MARINE ENGINEERING DIGEST

May 2009

A Legal Requirement for "Commercial Morality" in Ship Repair Contracts?

Ship repairs are notoriously expensive. Shipowners and ship repairers each have learned the value of carefully preparing repair contracts. Marine engineers often play a key role in negotiating these agreements, which are often only finalized after weeks or months of careful planning, costing and negotiating.

Ships and machinery, and the effects that the sea and shipping have on them, however, are not sympathetic to our schedules and negotiating styles. Unpredictable events require that some ship repair contracts be negotiated in a matter of hours or minutes, while the parties watch the ship slowly taking on water, or while standing beside a main engine that is smoking sickeningly. As discussed below, marine engineers should take caution when negotiating contracts when the circumstances do not allow for calm reflection on what is being bargained for, as the agreement they think has been reached may not be binding after all.

As a general rule, courts do not typically intervene when one party to a contract strikes a bad deal with the other. When, for example, a shipowner and a shipyard come to a clear understanding of an agreement for the cost of repair, the court will rarely have sympathy if one party feels unfairly treated at the end of the engagement.

An exception to the general rule that courts will not interfere with contracts is the doctrine of *conscionability*. This doctrine states that a party to a contract can be relieved of its obligations if the agreement is unconscionable, or contrary to good conscience in how the bargain was struck. The doctrine is an odd mix of commerce and morality, which are sometimes unfamiliar shipmates.

A recent British Columbia Supreme Court judgment involving a West Coast shipyard and pleasure vessel provides an important example of where the court applied its view of "commercial morality" by using the doctrine of *conscionability* to protect a party who did not negotiate a fair deal. While the case dealt primarily with the cost of the lay days, the principles in the case could apply to any term of a repair contract and to any size of vessel. This case is useful for marine engineers, shipowners and ship repairers to understand, for just as one side to an agreement may wish to rely on the doctrine in their dispute with the other, the other will want to avoid unfair allegations they acted unconscionably.

The case involved a large pleasure vessel hitting a submerged rock a short distance from a shipyard; so short in fact that the employees of the shipyard saw from shore the ship in distress and rushed to prevent the ship from flooding and capsizing with a full load of fuel. The shipyard moved the stricken ship onto it's ways and presented the owner with a salvage invoice and a repair work order, which included a cost of $4,500 per day for lay days while the owner's insurance company sought tenders for the impending repair work. After the ship was repaired by another contractor using the shipyard's facilities (because the shipyard's bid for repair was not successful), the owner paid security for the lay days charged to have the ship released from arrest, and the shipyard sued for the cost lay days charges.

In defending the claim for the $4,500/day lay day charge, the owner argued that the work order signed by the owner, approving the lay days, was *unconscionable*. The court summarized the test for whether a contract was conscionable as this:

firstly, proof of inequality in the positions of the parties arising out of ignorance, need or distress of the weaker, which leaves the weaker party in the power of the stronger, and secondly, proof of substantial unfairness of the bargain obtained by the stronger. Once these factors are shown to exist, the burden of proof shifts to the stronger who, in order to preserve his bargain, must prove that the bargain is indeed fair, just and reasonable. The threshold is whether the transaction seen as a whole is sufficiently divergent from community standards of commercial morality that it should be rescinded.

In this case the court found that shipowner understood he had no reasonable alternative but to accept the work order charging the $4,500/day lay day charge. His ship was on the ways and was not going anywhere until it was fixed – it was too large to be trucked away and could not be refloated without significant work. When the owner expressed concern about the lay day rate, the shipyard advised it was subject to negotiation when the work was complete but the shipyard did have a "no cash, no splash" policy. The Court concluded there was inequality of bargaining power between the parties.

The court then looked at whether the deal struck was fair and reasonable. On the evidence given by witnesses the court concluded a fair lay day cost for this type of ship and shipyard was $350 per day. The Court was satisfied that the $4,500/day lay day charge was *unconscionable* and dismissed the shipyard's claim for it, replacing it with a $350/day charge.

While a $4,500 lay day rate may be reasonable (if not inexpensive) for many larger vessels, it is important to note that the same two-part test applied in this case (*inequality in bargaining position* and *fairness of the contract*) would apply to even the largest vessels and shipyards. In the end, marine engineers should be mindful of the circumstances in which repair contracts are negotiated and avoid negotiating aggressively when the other party may be at a significant disadvantage due to urgent or perilous circumstances. These contracts, even though in writing, may not be worth the paper they are written on.

Darren Williams is a marine lawyer with Williams & Company in Victoria B.C. and can be reached for question or comment at dw@MarineLaw.ca, toll-free at 1-866-765-7777 or by emergency phone at 250-888-0002.