WHY EXCUSES TO IGNORE THE CONTRACT DO NOT FLOAT UPRIGHT

by Dr. Kenneth W. Fisher [*]

For a significant part of his 30 years in the maritime industry, Dr. Kenneth W. Fisher has been presenting training programs on *Contract Management for Ship Construction, Repair and Design,* and has also been presenting seminars on *Shipyard Change Order Negotiation, Pricing and Scheduling* in several countries. Dr. Fisher's wealth of information and his useful perspectives in the area of shipbuilding contract management, coupled with his considerable experience as an arbitrator of contract disputes and expert witness in contract litigation, make his writings and lectures a source of education at multiple levels. Accordingly, *ShipyardTechnology News* asked Dr. Fisher to share some of his thoughts and perspectives on that subject with our readers. -- *Editor, Shipyard Technology News, March 1996*

"We don't live long enough to make a sufficient number of mistakes from which to adequately learn; so learn from the mistakes of others." This has been the theme of my training program in *Contract Management for Ship Construction* and my seminar on *Shipyard Change Order Negotiation, Pricing and Scheduling.*

It is amazing, to say the least, to come across contract problems of the same nature and content at different ends of the shipbuilding world, and at multiple places in between: from Australia to Korea; from Canada to Germany; from USA to Japan. Shipyards and ship owners who have never done business together make nearly identical mistakes in contract management at such diverse locations. This illustrates that, regardless of location, an inherent characteristic in shipbuilding contracts promotes mismanagement through abuse of the contract. Those mistakes and that contractual abuse prove to be costly to all contracting parties in both financial and schedule matters.

A *Mantra* for the Maritime Industry

As a management consultant, expert witness and arbitrator for contract disputes pertaining to ship construction, repair and design, I have witnessed what can only be described as needless bloodshed in contract battles between parties that would otherwise appear to be civil and professional in all respects. It is needless because it was all avoidable. In the end, the blood -- that is, the money -- is drained from both organisations.

As a former professor, my association with education within the industry led me to analyze the fundamental causes of such contract disputes. My findings were almost too simple to be believed, namely, contract disputes arise because the parties ignore the contract. What could be more predictable, simpler or more self-evident? Yet the wisdom of that observation is rarely appreciated: contract disputes arise because the parties ignore the contract. It should be repeated as often as possible, as a *mantra,* by all contract management personnel: contract disputes arise because the parties ignore the contract.

Inadequate Excuses to Ignore the Contract

In nearly every instance of contract disputes with which I have been involved during or after contract performance, I discovered that the disputes arose because one party to the contract, or sometimes both parties, naively or knowingly chose to ignore the contract. The offending party believed that some aspects of the contract applied to the other party, but not to themselves. Perhaps they felt that they were too busy to give regard to the contractually required procedures and communications. Alternatively, they claim that

[*] President, Fisher Maritime Transportation Counselors, Inc., South Orange, New Jersey, USA. Tel. 201-763-4266, Fax 201-763-5048.

the contract did not adequately address the situation in which they now found themselves.

Clearly, at the time of contract negotiation and signing, the parties both thought the contract was adequately clear in defining the responsibilities of each party and sufficiently comprehensive to address all possible developments that might arise. But, alas, the time came when one of the parties suddenly perceived that the responsibilities were not adequately defined or that the contract did not incorporate sufficient flexibility to address developing situations.

These excuses to ignore the contract, regardless of how they are expressed, do not float upright, so to speak. The offending party has forgotten that a contract is dynamic, living document. The contract price and schedule are regularly amended to suit changes in the technical workscope. In the same manner, so too can other contract provisions be amended if the contract is not responsive to the needs of the parties during contract performance. Regardless of the alleged excuse to ignore the contract rather than work together to amend it if needed, the consequence is the same: contract disputes arise because the parties ignore the contract.

The Offending Party vs. the Abused Party

In nearly all instances, the offending party (that is, the one which first ignored the contract) had faith that the other party would be understanding and appreciative of the reason why the first party ignored the contract. I always find it difficult to express in a civil and polite manner my reaction to such faith. ("Balderdash!" is an understatement of my reaction.) What possible motivation could the other party have to politely ignore the contractual abuse of the first party? Why should the abused party freely forgive the offending party for costly and delaying actions that would have been avoidable if the contract had not been ignored?

Of course, the offending party will state that their actions were not costly and delaying; rather, only by temporarily ignoring the contract could the costs be minimised and the schedule saved from disaster. I have seen this stated by both shipyards and ship owners. The offending party will state that the ensuing dispute arose only because other party unreasonably refused to recognise the validity of that temporary necessity.

A Likely Outcome

If your contract management staff is ever on the verge of resorting to ignoring part of the contract, perhaps you will be well guided by putting yourself in the seat of an arbitrator or judge at some later time. The arbitrator or judge will first enforce the contract to the maximum extent possible. The arbitrator or judge will take the plain and simple meaning of the contract, not examine it to find some convoluted or prejudicial interpretation. The arbitrator or judge will be looking at the situation long after the heat of the moment has dissipated, when cooler heads will prevail, and (with hindsight) see that cooler heads should have prevailed at the time when the contract was ignored.

The arbitrator or court will be asked to determine who will have to take responsibility for the development of the dispute. Unless there are really extraordinary circumstances, the guideline is the same: contract disputes arise because the parties ignore the contract. The arbitrator or judge will most likely conclude that the offending party -- the one that ignored the contract -- instigated the dispute. The conclusion is apparent: the party that first ignores the contract is most likely going to be the one that must absorb the effects of having performed outside the contract. The burden will be on the offending party to

prove that it had no choice but to act outside the contract -- a difficult proof, to say the least. Please realise that I am not speaking in any theoretical manner -- this is the direct result of my experience as expert witness or arbitrator in several dozen cases.

The Reaction of the Abused Party

From the perspective of the party whose contract rights are being abused, it is not necessary to take such contract abuse without timely reaction. What should a party do when evidently the other party to the contract is not following contractually prescribed procedures or fulfilling contractual obligations? The answer is to recall a well-defined principle of contract management: Contract managers must be prepared to timely remind the other party to fulfill all of its obligations regardless of how trivial or non-critical those obligations may appear to be.

Often, in my observations, the abused party has not adequately demanded that the offending party correct its contractually abusive behaviour. Rather, the abused party thinks to itself, we'll let the other party get deeper into that hole since we are not responsible anyway.

That form of reaction to the contractual abuse -- pretending it isn't happening -- is contrary to the underlying intent of both contracting parties. The completion of the ship or repairs on time and within budget, per the contract, is the objective that provides the optimum returns to both parties. Any extra-contractual actions by either party that may affect costs and/or schedule will detract from achieving the optimum return. Any contractually allowed actions that can be taken to promote the likelihood of achieving the contractual objective are to be preferred to extra-contractual actions.

There is a potential further consequence of failing to notify promptly the other party that they have not fulfilled their contractual obligation if litigation or arbitration ensues. In view of the lack of contemporaneous documentation, the other party will be freer to rewrite history far different from your recollection of the facts at the time the dispute was born.

Basic Causes of Ignoring the Contract

Examination of numerous situations that led to contract disputes indicates that there are some very common basic causes of one party or the other taking extra-contractual actions. The most common one is the shipyard undertaking additional work without notification to the owner. This extra-contractual work is routinely initiated without the owner's prior approval because of the shipyard's lack of sufficient advance planning. This meant that the shipyard did not have time to go through the contractually defined change order process without disrupting its production staff. So, in order to keep the production staff going, the shipyard commenced the change work without having obtained the owner's prior authorization. The act of ignoring the contract, in that situation, is not done maliciously; just naively. It is done under the shipyard's implicit assumption that the shipyard knows better than the owner what the owner truly wants. The logic of that implicit assumption is, of course, challengeable, to say the least.

Another common basic cause of a party ignoring the contract is the late delivery to the shipyard of owner-furnished equipment. Usually the owner mistakenly believed that either the delivery was not on the critical path, or that the shipyard had to accept it whenever the owner delivered it. Meanwhile, the shipyard failed to tell the owner that it was late when the "need" date for the owner-furnished equipment had arrived and passed. The shipyard thought, the owner knows that he is delivering the equipment late, and will have to pay the consequences of its late delivery. Those actions by the owner, setting the

stage for arbitration or litigation by ignoring the contract, also are not done maliciously; just naively.

It would be remiss to not mention two other common, underlying causes of a party commencing to ignore the contract. Unlike the other examples, however, these are both characterised by the fact that the act of ignoring the contract is, in fact, done knowingly, not naively.

The first of those common but intentional causes is a late realisation by the shipyard that it did not fully understand the contract's technical specifications and contract plans when it signed the contract. Rather than absorb the losses that would result from full compliance with the contract, the shipyard suddenly alleges that the contract specifications and plans are incomplete and inadequate to allow the shipyard to complete the vessel. It then commences to deny contract responsibilities that were previously acknowledged.

The second of those two common causes is a comparably late realisation by the owner that the contract specifications and plans do not adequately incorporate all the features that the owner wants in the vessel. At that point, the owner's staff attempts to coerce the shipyard to incorporate those features by alleging that they are features that were *implicitly* required by the contract documents. The owner then threatens to withhold progress payments or some other coercive action to "convince" the shipyard to incorporate those features. In such an instance, the owner has simply refused to acknowledge that a proper contract change is needed.

Both Parties Pay for Extra-Contractual Work

From a cost perspective, the fact that the abused party is not responsible for the abuse becomes less relevant after the lawyers get involved. The potential costs of resolving disputes through post-contract arbitration or litigation are too much to ignore during contract performance. The actual legal and consultant fee outlays, as well as the non-productive time of senior personnel during the arbitration or litigation preparation and processing, can become quite significant. Even a monetary award for the party who appears to "win" will be greatly diluted by those costs and fees as well as the time delay in receiving it relative to when the losses were incurred.

Those direct and indirect costs can far outweigh the extra costs that would have been involved if the contract had been properly enforced in the first place. These direct and indirect costs are the spilled blood that I mentioned at the beginning of this article. It is largely avoidable if the maritime industry's *mantra* is remembered at all times: contract disputes arise because the parties ignore the contract.

Merely because the other party has ignored the contract is not an excuse for you to also ignore it. To do so then increases the likelihood that *both* parties will share in the needless expenses and consequences of having tried to operate outside of the contract. Keep in mind that by ignoring the contract abuse, you inadvertently create a window of opportunity for the other party to rewrite contract performance history to suit their needs.

Fisher Maritime Consulting Group

147 Columbia Turnpike, Suite 203
Florham Park, New Jersey 07932

Tel. (US/Canada) 800-SEA-FIRM
Tel. (elsewhere) +1 973 660 1116
Fax. (all points) +1 973 660 1144
wwwl@fishermaritime.com