all those types of organizations benefit from the "lessons learned" approach to managing all contractual commitments.

Tampa, FL	**Tues. - Thurs.**	**Sept. 11-13, 2018**
London, UK	**Wed. - Fri.**	**Oct. 17-19, 2018**

Consider arranging for a cost-effective in-house presentation of the course as described above.

The Port Engineer's and Owner's Representative's Course. This 3-day course is designed for shipowner's personnel who prepare specifications, who accompany the ship to the shipyard, and who arrange for new/growth/change work during contract performance. This course helps assure getting maximum value for money spent. Presented in-house only. Contact Fisher Maritime for details.

Shipyard Management of the Customer and Contract. This 2-day course for project managers, production supervisors, estimators and planners is the only training program specifically developed for mid-level managers of shipyards and subcontractors. Presented in-house only. Contact Fisher Maritime for details.