The Legal Desk January 2009

"Commercial Morality" in Ship Repairs – The Doctrine of *Conscionability*

Shipyards are frequently criticized for the cost of their work. This criticism is often, but not always, unfair. Many ships are bought without full knowledge of the work that is needed to make them truly seaworthy, or without appreciating the ongoing cost of properly maintaining a ship, so even a brief visit to a shipyard can produce a shocking bill. A cynical, or experienced, shipowner will sometimes quip that a realistic way of estimating a shipyard bill is to double and add fifty-percent to what they expect the bill will be. In fairness, however, operating a shipyard involves enormous capital expenditures and even larger operational costs. Without equivalent income to pay these expenses and make a modest return, there would be no (or far fewer) shipyards to service our ships.

It being said that neither ships nor shipyards can exist without the other, the law does not typically intervene when one of these parties strikes a bad deal with the other. When a shipowner and a shipyard come to a clear understanding of an agreement for the cost of repair, which in most cases is on a "time and charges" basis, the court will rarely have sympathy if one party feels unfairly treated at the end of the engagement. The court avoids interfering with the freedom of parties to contract with one another.

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. The doctrine is an odd mix of commerce and morality, which most of the time are uncommon bedfellows.

A recent B.C. Supreme Court judgment involving a local shipyard and a yacht 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. This case is useful for both shipowners and shipyards to understand, for just as shipowners may wish to rely on the doctrine in their dispute with a shipyard, shipyards will want to avoid unfair allegations they acted unconscionably.

Leaving aside the details of any ship or shipyard, or any means of identifying either of them, the facts of the case involved a large yacht 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 its ways and presented the owner with a work order for the salvage work, which included a costing 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, and the shipyard sued for the parts of its bill that remained unpaid, including the lay days.

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 identified two parts to the test for whether an agreement is unconscionable when it said:

> *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.*

As to the first part of the test, whether the party claiming the deal was unconscionable was in a weaker bargaining position, 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. The shipyard also advised the owner of their "no cash, no splash" policy to which the court said "*it was clearly evident that the last word on the matter was with the shipyard, which [the shipowner] could see was in a position to deny release of his ship until they were paid what they were charging*". The Court concluded there was inequality of bargaining power.

As to the second part of the test, whether the bargain was substantially unfair, the court said:

> *"an additional $4,500 per day, which, as will be shown, was far above the usual fees in the industry, was only charged because the shipyard was dealing with a captive customer. There was no evidence to support any claim that $4,500 per day in lay day fees was justified as fair market value. It was not a price that would likely be acceptable to a reasonable, knowledgeable customer unaffected by extraneous pressure.... It is enough at least for me to have some confidence in finding that a fair lay day fee would not be more than $350 per day. In my view, $4,500 per day was an unfair bargain."*

In finding that the shipowner was in the weaker bargaining position and that the bargain was substantially unfair, 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.

The Businesses Practices & Consumer Protection Act

Also important for shipowners and shipyards to appreciate from this case is the effect of the *Business Practices & Consumer Protection Act ("BPCPA")*, B.C. legislation designed to prevent deceptive trade practices. Although the *BPCPA* does not change the two-part test discussed above for whether a deal is *conscionable* or not, the *BPCPA* shifts the burden of proving the test from the shipowner to the shipyard, but only where the ship repairs are done to a non-commercial ship. For example, in cases where a commercial shipowner alleges the shipyard acted unconscionably, the shipowner must prove they were in a weaker bargaining position and the deal was substantially unfair; however, if the ship is used for non-commercial (used for "personal, family or household") purposes the shipowner merely has to raise the allegation the deal was not conscionable, and the shipyard then has to disprove it acted unconscionably.

Therefore, shipyards have a greater exposure to claims that they have not acted conscionably when they are negotiating work on pleasure craft, than when they negotiate work on commercial ships. While shipyards should be cautious in negotiating work orders with commercial ships to ensure the shipowner is not in a weaker bargaining position and the deal is not substantially unfair, they should take even greater care when negotiating with non-commercial vessels.

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