Subcontracting in the Chinese Shipbuilding Contract

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Introduction

My thesis is about the subcontracting issue under the Chinese shipbuilding contract. In shipbuilding practice, it is very common that shipyards enter into contracts to subcontract part of the construction and design work of the vessel to some other manufacturers which are more specialized in that particular area. Therefore, shipbuilding contracts normally contain specific provisions defining and limiting the extent of the builder’s rights to subcontract.

In the past decades, Chinese shipbuilding industry has achieved substantial development. Recently, China has taken over Japan’s place and became the world-second-biggest shipbuilding nation. Additionally, in order to boost Chinese domestic shipbuilding industry, the Central Government has adopted long-term policies to encourage Chinese ship owners to build vessels in domestic shipyards. By 2015, China is aiming to become the world’s largest shipbuilding nation, with its annual output 35 percent of the world’s total. However, China's lack of a large marine components industry in comparison with its competitors such as Korea and Japan is a big problem for the shipbuilding sector. Currently, most Chinese shipyards are not qualified to produce world-class ship equipments. More than 60 per cent of the raw materials and accessories used in China's shipyards are now imported from Europe. Chinese builders have to rely on other manufactures to complete the whole construction work of the vessel. In consequence, subcontracting has become a must part in the shipbuilding context in China. My thesis, therefore, focuses on subcontracting, this particular issue under the shipbuilding contract. The multi-party contractual relationship between the buyer and the builder, the builder and the subcontractor are usually very complicated. Chinese builders, in order to protect themselves, have to sufficiently analyse the situation when they subcontract the work.

On the other hand, with the boost of shipbuilding industry, there are more and more new local shipyards pouring out in China every year. In order to attract new customers and expand business, some shipyards even don’t mind to use the buyer’s nominated contract form with the buyer’s preferable governing law. Thus in turn, when disputes arise, the Chinese shipyards will apparently in a weak situation. In China, there is no agreed standard form of shipbuilding contract. The most widely used contract is the standard
form which is used in China State Shipbuilding Corporation (CSSC). That’s only because China State Shipbuilding is the biggest shipbuilder in China and more than 60% of Chinese-built ships are constructed in CSSC. Hence, an agreed Chinese standard form of shipbuilding contract shall be produced as a basic form. In my thesis, an overview of this CSSC form will be given as background material before I start to address the subcontracting issue.

Since most of the international shipbuilding contracts in the world are governed by English law, the problems discussed in the paper will be dealt both under Chinese and English law. Meanwhile, some comparison will be made between the Chinese shipbuilding contract and Norwegian shipbuilding contract when the presentation of the contract is given. Therefore, relevant Norwegian legislation will also be referred.

The paper will begin with an outlook of the present Chinese shipbuilding industry so that the reader may have a rough picture of the shipbuilding development in China. Then, in the second part of my thesis, a presentation of the whole CSSC form will be given. As no literature is written about the Chinese shipbuilding contract, an overview of the form is therefore necessary as a background material before addressing a particular issue. Next part is on the subcontracting issue under the shipbuilding contract. When there are several subcontracts parallel with the main shipbuilding contract, a lot of questions will be posted? First, what is a subcontractor in the sphere of shipbuilding project? After clear the definition of a subcontractor, what is the legislation regulating subcontracting both in China and England? What are the builder’s rights and obligation when he intends to subcontract the work? Is he allowed to delegate the work at his own liberty? Are there any particular contract terms which the builder has to pay attention to when they conclude a subcontract? After the delivery of, if disputes arise due to the defects of the subcontract work, how the disputes can be settled between the builder, the buyer and the subcontractor? Is the builder still responsible for the subcontract work? Can the builder build a direct contractual relationship between the buyer and subcontractor and entitle the buyer bring the claim directly against the subcontractor? How can this direct action be achieved? All the questions will be addressed seperately in the third part of the thesis.
The CSSC contract is the basic legal source I use in my thesis. The contract is the standard form which is used in Chinese biggest shipbuilding factory, China State Shipbuilding Corporation. The form is basically formed from the wording of the Japanese SAJ form and therefore has all the common features which other standard forms have in the contract. Of course, it also contains several special “Chinese” provisions in the contract. During the presentation of the contract, I pick up some clauses in the Chinese form to compare with the corresponding terms in Norwegian standard form of shipbuilding contract 2000. This standard form of contract is an agreed contract which is published by Norwegian shipowner association. It is now the most commonly used shipbuilding contract in the world.

While Norway and England categorise a shipbuilding contract as a contract for the sale of goods, a shipbuilding contract is regarded as a contract of work in China. The most important source of law in the sale of goods area in England is The Sale of Goods Act 1979. The 1979 Act has since been supplemented by the Sale and Supply of Goods Act 1994. The Act draws a distinction between “sales” and “agreements to sell”. In Norway, judges and arbitrators also use the provisions in its own Sale of Goods Act of 13 May 1988 to supplement the shipbuilding contract when disputes arise.

In China, All criteria of contracts are regulated by the Contract Law of People’s Republic of China. This Contract Law is published on 15th March, 1999 and came into force on 1st October in the same year. Contract of work has a separate chapter in the Contract Law. Relevant articles regarding subcontracting in the Contract Law are referred when I address the problem under Chinese law.

The law of Property Act 1936 is mentioned in the subchapter-assigning the benefits of the contract in English law. When an assignment meets the requirement of the provisions in the Act, the assignee will be entitled to enforce the contract directly against the other contracting party. Finally, the Third Party Act 1999 was referred where the buyer’s direct claim against the subcontractor in England is addressed. It simplifies the buyer’s direct action against the subcontractor and provides the possibility for the buyer to do so.
Finally, Norwegian and English cases are used to illustrate whether the courts in England and Norway accept the buyer’s direct claim against the subcontractor.

Meanwhile, I would like to express my appreciation to Advocate Andreas Meidell and Stephen Knudtzon in Thommessen for their assistance during the study of my thesis. The sample clauses regarding the builder’s right to subcontract and assignment of subcontractor’s warranty contained in my thesis were provided by them.¹

¹ I would also like to thank my grandfather, who inspired me to write a paper on Chinese shipbuilding. He devoted all his life to the shipbuilding industry in China.
1 General overview of the Chinese shipbuilding industry (heading 1/ Alt-1)

1.1 Rosy outlook of Chinese shipbuilding industry (Heading 2 / Alt-2)
With the help of cheap labour cost and government incentives, China’s shipbuilding industry is about to embark on a decade of unprecedented growth. After years of moderate development, China’s shipbuilding industry has achieved substantial progress in modernizing facilities and upgrading production capacity. According to the Working Party on Shipbuilding Organization for Economic Cooperation and Development (OECD) council, last year shipbuilders in China produced a total of 7 million deadweight tons of vessels, 19 percent of the global total, while Korea still takes more than 38 percent of the world total. After being the world third largest shipbuilding nation for years, China has taken over Japan’s place and become the world second largest shipbuilding nation. An expert from China National Offshore Oil Corp. (CNOOC) believes that China not only has a competitive edge in its low labour costs compared with developed countries, it also has among the best pools of technology and capital from which to draw among developing nations. “We have comprehensive advantages,” the expert said.

Compared with the other shipbuilding country, China-made ships boast many competitive advantages in terms of quality, performance, price and the time of delivery, another strong point of Chinese builders is, according to Norihiko Fujii’s opinion, chief

2 http://www.csscinfo.com.cn/cssclm/luntan.asp
3 Cai Shun , Beijing Review
representative of "K" Line in Beijing, that Chinese shipyards are more flexible in building to specifications.  

On the other side, in order to boost the domestic shipbuilding industry, the Central Government has adopted long-term policies to encourage Chinese ship owners to build vessels in domestic shipyards by subsidizing 17 percent of the cost of making each ship. On top of that, the construction of large oil tankers is being encouraged with discount government loans. Such preferential policies seek to keep Chinese ship makers building most of their new ships at home. By 2015, China is expected to become the world’s largest shipbuilding nation, with its annual output reaching 24 million deadweight tons, or 35 percent of the world’s total.

1.2 Potential Problems (Heading 3 / Alt-3)
While on one hand, Chinese shipbuilding industry is prepared to embark on a boost future, on the other hand, there are still a few unfurnished areas. China’s shipbuilding industry attained international standards in the early 1990s. However, some high-tech and high-value-added ships, such as ultra-large container ships, large liquefied oil and gas carriers, natural gas carriers, luxury cruisers, are still underdeveloped. On contrast, Korea and Japan are transferring their main shipbuilding business on building such high-valued-added and high-tech ships, not only in order to maintain their reputation to be the world-first-class shipbuilding nations, but also to obtain high benefit outcome.

Cai Shun, Beijing Review
The Commission of Science and Technology for National Defense predicted
In addition, China's lack of a large marine components industry in comparison with its competitors is a big problem for the shipbuilding sector. Currently, world-class equipments are still mainly produced in European countries, such as Germany, Sweden and Norway. These countries, export 60 percent of the ship apparatus they make. In contrast, more than 60 per cent of the raw materials and accessories used in China's shipyards are now imported. China, with a low-cost labour pool, is becoming the center for large-scale ship manufacturing. China’s labour cost is only one-10th to one-15th of that of Japan or Korea where labour costs account for about 30 percent of the total costs of building a ship. This makes China a cheaper place for heavy manufacturing. A business insider said, “China’s advantage in labour cost is greatly offset by low efficiency, small-scale operations and the purchasing of most ship components from abroad.”

In the long run, as China’s economy develops, the wages of Chinese labourers will rise, which will undercut the current advantage of low-cost labour. As a result, in five to ten years, the price gap between Chinese and Korea shipbuilding operations will narrow greatly. The current shift in the market share of the shipbuilding industry is quite different from the time when shipbuilding business moved from old generation maritime powers to Japan and the Korea. Technology and management are playing an increasingly important role. After the anticipated boom, if Chinese shipbuilding industry wants to remain competitive, breakthroughs have to be made in producing high-tech and high-value-added ships, and also put more strength on Chinese ship components industry.

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7 Cai Shun, Beijing Review
While the shipbuilding technique field in China needs breakthrough, relative legal resources also need improvement. Nowadays, there are more and more new local shipyards pouring out in China every year. In order to attract new customers and expand business, some shipyards even don’t mind to use a completely unfamiliar contract form with a completely unfamiliar governing law. Thus, in turn, when disputes arise, the Chinese shipyards will apparently in a weak situation. Meanwhile, very few Chinese lawyers are specialised in shipbuilding field. According to a report from Chinese Maritime Arbitration association, arbitrators who are specialists in shipbuilding and ship sale and purchase area are fairly few. Up till now, no literature on Chinese shipbuilding was published.

2 Chinese Standard form of shipbuilding contracts-CSSC form

2.1 Introduction

In China, a contract to build a ship is regarded as a contract of work. Generally, all criteria of contracts are regulated by the Contract Law of People’s Republic of China. Therefore, if the law governing the contract is Chinese law, the Contract Law in China will apply in principle. However, more than 90 per cent of the shipbuilding contracts in the world are governed by English law. In England, a shipbuilding contract is treated as a contract for the sale of goods. Thus, the Sale of Goods Act 1979 will be decisive in
any determination of the parties’ respective rights and obligations under the contract.\(^8\)

In my thesis, both Chinese and English law’s approaches will be dealt with.

China State Shipbuilding Corporation (CSSC), established on the 1st of July, 1999, is an extra-large conglomerate and state-authorized investment institution directly administered by the central government of China. It boasts about being the mainstay of the shipbuilding industry in China. Under its wing, there are totally 60 sole proprietorship enterprises and shareholding institutions, including a batch of most powerful and some renowned shipbuilding and ship repairing yards, research and design institutes, marine-related equipment manufacturers and trading firms in China. More than 60 per cent of Chinese-made vessels which are exported to Europe are constructed there. The CSSC form is its own standard form of shipbuilding contract.

The CSSC form is basically formed from wording of the “SAJ form”\(^9\). Like other standard shipbuilding forms, the CSSC form also seeks to regulate the following matters: ship description; price; inspection and supervision; contractual modification to the agreed description or specification; trials; time and place of delivery; warranty of quality; title and risk; the insurance against and rectification of defects. On the other hand, this Chinese shipbuilding contract also contains several “Chinese” clauses. In the following, a presentation of the whole contract will be given.

\[^{9}\] SAJ form is published in January 1974 by The Shipbuilders’ Association of Japan.
2.2 Overview of the Contract Terms

2.2.1 Description of the ship (Art. I)

The CSSC form sets out at the beginning of the contract the identification and
description of the ship. This defines the subject matter of the contract. It establishes
what the buyer can expect from the final product. If the completed ship varies from the
description, the buyer is entitled to invoke sanctions for breach of the contract.\(^\text{10}\)

Art I no.1 clarifies the following:
the ship is identified by the seller’s hull number
the ship shall be built in accordance with the class and regulation which is agreed in the
contract
the ship shall be “constructed, equipped and completed” in accordance with the
“Specifications”. The “Specifications” in the contract includes “Specification, General
Arrangement, Midship Section, and Makers list”

The ship’s physical capacities and characteristics are designated in Art.I no.3-no.6:
Main dimensions (length, breadth, depth, designing draft), main engine, speed and
consumption. The further details are defined by reference to the Specifications, see Art I.
no.1

In Art I, no.2, it is stated that the vessel, including its machinery and equipment shall be
“constructed in accordance with the rules and regulations” of a “Classification Society”
designated in the contract and obtain the Class Society’s approval records with a

\(^{10}\) See Thor Falkanger, Introduction to Maritime Law Ch.4, “Shipbuilding and Repair contract”, p.90
mark”+”. All the rules and regulation are described in the Specification. Usually, the reference to rules and regulation of class society and their requirements is of fundamental importance in shipbuilding contract because the ship will be of a standard where it will be acceptable by the buyer and port authorities when it begins trading.11

In no.2 second paragraph, it is stated that “the Seller shall arrange with the Classification Society assigning a representative or representatives”, so-called "Classification Surveyor", to the Seller's Shipyards for supervision of the construction of the Vessel. The world best Classification Society are mostly from Europe, and it is always of critical importance to the buyer that the vessel should achieve the classification status. A surveyor from the vessel’s classification society, who will supervise the whole construction of the vessel, will be definitely helpful to Chinese shipyards, and simultaneously, securing the vessel’s building quality. The seller is responsible for all fees and charges which are the result of complying with the rules, regulation and requirement issued before the signing date of contract in the Specification.

Subcontracting is regulated in Article I, no.7 under the CSSC contract. According to Article I, no.7, the Seller may, “at its sole discretion and responsibility, subcontract any portion of the construction work of the Vessel to experienced subcontractors,” it is also stated that the final assembly into the Vessel of any work subcontracted shall be at the Seller's Shipyards. This article gives the builder full liberty to subcontract.

11 See Thor Falkanger , Introduction to Maritime Law Ch.4, “Shipbuilding and Repair contract”, p.90
In comparison, the Norwegian Shipbuilding contract, to some extent, limits the builder’s freedom to subcontract. Article II.4 established the limits:

The first paragraph requires that if the hull or major sections are to be built at another yard, the buyer must consent, but such consent is “not to be unreasonably withheld”. Otherwise the builder is free to “sub-contract any proportion of the construction of the vessel”. Notwithstanding that, the builder “shall remain fully liable for the due performance as if done by the builder at the builder’s yard.”

In the second paragraph, the builder is, as a starting point, free to select sub-contractors. However, limitations can be imposed by incorporating a “Makers’ list”. The “Maker’s list” is a list of subcontractors and suppliers contained in the Specification. The list has to be pre-approved by the buyer. Meanwhile, in case of major orders, the builder shall in advance inform the buyer and “give reasonable consideration to Buyer’s request”. But the buyer’s opinions or requests have no impact on the builder’s obligations or liability.

In practise, the builder’s freedom to subcontract is usually limited by the buyer. While used as part of the general conditions, in practise, the subcontracting clause of the CSSC form is usually amended by the parties. In the third part of my thesis, a substantial analysis of subcontracting will be discussed.

2.2.2 Modifications to the agreed specification

After the contract has been signed, there will be extensive planning and drawing work on the builder’s side. Like all other major projects, it is not possible to predict all
eventualities or to cover possible improvements and changes in the design or construction which come after the contract has been signed. There will often be alterations and modifications which go beyond the initial scope. The modifications usually involve design, layout and machinery. Such changes may be initiated by the desire of the buyer to increase the standard of the vessel, or because new rules and regulations are produced by Classification society.  

Generally, the builder will consent with the modifications to the contract specification if the parties agreed the basis of remuneration and also provided that this does not create problems in relation to the builder’s other commitments and the organization of the yard. In Article V.no.1, the CSSC form requires the builder to accept modification proposed by the buyer if two conditions are satisfied:

(i) “such modifications or changes or an accumulation of modifications will not, in the seller’s reasonable judgment, adversely affect the seller’s other commitments”
(ii) the buyer shall agree to “adjustment of the contract price, time of delivery of the vessel and other terms of the contract”

Provided that the above conditions are satisfied, the builder will “exert their best effort to accommodate such requests so that the said changes or modifications may be made at a reasonable cost within the shortest reasonable time.”

The necessary evidence of such agreement can be:

(i) exchange of duly authenticated letters or telex;
(ii) an amendment of the Specifications;

However, the last sentence of Art V. no.1 provided that if in any case, the parties fail to agree on the price adjustment, extension of the delivery time or provide additional securities, the builder is not obliged to accommodate the modification and change. The wording here is obviously builder-friendly. In contrast, Norwegian shipbuilding standard form ends up with submitting the disputes to the arbitration if the parties failed to agree on the adjustment of price (Art.VI.2b).

As the ship equipment industry in China is not well developed, in many cases, the buyer will reserve the right to deliver equipment to the ship, so called “buyer’s supply”. In practice, a late delivery can delay the builder’s progress, and where operational problems arise following delivery, disputes may arise whether this was caused by the equipment supplied by the buyer. While the Norwegian form chooses to be silent on the builder’s right to claim damage for buyer’s late delay, in art V.no.4, the CSSC form entitles the builder to claim payment for the loss he suffered. Such payment shall be made upon delivery of the vessel.

Finally, it is worth mentioning here that to a certain extent, the builder is entitled to “supply the materials and equipment of the equivalent quality”. Of course, the quality must be capable of meeting the requirements of the classification society and the rules. (Art V.no.3)

2.2.3 Approval of plans; inspection and supervision

While it is the builder’s exclusive obligation to construct and complete the vessel in accordance with the contract and specification, it is customary in shipbuilding for the
buyer to be permitted continuously to monitor the progress of the work. Normally, the buyer is afforded two contractual privileges:

a) the right to approve in advance the builder’s detailed plans and drawings for the vessel

b) the right to be personally represented at the shipyard by resident supervisors who are contractually entitled to inspect and improve the work. These obligation and rights are regulated under Article IV in CSSC form.

Under Art IV no.2, the parties shall agree upon a list of plans and drawings which are to be sent to the buyer within a limited period after the contract was signed. The list of plans and drawings shall be sent not later than the arrival date of the appointed supervisor. The buyer, after receiving them, shall send the documents back either with approval or remarks on them within a contracted period, with the mailing time excluded. The plans and drawings approved by the buyer shall be final and binding. Any changes afterwards shall be regarded as modification defined in Article V. There are no exact days to limit the buyer’s approval time under CSSC form. In practice, the days will be negotiated by the parties. Normally, other shipbuilding contracts give the buyer 14 days maximum. Through this clause, we can see Chinese yards are more flexible and negotiable in this prospect.

The buyer’s right to have one or more representatives at the seller’s shipyards is provided in Art IV no.1. Upon arriving at the shipyards, the representatives shall also be authorised by the buyer to have the right to approve or disapprove the plans and drawings which have not yet been sent to the buyer. The representatives shall have free access to

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all activities at the builder’s shipyard, its subcontractors or any other place where the work is done. Also the representatives are entitled to attend all tests which are agreed in the test list (Art IV.no.3 second paragraph).

If the buyer’s representatives discover unconformity with the contract requirements, they shall inform the builder as soon as possible. But the buyer shall “assure the builder that the supervisor carry out the inspections according to the inspections procedure and shipbuilding practise so as to minimize any increase in cost and delays in the construction of the vessel”(Art IV.no.3 second paragraph)

The builder, on the other side, is under an obligation to furnish the facilities for the representatives (no 3 third paragraph). In addition, under no 1 Art IV, the builder is responsible for applying the necessary visa for the representatives to enter into China. In accordance with the Chinese Immigration Regulations, foreign citizens who will go to China for business visit shall apply for valid Chinese visas. As normal application will take one or two days, the contracts here add this sentence to prevent unnecessary delay.

2.2.4 Test and trials (Art VI)

The buyer will have approved the vessel’s plans and drawings and inspected her throughout the construction period. However, the only possibility to test whether the ship complies with the standards set by the contract is when the ship is about to enter service. Therefore, it is normal procedure to conduct a “sea trail” before the delivery date. During the course of the trails, the builder will seek to demonstrate that the vessel performs in accordance with the contract requirements. The engines and navigational
capacities will be tested, their features of the ship which have not been inspected during the building phase are checked.\textsuperscript{14} The main features of test and trails are as follows:

First, under Art VI.no.1, the builder shall send 7 days written notice or by telex in advance informing the buyer the time and the place of the sea trial. If, notwithstanding the notice has been given, the buyer’s representatives still fail to attend the trail and cause the trail delayed more than 7 days, the buyer will be deemed to waive his rights of attendance. However, this does not mean that the builder is entitled to conduct a “sea trial” as he wants. In order to protect the buyer, the contract requires the builder to issue a certificate to identify the vessel’s standard. The certificate shall be countersigned by the classification society.

In addition, Article VI.2(a) of the CSSC form requires the builder to “prove fulfillment of the performance required for the trial run as set forth in the specifications.” More detailed regulation of weather conditions necessary for performance of the sea trail, as well as how the trial shall be conducted are in the specifications.\textsuperscript{15}

In case that the outcome of the sea trial confirms everything appears to be in good order, the buyer or the buyer’s representatives shall, after receiving the completion notice from the builder, within six business days, confirm in written form either accept or reject the vessel(no.4a). If the acceptance is given, it shall be final and binding, the buyer will be precluded from refusing formal delivery of the vessel by the builder (no.6).

\textsuperscript{14} See Thor Falkanger, Introduction to Maritime Law ch.4, “Shipbuilding and repair contract”, p. 98
\textsuperscript{15} See Thor Falkanger, Introduction to Maritime Law ch.4, “Shipbuilding and repair contract”, p. 98
If, however, the sea trail reveals deficiencies of the vessel, the builder shall, at his own cost, rectify these non-conformities. If necessary, there even will be a new trail. When the builder contends that the rectification has been done, he shall again notify the buyer about the completion and the buyer shall, again within six business days, confirm either acceptance or rejection of the vessel. It is worth mentioning that there is no definition of “business day” in the contract. Therefore, in order to avoid misunderstanding, it is advisable to insert a definition clause to make it clear what the “business days” in the contract is. (no.4b)

Rejection of the vessel by the buyer requires the reasons (no.4a). If there are conditions and remarks imposed by classification society after the trail, the buyer will not have the right to reject the vessel if
(i) the conditions and remarks are acceptable by the buyer.
(ii) the builder rectifies the deficiencies before the contract delivery date.

Finally, if the parties can not agree on the result of the trail, the disputes shall be submitted to arbitration (no.4d)

2.2.5 Delivery of the ship and delays in delivery

Almost every shipbuilding contract stipulate the time and place at which the ship is to be delivered to the buyer by the builder. Normally, the place of delivery is at the builder’s yard. This is a contractual provision and if the ship is not delivered in accordance with it, the builder will be in breach of the contract and will be liable to the
buyer unless there are certain circumstances such as force majeure or similar events which have been brought into operation to extend the time.\textsuperscript{16}

Under CSSC form Article VII.no.1, the “Delivery Date” is expressed to be capable of extension pursuant to the terms of the contract. This is in line with the force majeure provision under Article VIII.no.1, which is defined as by reason of delays that is “beyond the control” of the builder either in “construction of the vessel” or in “any performance required under this contract”

The form requires the ship to be delivered either “on or before” the delivery date. In other words, it means the buyer may be obliged to accept the vessel whenever she is validly tendered to him by the builder\textsuperscript{17}. Where the builder sends prior notice not less than a contractual period to the buyer informing that the vessel will be delivered earlier than the Delivery date, he will be entitled to have an agreed bonus pursuant to Article III.no.1e.

The amount of the “bonus” will be calculated on the basis of per diem where the earlier date is more than 15 days (see Article III.no.1e). However, the maxim amount will be limited between the parties. Notwithstanding that, under Article III.no.1f, there is a “back-up” provision in case that the builder will not be able to deliver the vessel at the new date. In this case, the builder can still deliver the vessel on any other day after this new declared date, provided that the delivery day is before permissible delay.

\footnotesize

On the delivery date, a “Protocol of Delivery and Acceptance” will be delivered to the buyer, also a series of documents in accordance with the Specifications such as drawings and plans, all required certificates and so on need to be handed over. The title and risk will pass to the buyer upon delivery (Art VII.no.4) and the buyer shall remove the vessel from the seller’s yard within 7 days after delivery (no.5).

The delivery date may be postponed. Circumstances on the buyer’s side may trigger delays. This is the case where the buyer requests changes or modification. (Art. V) Or the vessel’s classification society changes requirements and rules. On the other side, there may also be circumstances on the builder’s side such as poor planning and external events which prevent the progress.

One of the commonest problems in shipbuilding contracts in relation with delivery is that some external incidences turn out to affect the building work, and in turn lead to delay delivery of the vessel. Those external incidences are so-called “force majeure” events.

Under Article VIII No.1, force majeure is defined to encompass “causes beyond the control of the seller or its sub-contractors”. In detail, force majeure events under CSSC form include Acts of God, strike, fire which is not caused by negligence on the part of the builder or the sub-contractors, bankruptcy of the equipment and material suppliers, or even local temperature which is higher than 35 degree centigrade.

No.2 of Article VIII contains a notice requirement. The builder shall notify the buyer about the delay resulting from force majeure in writing within seven days since the delay commences. The same duty of notification applies when the delay ends. On the other side, if the buyer fails to confirm the delay notification within thirty days after receipt, he will be deemed to waive his right.

Last, but not least, the CSSC form incorporates in Article VIII a definition of Permissible delay. However, while other standard form defines the permissible delay being result from force majeure events as well as “any other delays of a nature which under the terms of the contract permit postponement of the delivery date”, the CSSC
form excludes the latter eventuality. This is, in my opinion, contrary to shipbuilding practice. Thus in turn, disputes will easily arise when delays of such a nature happen.

2.2.6 Price and payment terms (Art.II)

All standard forms commonly provide for a fixed price payable in installments linked, as in non-marine construction contracts, to various stages reached in the work. Although normally, the contract price will be adjusted in the event of modification or reflect any liquid damages payable by the builder as a result of delay delivery or technical deficiencies. In CSSC form, the price and payment terms are regulated under Article II.

Under the Chinese shipbuilding contract, the payments will be paid in five installments, the last one shall be payable in connection with delivery of the ship. The buyer is obliged to “make a deposit with the bank nominated by the builder” at least three days before the scheduled date of delivery. The deposit shall cover the amount of the fifth installment and be released against presentation of required documents by the builder.

In addition, Chinese builders also require security for all the other payments. That’s the reason the CSSC form incorporates Article II.no.6. The Buyer shall, “concurrently when the contract being signed”, issue the builder an irrevocable and unconditional Letter of Guarantee in favour of the builder. The Guarantee shall be issued by a first class international bank which will be acceptable to Bank of China and shall secure the

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Buyer's Obligation for the Payment of all 2nd, 3rd and 4th installments of the Contract Price.

2.2.7 Builder’s default

In shipbuilding contracts, detailed contractual provisions are usually found regulating the builder’s liability for defects. In the event of certain types of default, the buyer has a right either to an adjustment in price or to receive liquidated damages or to even rescind the contract. \(^{19}\)Defaults of various types are described especially in Article. III regarding “adjustment of the contract price”

Under Article III, four categories of deficiencies are first and foremost subject to reduction in price. The four deficiencies are late delivery, speed, fuel consumption and deadweight. As it is usually difficult for the buyer to find the precise extent of such losses he suffered from the deficiencies, it is agreed by both parties fixing standardized adjustments of price should be considered liquidated damages as opposed to penalties. (see Art III, first paragraph)

In connection with delayed delivery, the builder is permitted a period of 30 days beyond the Delivery Date defined in Article VII within which he may deliver the vessel without any adjustment of the price. After the thirty-day period expired, the builder becomes liable to pay to the buyer liquidated damages for each further day of delay up to an agreed period, usually 180 days. Where the delay in delivery of the vessel reaches a period of days after the Delivery Date, “being the total of non-permissible delays and

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\(^{19}\) See Iain Goldrein, Ship sale and purchase (3rd edition, London 1998), p.41
permissible delays”), the buyer is entitled to rescind the contract in accordance with Article X.

Standard shipbuilding forms usually limit the builder’s liability for defects to a guarantee period after delivery of the vessel. Under CSSC form, this is described as “warranties of quality”\(^{20}\). Under Article IX, the builder has a repair and rectification duty in connection with deficiencies which are found “12 months following delivery the vessel”. Any defects which are due to defective materials or poor workmanship by the builder or its subcontractors shall be included, however with materials and equipment which are supplied by the buyer excluded. When a deficiency is discovered during this guarantee period, the buyer shall “notify the builder in writing as promptly as possible”. Therefore, during the warranty period, the builder is fully responsible for any of the subcontract work.

The builder will rectify the defects at its own cost, normally in its own premises. However, if it’s impractical to have the repair work in builder’s yard, and if “forwarding by the seller (builder) of the replacement parts and materials can not be accomplished without impairing or delaying the operation of the vessel”, the buyer may have the necessary repairs made in elsewhere provided that first notify the builder in writing of the time and place of such repair work. (see Art IX. No.3)

2.2.8 Arbitration

As in any large construction project, there is enormous potential for disputes to arise between the parties to shipbuilding contract. The traditional mechanism of solving the shipbuilding disputes is arbitration.

In CSSC form, Article XIII.1 provides that “any dispute between the parties arising out of or relating to this Contract shall be submitted to China Maritime Arbitration Commission (CMAC) for arbitration which shall be conducted in accordance with the commission’s arbitration rule”. The arbitration award shall be final and binding upon the parties. However, many foreign buyers will question the enforceability and validity of an foreign arbitral award in China. Thus, I will give a short presentation of Chinese arbitration.

In 1987, China became a member of New York Convention, 1958\textsuperscript{21}. Therefore, theoretically, any foreign arbitral award which is competent under New York Convention is valid and enforceable in China. Meanwhile, in 1994, China enforced its own arbitration law. In Chapter 7, there are some particular provisions regulating international arbitrations. According to article 70 and article 71, a Chinese court, after examination and verification by its collegiate bench, shall cancel or not enforce an award, provided that a party provides evidence proving that the arbitration award involves one of the circumstances prescribed in Article 260 of the Civil Procedure

\textsuperscript{21} The enforcement of foreign arbitral awards is regulated primarily by the New York Convention of 1958
Law. Thus, when a foreign arbitral award is deemed to harm to the public interests in China, the award will be unenforceable.

2.3 Summary
In summary, given its origin, it is unsurprisingly that the CSSC form is weighed in favour of the builder. The imbalance can be seen at various points in the text, particularly in the provisions relating to subcontracting (Article I.7), builder’s Bonus (Article III.1e), modifications (Article V) and force majeure (Article VIII). However, in practise, depending upon the parties’ previous relationship and the strength of their respective bargaining positions, the wording of the standard form will be usually amended by negotiating. In my next part, the subcontracting issue in shipbuilding will be specifically addressed.

3 Subcontracting

3.1 Introduction
In shipbuilding practice, subcontracting is of great importance. since building a ship is almost like building a small factory on sea. Apparently, it is impossible for a shipyard to

22 Article 260, Civil Procedure Law A Chinese courts shall, after examination, rule to cancel or not to enforce , if a party provides evidence one of the following circumstances 1) there is no valid arbitration clause in the contract.2)the party wasn’t informed the arbitration .3) the arbitration tribunal or the arbitration procedure is not in accordance with the arbitration rules 4) the arbitral tribunal is invalid ; In addition, if the award will harm to the public interests, the courts shall not enforce it.
complete the whole project solely on their own. Usually, they have to rely on some special technological knowledge of other undertakings. It is therefore common that shipyards enter into contracts to subcontract part of the design and construction work to some other manufactures. Normally, while subcontracting, the builders are still fully responsible to the buyer for any subcontract work as if done by themselves.

Although in most of the cases, it will be the builder, rather than the buyer who will seek the liberty to subcontract the construction work of the vessel, the buyer may always wish to monitor the delegated task instead of giving the builder full freedom to do so. The reason is that the buyer wants to be secured that the vessel will be in the full compliance with the quality standards of what he purchased. Therefore, where subcontractors are to be used, the Buyer will normally wish to ensure that:

(a) it has a right of approval over the subcontractors who are to be used
(b) the terms of each sub-contract will be made available to it and the Builder will be under an obligation to ensure that the same are consistent with the terms of the Shipbuilding Contract;
(c) the benefit of the sub-contracts can be assigned to the Buyer following any termination of the Shipbuilding Contract should the Buyer wish to take over and complete the ship;
(d) the Builder obtains guarantees and warranties from the sub-contractors which allow the Builder to give the required warranties to the Buyer.

And meanwhile, in each case the Buyer will also be seeking for the Builder to continue to be wholly liable to the Buyer in relation to any works that a sub-contractor may carry out. In this chapter, the above issues of subcontracting will be discussed separately.

3.2 The definition of subcontractors

Under the CSSC form, there is no clause defining the concept of “subcontractor”. Thus, it is necessary to explain the concept of “subcontractor” in the shipbuilding context first.

In China, the law regulating different contracts is the Contract Law of The People’s Republic of China. Therefore, a subcontract is in principle included in the general regulation of the Contract Law. This statute does not give a definition of a subcontractor.
Neither can the legal definitions be found in English statute. However, the term “subcontractor” is defined from the contractual relationships existing between three persons or legal entities. A subcontractor is entrusted by the main contractor with the performance of the contractual obligations of the latter resulting from a contract with a third person. In other words: the main contractor performs the duties arising out of the main contract by using the subcontractor.

Under Norwegian Shipbuilding form, the “subcontractor” is defined as “any person (not being a servant or employee of the Builder) or company, with whom the builder has entered into a contract for the design, construction, manufacture or supply of any item, equipment, work or service for the vessel. In other words, under Norwegian shipbuilding contract, subcontractors include not only persons who undertake part of the construction work but also suppliers who provide particular items and vessel’s equipments.

Generally speaking, the subcontractor often not only executes work but also supplies goods. For instance, he can supply ship components such as radar, telecommunication equipments, elevator, or even the air conditioning installation of the vessel. The difference between a subcontractor and a supplier is that a subcontractor will be the one who provides service and labour or both materials and service (e.g., supply and fix). His service may extend to design. In contrast, a supplier only supplies goods and materials. It is then important to clarify whether the subcontractor’s most important contractual

23 J florian Pulkowski, “The subcontror’s direct claim in international business law”, ICLR 2004, p.33
obligation is the supply of goods or the execution of work. In this way, it can be defined whether the contract is governed by sales of goods law or other contract law.\textsuperscript{25}

3.2.1 The law regulating subcontracting

After having examined the definition of subcontractors, the next problem is what kind of law is relevant to a subcontract under a shipbuilding contract. Is there any specific statute that particularly regulates the subcontracting? In the following text, I will go through the legal sources regulating subcontracting both in China and England. As my thesis is focus on Chinese shipbuilding contracts, firstly, let’s examine the law regulating subcontracting in China

3.2.1.1 The law regulating subcontracting in China

As mentioned before, in China all criteria of contracts are regulated in the Contract Law. A subcontract shall therefore also be included in principle. There is no separate chapter which specifies the contractual relationship of the parties under a subcontract in the Contract Law.

While Norway and England categorize the construction and sale of ships as contracts for the sale of goods, China, like Japan and Germany, categorizes it as contracts of work. Contracts of work are separated in Chapter 15 under Contract Law of The People’s of Republic of China. In this chapter, two articles are particularly relevant to

\textsuperscript{25} See Hans Van Houtte, International subcontracting ICLR 1991, p. 312
subcontracting. Meanwhile, several provisions in the Chapter of Contracts for Construction projects are also relevant.

Article 253 of Contract law, second paragraph states:

“Where the contractor assigns the contracted work to a third party for completion, the contractor shall be responsible to the ordering party in respect of the work results completed by the third party. Where the assignment is without the consent by the ordering party, the ordering party may rescind the contract.” 26

The English version of this article is a bit misunderstanding. According to the correspondent Chinese version, “the contracted work” which the contractor assigns to a third party means part of the contracted work. In China, the whole contract work is not allowed to subcontract. This is regulated in second paragraph of Article 272. 27 Thus, Article 253 is exactly in line with the common shipbuilding practice. If the builder intends to delegate part of the construction work to a third party, such as the main engine or the vessel’s hull, the builder shall first get the buyer’s prior consent of such delegation. If not, under Chinese contract law, the subcontract is invalid in relation to the buyer.

In case that the main contractor (yard) only subcontracts some auxiliary work, article 254 shall be applied:

26 Article 253, Contract Law of The People’s of Republic of China, 2002,

27 Article 272 says “The contract letting party may not divide the construction project that should be fulfilled by one contractor into several parts so as to be finished by several contractors.”
“The contractor may assign some auxiliary work contracted to a third party for completion. The contractor shall be responsible to the ordering party for the work results completed by a third party if the contractor assigns the auxiliary work to the third party.”

The difference between article 253 and article 254 concerns the nature of delegated work. In fact, the “auxiliary work” under article 254 means the labour work. In other words, it is not the construction work which needs technical and professional skills, and can be finished by normal workers. For example, this can be the daily cleaning for the vessel. While assigning such work, the main contractor has the right of decision and he doesn’t need to get the consent of the buyer. But he is still fully responsible for the subcontracted work. In fact, the same rule applies to the shipbuilding. Generally, when the subcontract work has no impact on the quality standard of the vessel, the buyer will not be concerned with minor items of the subcontracted work as long as the builder remains fully responsible for the work completed by the subcontractor.

In addition, Article 272 of the Contract Law provides that “The contractors are forbidden to sublet the project to any unit not having corresponding qualifications. The sub-contractor is forbidden to sublet its contracted work once again.”

Therefore, under Chinese contract law, the builder is not allowed to freely choose subcontractors whoever he wants. The article requires that the subcontractor has to be qualified in the corresponding area. Otherwise, the subcontract is deemed to be invalid under Chinese law. The second sentence of this article regulates that the subcontracted work is not allowed to be sublet to any other party again. The subcontractor is obliged to complete the work on his own once the work was delegated to him.

3.2.1.2 The law regulating subcontracting in England

As almost 90 per cent of the shipbuilding contract is governed by English law, the relevant questions which were addressed above must be discussed separately according to the principles of English law.
In England, there is no separate legal act regulating specifically the subcontracting like in France. It’s therefore important to clarify the nature of the contract, whether the most important contractual obligation of a subcontractor is the supply of goods or execution of work. Hence, it can be defined that which kind of contract law will apply, sale of goods law or other contract law.

If a subcontract concerns the construction and the sale of machinery and equipment for the vessel such as a propeller, in England, this kind of contract is categorized as contracts for the sale of goods like the main shipbuilding contract. This contract is unquestionably a contract for the sale of future goods. The most significant source of law governing contracts for the sale of goods in England is the Sale of Goods Act 1979 (the “1979 Act”). The Act has since been supplemented by the Sale and Supply of Goods Act 1994. (the “1994” Act)

Another important source of law relating to the subcontracting area is The Supply of Goods and Services Act 1982. This is an Act of the Parliament of the United Kingdom that requires traders to provide services to a proper standard of workmanship. Furthermore, if a definite completion date or a price has not been fixed then the work must be completed within a reasonable time and for a reasonable charge. Also, any material used or goods supplied in providing the service must be of satisfactory quality. The law treats failure to meet these obligations as breach of contract and consumers would be entitled to seek redress, if necessary through the civil courts.

We can take a case as an example to see how a subcontract is restricted by different rules of law. In this case, the purchaser required the main contractor to obtain concrete columns from a nominated supplier on terms fixed by the purchaser. In other words, the purchaser forced the main contractor to have subcontracts with the supplier. The term of the supply contract between the main contractor and supplier limited the liability of the supplier to free replacement and excluded liability for consequent loss. The columns has defects which were undetectable when supplied, but later became manifest. The House of Lords held the fact implied in the main contract that the columns would be of good quality and fit for their purpose. This case can be solved by reference to section 5 of the Supply of Goods and Services Act 1982 and section 14 of the Sale of Goods Act 1979, which specifically provide for the circumstances in which terms as to merchantability and fitness for purpose will be implied in a contract for goods and materials.

Section 14 of the Sale of Goods Act 1979 regulates implied terms about quality or fitness. Under Section 14(2), it says “Where the seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of merchantable quality, except that there is no such condition”, and Section 14(6) continues to say that ‘Goods of any kind are of merchantable quality within the meaning of subsection (2) above if they are as fit for the purpose or purposes for which goods of that kind are commonly bought as it is reasonable to expect having regard to any

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30 Gloucestershire County Council v. Richardson [1969] 1 AC 480
description applied to them, the price (if relevant) and all the other relevant circumstances.”

The above case drew an illustration that how a specific dispute arising from a subcontract was settled by reference to relevant legal sources in England.

3.3 The builder’s obligation to make consistency between the main contract and subcontracts

As is mentioned above, while subcontractors are used, the builder is still fully liable for the subcontracted work as if the work is done by the builder himself. And therefore, in order to avoid unnecessary procedure and jurisdiction difficulties, Chinese builders are under an obligation to ensure the consistency of the contract terms between the shipbuilding contract and subcontracts. The subcontracts must be in line with the main contracts. The rights and obligations of the subcontractors must be coincided with the builder’s rights and obligations under the shipbuilding contract. Usually, the subcontract reflects many provisions of the main contracts and provides that the specifications which the buyer imposes on the shipyards are also applicable to the subcontract. Hence, the subcontractor will have to take into consideration the contractual obligations and rights of the main contracts. 32 In a subcontract, the first and upmost contract term which shall be coincided with the main shipbuilding contract is the choice of law

3.3.1 Choice of law

The law which the parties choose is the law which is to govern the contractual relationship between the parties. It provides the rules that the judges will apply to settle the disputes. An additional difficulty will easily arise when the shipbuilding contract and subcontract are governed by different law. If the subcontracts and the shipbuilding contract are governed by different law, for example, the shipbuilding contract is governed by English law whilst the subcontract is governed by Chinese law, since China is a civil law country, while England is a typical common law country, the interpretation of identical clauses can be totally different under the two various legal systems. In consequence, the main contract and the subcontract ideally should be governed by the same law.

Some subcontracts don’t contain a choice of law clauses, however, judges or arbitrators can nevertheless deduce an implied choice from the parties form contractual provisions or other circumstances. In shipbuilding, an implicit choice of law may follow from the fact that the subcontract referring to the main contract or incorporates conditions contained in the main shipbuilding contract.\textsuperscript{33} For example, all the concerning parties’ name including the builder, the buyer and the subcontractor are concluded at the beginning of the subcontract agreement and it is also stated that the builder and the subcontractor desire to enter the agreement to perform certain work specified in the contract between the builder and the buyer. In this way, the parties are aware of the fact that the subcontract will have to fit with the main contract so that they also implicitly applied the same choice of law of the main contract to the subcontracts. This thought is also clearly illustrated by an arbitration award of the International Chamber of Commerce.

\textsuperscript{33} See also Hans Van Houtte, International subcontracting ICLR, 1991, p. 309
Commerce. A Dutch buyer ordered two ships from a French shipyard. The ships were delivered too late and there were defects, including faulty turbines which had been supplied by an English manufacturer. The dispute was brought before arbitrators; and the English subcontractor intervened in the arbitration proceeding. In the shipbuilding contract, French law was chosen. The subcontract did not contain a choice of law clause. The English subcontractor alleged that English law shall be applied to the subcontract; as the contract was drafted in English; the contract contained typical English exoneration clauses; payment was due in pounds; delivery was made FOB England. However, the arbitrators held that the turbines to be delivered under the subcontract were intended for ships to be built under a main contract. From this, the arbitrators concluded that the parties intended the subcontract to be in line with the main contract. And therefore, the subcontract was also governed by French Law.\textsuperscript{34} The judge and arbitrator must, however, be prudent when attributing an implicit choice of law to the parties. He may only do so when it is clear to him that it was the intention of the parties to submit the contract to such law. Although it is sometimes difficult to trace the intention of the parties in cases where parties apparently have insufficiently analysed the situation, I think it would be more reasonable to follow what the parties would have intended before the disputes rather than what the defendant argues.

Failing any implicit choice law, the subcontract is governed by the law of the country with which it has the closet connection. Thus, the subcontract may turn out to be governed by a different law from that of the main contract. It is therefore of crucial importance for the parties, especially the builder to take into consideration about the

\textsuperscript{34} ICC No.2119 (1978), JDI, 1979,997
consistency of choice of law between the shipbuilding contract and the subcontract in advance.

3.3.2 Arbitration

The specific character of shipbuilding project, involves a broad range of shipbuilding techniques and financial insight, and also professional legal knowledge. For this reason, when disputes arise, the parties often prefer specialists who are fairly familiar with the area to settle the disputes rather than the judges with a general legal background. This is the reason that all the standard forms of shipbuilding contracts contain an arbitration clause. However, the arbitration award only binds the parties who have signed the agreement. Therefore, an arbitration award on the main shipbuilding contract does not bind the subcontractor, and vise versa. Consequently, it is also advisable that, when entering into subcontracts, the parties co-ordinate arbitration proceedings concerning the main contract and subcontract. Both the main contract and the subcontract can be submitted to the same arbitration institute or appoint the same arbitrators. 35

3.4 The builder’s rights to subcontracting under shipbuilding contracts

In most cases, the builder’s rights to subcontract will be limited by the buyer. Through negotiating, the subcontracting clause in the contract will usually be largely amended by the parties. Hence, the buyer may get control of the subcontract work only by looking into the subcontract clause under the shipbuilding contract between the builder and

35 See Han Van Houtte, The Law of International Trade .p.413
himself rather than paying extra attention to the subcontracts between the builder and third parties. Below are two samples of the amended subcontracting clause.

Sample one: Subcontracting
The BUILDER may, at its sole discretion and responsibility, subcontract any portion of the construction work of the VESSEL.
The BUILDER may sub-contract any portion of the steel work of the VESSEL to experienced and qualified sub-contractors provided (i) that the BUYER's prior written consent shall be obtained in the event that such sub-contracted work exceeds five percent (5%) of the steel structure excluding castings; (ii) that such sub-contracted work shall not include the bow or stern or other complex sections; (iii) that the BUYER shall have the same rights of supervision as if the sub-contracted work were to be effected at the BUILDER's Shipyard and the BUILDER shall provide transport for the Supervisor as reasonably required for this purpose; (iv) that the BUILDER shall notify the Supervisor of such sub-contracting in good time with an appropriate description of the work including construction programme; and (v) that the delivery and final assembly into the VESSEL of such sub-contracted work shall be at the BUILDER's Shipyard and that the BUYER's right hereunder shall be in no way diminished in respect thereof.
It is understood that the expression "subcontract" covers any steel work which is to be done by third parties outside of the BUILDER's main shipyard in accordance with drawings or plans prepared by the BUILDER and which is subject to the BUILDER's supervision and is to be distinguished from materials and equipments to be purchased from suppliers included in the Makers List incorporated into the Specifications."

Although in the first paragraph, the contract entitles the builder to subcontract any part of the work at his own discretion, in the second paragraph, to some extent, the contract turns back to limit the builder’s liberty to do so. If the subcontracting work exceeds a limited percentage of the steel work, the buyer shall give the prior approval of such work; and when the work involves complex steel sections such as bow and stern, the builder even is not allowed to subcontract. Even if the subcontract work is nominated, the buyer shall still have the same rights to supervise the work as if to the builder. And besides, the builder is responsible for the final assembling of the subcontracted work. In other words, it means that the builder remains fully liable for any subcontract work until the subcontracted parts are installed to the vessel.
From the above clause, it is stated that the subcontract includes any work “which is to be done by third parties outside the builder’s premise” and shall be distinguished from “suppliers in the Maker’s list incorporated into the Specifications.” The difference between a subcontractor and a supplier has already been discussed in the subchapter of the definition of the subcontractor. Although, in a general sense, a supplier is also a subcontractor, even Norwegian shipbuilding form includes a supplier as a subcontractor, in shipbuilding practice, a subcontractor under the subcontracting clause is strictly be taken as some one who execute part of the design and construction work of the vessel for the builder. In fact, by this distinguishing, the builder’s right to subcontract is to a large extent limited.

Sample two:
The Seller may subcontract the design and any portions of the construction work of the Vessel with Purchaser's prior written approval, such approval not to be unreasonably withheld. However, in this event, the Seller shall remain always fully responsible and liable for the due and proper performance of his subcontractor(s) and of this Contract. All acts, omissions or negligence of any subcontractor shall be deemed to be acts, omissions of the Seller. The purchasing of materials and equipment shall not be deemed to be a subcontracting and the Seller shall be responsible for ensuring that the quality and condition of such materials and equipment complies with the requirements of this Contract, the Specification and the Plans. Should the Seller wish to subcontract any work to be performed outside the Shipyard, the Seller shall notify the Purchaser of this intention at least thirty (30) days in advance of such subcontracting. The Purchaser shall have the option to approve any such subcontract by notifying the Seller within ten (10) Working Days of receipt of such notice from the Seller, such approval not to be unreasonably withheld.

It is understood that [...] Shipbuilding Company Limited is a wholly owned subsidiary of the Seller and as such any work carried out by that yard will not be considered as subcontracted work under this Contract, provided that such work always remains the full responsibility of the Seller."
Compared with Sample one, Sample two is more general. The builder may subcontract part of design and construction work, provided that the builder give enough notification time to the buyer and obtain his prior consent. Again, in this amended clause, the purchasing of materials and equipments is not regarded as subcontracting. In the second paragraph, it’s also stated that if part of the construction work is done by a shipyard which is owned by the builder, in other words, the builder’s subsidiary, it is not deemed as subcontracting as well.

Thus, compared with the standard form which gives the builder’s full liberty to subcontract, the above two sample clauses clearly illustrate that in shipbuilding practice, the builder’s freedom to subcontract is to a large extent restricted by the buyer. Most of the subcontracting clause under a shipbuilding contract will be amended by the parties. The builder’s right towards the buyer to subcontract is therefore limited by the amended clause. In addition, the two amended clauses give a clearer definition of what “subcontracting” is under the shipbuilding contract in practice. In a strict sense, a supplier in the “Maker’s List” shall be distinguished from a subcontractor under the subcontracting clause. The builder’s right to subcontract is first limited when the “Maker List” was incorporated in the specification because the list is already pre-approved by the buyer. Then under the subcontracting clause, the builder’s liberty to subcontract is further restricted by strictly defining the concept of a “subcontractor”. Thus, the buyer will be able to monitor any of the subcontract work throughout the construction period.
3.5 The buyer’s claim against the subcontractor

During the construction period, the builder naturally remains fully liable to the performance of the subcontracted work. However, when the construction is finished and the buyer has already taken delivery of the vessel, the builder may not be prepared to accept taking the responsibility for the technical risks of the major items which are made by the subcontractors. Therefore, usually, in respect of the post-delivery period, the builder will, instead of providing his own warranty, either negotiates with the subcontractors to issue a subcontractor’s warranty to the buyer, so that the buyer may obtain a direct contractual relation with the subcontractor, or assign the benefit of any guarantees provided by the subcontractor to the buyer. 36 Thus, when disputes arise, the buyer can bring claims directly through contractual relation against the subcontractors, not the builder. Even if in some cases, the subcontractors’ warranty wasn’t issued to the buyer directly or the builder forgets to assign his assignment under a subcontract’s guarantee to the buyer wasn’t done, the buyer may still, in certain circumstances, be entitled to bring claim directly against the subcontractor in tort if the subcontractor has been neglect or on the basis of breach some statutory duty. In the following context, the different claim action will be addressed separately.

3.5.1 Contractual claim

In case that the subcontractor’s warranty is provided directly to the buyer, the buyer will have a direct a contractual relationship with the subcontractors. In this case the entitlement to claim will mainly depend on the terms of the contract. In this chapter, the content will mainly focus on whether the benefit of subcontractor’s guarantees can be

36 See Simon Curtis The law of the shipbuilding contracts(2nd edition London 1996), p. 29
assigned under Chinese law and English law, and how the benefit is assigned in practice.

First let’s see a sample clause:

9.1. For a period of twelve (12) calendar month (the Guarantee Period) following the actual Delivery and acceptance of the Vessel, the Seller shall be obligated to repair any defects which may have developed in the Vessel or any parts thereof during this period or which may have been present prior to the delivery of the Vessel, provided that such defects are the result of faulty design, poor workmanship, or faulty materials and are not the result of overloading, normal wear and tear, misuse, negligence or accidents or the result of bad maintenance or improper handling of the whole Vessel as well as of the particular parts.

However, the Seller shall have no responsibility for any defects and/or the consequences thereof due to the fault and/or deficient materials supplied by the Purchaser except if they have not been proper installed on board the Vessel by the Seller.

9.6. If any subcontractor is granting a guarantee, in excess of any further the Guarantee Period hereunder, the Seller shall assign the benefit of such guarantee to the Purchaser. The Seller shall be responsible under the Guarantee granted by the Seller under Article 9.1."

According to Clause 9.1, the so-called “Buyer’s warranty”, during the twelve-month-long guarantee period, the seller is liable to any defects which are the result of any poor design, workmanship, faulty materials, with normal tear and wear excluded. However, the seller is not only responsible for his own, but also responsible for any subcontractors’ poor design or workmanship.

Clause 9.6 provides that if there is any subcontractor’s guarantee whose guarantee time is longer than twelve months, the seller shall assign the benefit of such guarantee to the buyer.

Thus, in practice, the Builder's general guarantee covers the sub-contracting work for a period of time, usually twelve months, and thus, an assignment of subcontractors’ guarantee is therefore mostly needed for possible extensions of guarantee time.
The following question is to what extent the benefit of a subcontractor’s warranty can effectively be assigned under the governing law. Both the effectiveness under Chinese law and English law will be discussed.

3.5.1.1 Assigning the benefits of a contract in Chinese law

Under Chinese contract law, the rights and obligations of a contract can both be assigned, as long as it is agreed by the parties.

In Chinese Contract Law, assignment of contracts is regulated in Chapter Five. Article 79 says that a party may “assign his rights under a contract, wholly or partly to a third party”, however, except for the following circumstances,

1. The rights under the contract may not be assigned according to the character of the contract;
2. The rights under the contract may not be assigned according to the agreement between the parties;
3. The rights under the contract may not be assigned according to the provisions of the laws.

Nevertheless, Article 80, states that the party who intends to assign the benefits to a third party shall first notify the other party, otherwise, the assignment is invalid.37

While Article 79 and 80 regulates the assignment of rights, Article 84 regulates the assignment of contractual obligations.

37 Contract Law of The People’s of Republic of China, 2002, Article 80: An obligee assigning its rights shall notify the obligor. Without notifying the obligor, the assignment shall not become effective to the obligor.
Under Article 84, a party may, wholly or partly, assign his obligation under a contract to a third party, provided that the other party gives the consent.\[^{38}\]

Finally, Article 89 provides that the contractual rights and obligation may at the same time be assigned to a third party, with the pre-consent of the other party\[^{39}\]

In shipbuilding practice, none of the buyers would like to undertake the extra burden of a subcontractors’ guarantee. Therefore, Article 84 and Article 89 are not relevant here. Under a shipbuilding contract which is governed by Chinese law, if the builder intends to assign the benefit of a subcontractor’s guarantee to the buyer, the builder shall notify the subcontractor about the assignment in advance in order to get his consent, otherwise the assignment is deemed to be invalid under Chinese law.

### 3.5.1.2 Assigning the benefits of a contract in English law

In shipbuilding practice, more than 90 per cent of the contracts are governed by English law. Hence, it is necessary for Chinese shipyards to have some knowledge of the general principles of English law relating to the assignments of contractual rights and obligations.

Under English law, the benefits, (not the burdens) of a contract are generally capable of assignment by either party in favor of a third party. In other words, only the contractual rights can be assigned, while the contractual obligation can not be discharged by

\[^{38}\] Contract Law of The People’s of Republic of China, 2002, Article 84
\[^{39}\] Contract Law of The People’s of Republic of China, 2002, Article 89
assignment. This is however different from Chinese law. Our concern is the effect of the assignee’s (buyer’s) right of action against the debtor (subcontractor). Can an assignee sue the debtor by bringing an action in his own name? Depending upon the substance and form, such an assignment may either be legal or equitable in nature.  

In English law, an assignment may either be legal or equitable according to its substance. A legal assignment is a right which can be enforced by action at law. An equitable assignment is a right that was enforceable only by a suit in equity. In case of a legal assignment, the assignee will assume all the rights of the assignor under the agreement and may enforce its terms against the other party without the assignor’s joining to any legal proceedings in connection with such enforcement. By contrast, where an assignment takes effect only in equity, the assignee’s rights are more limited. He may not assume all the rights of the assignor and will normally have to be required to join the assignor to any proceedings he starts to enforce the agreement.

Where distinguished by form, an assignment my either be absolute or non-absolute assignment. An absolute assignment is one by which the entire interest of the assignor in the chose in action is transferred unconditionally to the assignee and placed completely under the assignee’s control. By contrast, like an equitable assignment, a non-absolute assignment does not entitle the assignee to sue the debtor in his own name, but requires him to ask the assignor to join as a joint party.

When a legal assignment is expressed in absolute terms, and a notice in writing of the same is given to the other contracting party, such an assignment will satisfy the requirements of s.136 of the Law of Property Act 1925 and the assignee will be entitled to enforce the contract directly against the other contracting party.45

Therefore, when the above requirements are satisfied, the assignment of the subcontractor’s warranty under a shipbuilding contract is valid in English law.

However, it’s also worth to be mentioned that in relation to a subcontractor’s warranty, whether this can be effectively assigned by the builder to the buyer will not only depend on the particular terms but also the law by which it is governed.46 As the law governing the subcontracts may be different from the law governing the shipbuilding contract, it will then effect the assignment of subcontractor’s guarantee by the builder to the buyer. Thus, as is already discussed above, the builder, when enters into a subcontract, shall bear in mind that make the main contract and subcontract consistent.

3.5.2 Extra-contractual claim against the subcontractor
If the buyer does not have a direct contract with the subcontractor, he will only have to establish his claim either in tort or on the basis of breach of some statutory duty. Whether the buyer may bring claim directly against the subcontractor will depend on whether the statues provide the possibility of this direct action. I turn next to examine

the possibility of this direct claim in the three different countries-China, Norway and England.

3.5.2.1 The buyer’s direct claim against the subcontractor
In China, Article 267 of the Contract Law regulates that “Co-contractors shall bear joint and several liability to the ordering party.” Meanwhile, third paragraph of Article 272 also says that “With the consent of the contract letting party, the general contractor or the contractors for survey, design or construction may assign part of the contracted work to a third party. The third party shall assume joint and several liabilities to the contract letting party together with the general contractor or the contractors for survey, design or construction in respect of its work achievements.”

Therefore, in accordance with Chinese Contract law, the subcontractor is bound to be liable to the buyer for the subcontract work together with the builder. The buyer may claim against either the builder or the subcontractor for any defects of the subcontract work. This is mandatory. Even there are terms in the subcontract that limit the liability of the subcontractor and prohibit the possibility for the buyer to bring the claim against him, those terms are deemed to be invalid under Chinese law.

While in Norway, there is extensive case law regarding the claims against the subcontractors. I therefore use a case to address this problem in Norway. In ND.1995.251 NCA TAREHAV, the court accepted a direct claim from the buyer against the sub-contractor. This case concerned a claim by the owner (buyer) against the subcontractor about the non-conformity of the ship's engine. The subcontractor is a
The subcontractor alleged that the reason that the engine broke down is resulted from the crew's mis-operation, not the insufficient power of the engine. However, the court dismissed the subcontractor’s appeal. They applied the Sale of Goods Act section 18(2) in this case that the engine is in non-conformity because it is not in accordance with information which the subcontractor has furnished in the brochure. The court therefore awarded the buyer’s claim for both direct and indirect loss according to section 40(3) of the Sale of Goods Act. 47 Thus, in Norway, it is also possible for the buyer to claim directly against a subcontractor on the basis of breach the duty under the Sale of Goods Act.

While in England, since The Contracts (Rights of Third Parties) Act 1999 enters into act, the buyer’s claim against subcontractors has also been simplified.

The Contract Act 1999 has made a fundamental change to English contract law in that it enacts a substantial exception to the doctrine of privity of contract, which had long been a central, albeit controversial part of English contract law. 48 Under the Rights of Third Party Act 1999, it is in certain circumstances possible for a person who is not a party to contract (a “third party”) to enforce a term of this contract provided that (a) the contract expressly provides that he may” or (b) the term “purports to confer a benefit on him”. 49

47 Sale of Goods Act §18(2) The rules of the proceeding paragraph apply similarly when the goods are not in accordance with information which any person other than the seller has furnished on the packaging of the goods, in advertising or other marketing on behalf of the seller or prior sales stages.
49 S. 1 (1) Act 1999
And “on a proper construction of the contract, it appears that the parties intend the term to be enforceable by the third party”\textsuperscript{50}

Such rights, when applied against a subcontractor, arise accordingly where either (i) the subcontract expressly provides that the buyer may exercise such rights or (ii) the builder and the subcontractor have intended to confer an entitlement upon the buyer by their subcontracts to do so. The buyer “needs not to be in existence when the contract is entered into.”\textsuperscript{51} The fact that the buyer has benefited from the work undertaken by the subcontractor will not in itself be sufficient to generate statutory rights in favor of the buyer.\textsuperscript{52} Such rights, normally arise where the subcontractor had given the warranty of his subcontracted work to both the builder and “any purchaser” of the vessel. However, the fact that a third party’s rights have been granted does not prevent the builder’s enforcement of the subcontract. The statutory rights are only additional rights, but not a substitution for the rights of the builder as the original party to the subcontract.\textsuperscript{53}

3.5.3 The buyer’s claim in tort against the subcontractor.

As to tort, there is no need for any contractual relationship between the parties. A person may claim for the loss he suffered resulting from a person’s negligence. Below, the analysis will be based on the English law so that Chinese builders may acknowledge some concept of English law.

\textsuperscript{50} S.1.(2) Act 1999
\textsuperscript{51} S.1 (5) Act 1999
\textsuperscript{52} See Simon Curtis The law of shipbuilding contracts (3rd Edition London 2002), p.30
\textsuperscript{53} See Simon Curtis The law of shipbuilding contracts (3rd Edition London 2002), p.31
In England, the question of whether a third party who has suffered loss arising from the building defects may recover damages in tort against the person who is responsible for the defects has varied in the past few decades.\textsuperscript{54} The debate concerned the tort of negligence has three ingredients:\textsuperscript{55}:

1. a duty of care owed by the particular defendant to the plaintiff;
2. breach that duty;
3. consequent loss;

Most specifically, the debate has centered upon, first, the test of duty of care. Secondly, in which circumstances there may be recovered purely “economic” or pecuniary loss as distinct from loss related to physical injury or damage to property.

Usually, there are two stages to determine whether a duty of care is owned. At the first stage, a relationship of “proximity” sufficient between the parties is determined to give arise to the prime facie duty, and at the second stage, an evaluation of any negative policy will be considered. Application of the test resulted in that recovery of economic loss in some circumstances which previously it was considered irrecoverable. A general opinion is pure economic loss in tort is not considered recoverable only in case the loss resulted immediately consequential upon physical injury or damages.\textsuperscript{56}

In “the Diamantis Pateras”\textsuperscript{57}, the plaintiff alleged negligence by the manufacturer of the vessel’s oil burners and further claimed the manufacturer owed him a duty of care about

\textsuperscript{57} Diamante Sociedad de Transportes S.A. v. Todd Oil Burners Ltd [1966] 1 Lloyd’s Rep
the design and manufacture of the burners for the furnaces in the vessel. Although finally, the claim failed on facts, a duty of care was held to arise between a subcontractor and the purchaser of the newbuilding.

However, in “Junior Books ltd . v. Veitchi Co.ltd, 1982”, it concerned a claim in delict by a building employer against a subcontractor to recover the cost of re-laying a defective floor laid by the latter. The floor was not alleged to pose a danger injury to person or damage to other property. The defendant contended that the pleading disclosed no cause of action. Later, the majority of House of Lords considered that the pleading did disclose a cause of action on the basis that the duty of care in tort did extend to avoid pure economic loss consequent upon defects in the work. This case stands inconsistency with other cases suggesting that in some circumstances, there should be no recovery of economic loss. In 1990, the view in “Junior” was overruled that there needed to be “sufficient proximity” between the buyer and subcontractor was again reviewed by Lord Keith in Murphy v. Brentwood District Council\textsuperscript{58}.

In summary, at the time being, the best view is unless the economic loss is immediately consequential upon physical injury or damage to property (other than the building works themselves) the purchaser can not recover it in tort against the subcontractor. Thus, the buyers prefer to obtain subcontractors warranties so that he may have contractual remedy in the event of default.

Hence, in conclusion, after the warranty period, if a Chinese shipyard wouldn’t like to undertake any defects or consequences due to the fault made by the subcontractors, he

\textsuperscript{58} Murphy v. Brentwood District Council [1990] 3 WLR 414
shall endeavour to make a contractual relationship directly between the buyer and the subcontractor, either by negotiating with subcontractors to issue a warranty directly to the buyer, or by assigning his benefit of the subcontractor’s warranty to the buyer. However, before taking further steps, the yards shall always consider the validity and enforceability of such warranties and assignment under the contract’s governing law. Otherwise, it is still possible that the builder will have to bear the responsibility for any of the subcontract work.

4 Conclusion

Aiming to become the world biggest shipbuilding state, Chinese shipbuilding industry still faces a lot of challenges to be overcome. While fully develop the domestic ship component industry, Chinese government shall also put more effort to produce relevant legal regulations. A law which is specifically on shipbuilding and subcontracting may also be necessary. Thus, it’s much easier for judges and arbitrators to find statutory source.

Secondly, in order to protect some small and unexperenced Chinese yards who are usually in a weaker negotiating position at the pre-contract stage, an “agreed” standard form of shipbuilding contract shall be produced and generally used in China, like the Norwegian Standard Form of Shipbuilding Contract in Norway. Albeit the CSSC form is used in more than 60% of Chinese shipyards in China now, most of the yards are the subsidiaries of China State Shipbuilding Corporation. My opinion is we can base on the CSSC form. The wording of both the Chinese and English version needs polishing, thus the contract will be more professional. A generally used standard form shall be professional not only in context but in wording also. Thus in turn, both the Chinese and English wording of the contract needs polishing.

Accordingly, more legal talents specialized in shipbuilding are needed. And it is always of central importance for Chinese yards themselves to learn certain legal knowledge of the governing law of the contract.
Thus I hope, in the near future, China is qualified to construct 100 percent Chinese-made vessels and become the world real biggest shipbuilding nation.
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5 Annex (optional)