



OFFSHORE CONSTRUCTION CONTRACTS – “FIT FOR PURPOSE” AND OTHER POTENTIAL ONEROUS WARRANTIES

Mt Højgaard A/S v. E.ON Climate & Renewables UK Robin Rigg East Limited [2017] UKSC 59

The Supreme Court has in a recent decision decided on a contractor’s liability in a contract where there is potential conflict between a contract provision requiring the contractor to apply specified standards and a provision requiring the contractor to obtain a particular result. In the case at hand, the contractor’s compliance with the standard required by the contract prevented the contractor from obtaining the result required by the contract.



BY CAMILLA BRÅFELT

Background

After a tender process, E.ON (through two E.ON companies, jointly referred to as “E.ON”) entered into a contract with MT Højgaard A/S (“MTH”) in 2006, where MTH agreed to design, fabricate and install foundations for

an offshore wind farm.

In performing their obligations MTH, as required by the contract, relied on an international standard for the design of offshore wind turbines (J101) published by Det Norske Veritas (“DNV”). The J101 contained an equation that showed how the interface shear strength due to friction was to be calculated. The detailed design was prepared by MTH’s subcontractor and was submitted, as required by the contract, to DNV as an independent certifying authority for evaluation and approval. MTH completed installation of the works in February 2009.

In the summer 2009, it was discovered that there was an error in the J101 equation showing how the interface shear strength was to be calculated. The error in the equation resulted in substantial over-estimation of the axial capacity of the grouted connection in the wind farm foundations.

In April 2010, the wind farm foundations designed, fabricated and installed by MTH started to fail. Remedial works were performed, and the question decided by the Supreme Court was whether the

contractor MTH was liable for the failure, and hence obligated to bear the costs of the remedial works.

The Contract

The tender documents included a document called “Technical Requirements” (“TR”). The TR included a “General Description of Works and Scope of Supply”, which stated e.g. that the work elements were to be designed for a minimum site specific design life of 20 years without major retrofits or refurbishments. The TR further required MTH to prepare the detailed design of the foundations in accordance with J101, as well as stating that the design of the foundations shall ensure a lifetime of 20 years in every aspect without planned maintenance or replacement.

The contract that was entered into between MTH and E.ON contained a “fit for purpose” obligation, where the foundations were to be designed, fabricated and installed fit for purpose. “Fit for Purpose” was a defined term in the contract as “fitness for purpose in accordance with, and as can properly be inferred from, the Employer’s Requirements [which included the TR].” There was a further provision in the contract that required MTH to make good defects or damage arising out of “Works not being Fit for Purpose” that arose within the defects liability period. The liability period was defined as 24 months from the date E.ON took over the works from MTH.

The question to be decided was whether an enforceable 20-year warranty had been given by MTH.

In the lower courts, there had been a discussion about whether the potential warranty was a warranty for 20 years *operational* life or only a warranty for 20 years *design* life. The Supreme Court did not find it necessary to address this point, or whether the defect must have been discovered within the first 24 months. This was because the foundations failed within 24 months in any event, thus the foundations would never have had an operational life or design life of 20 years.

The arguments

E.ON argued that the TR amounted to a warranty that the foundations would last for 20 years. E.ON based their argument on the TR having been incorporated into the contract because the main body of the contract required the work to be fit for

purpose. That in turn equated to compliance with the Employer’s Requirements defined in the contract as including the content of the TR which explicitly referred to the foundations having a life of 20 years. E.ON argued that MTH had breached the TR insofar as the foundations did not have a life of 20 years, and that MTH was therefore liable for breach of contract.

MTH on the other hand, argued that the works were to be constructed in accordance with the requirements of J101. A provision in the tender documents catering for a 20-year design life, cannot render the contractor liable for faulty construction when the work was actually performed in accordance with the required standard. The nature of the TR was technical, not legal. If the parties had intended that MTH was to warrant a 20-year lifetime, a term to that effect would have been included.

The Award

The Supreme Court found in favor of E.ON and held that MTH were liable for the cost of remedial work of the foundations.

In their decision, the Supreme Court established, based on an analysis of previous case law, that the courts are generally inclined to give full effect to requirements in a contract setting out prescribed criteria for the item to be produced, even if the customer has specified or approved the design of the item. It was emphasized that it is the contractor who can be expected to assume the risk of complying with the prescribed criteria if he agreed to work to a design which would render the item incapable of meeting the criteria to which he has agreed. MTH could therefore not be heard with their argument that the failure was due to their compliance with J101, which was required by E.ON. It was specified that the resolution of this issue may turn on the particular wording of the contract. In the relevant contract, the Supreme Court emphasized that the obligation to comply with J101 was a minimum requirement, with a further obligation for MTH to identify any areas where the works needed to be designed to any additional or more rigorous requirements or parameters so as not to conflict with the obligation to provide foundations that would last for 20 years.

The Supreme Court did not have much sympathy for MTH’s argument that an enforceable 20-year

warranty would not be as diffuse or unsatisfactorily drafted and tucked away in a technical tender document. The fact that the contract and the TR were tainted by being drafted by several authors with diffuse and long, detailed descriptions in the TR, did not give a reason for departing from the fundamental rules of construction. When using the rules of construction, the Supreme Court found that the TR did contain a 20 year-warranty, and that the TR was incorporated in the contract through the main terms of the contract.

Comments

As highlighted by the award, it may not be sufficient for a contractor to apply the required standards, complying with the specifications or design approved by the customer if the contract contains an obligation to obtain a particular result, in this case to achieve

a particular purpose or service life. Care should be taken by contractors to identify any obligation to obtain a particular result, achieve a particular purpose or service life, before entering into the contract.

Offshore engineering and construction contracts, both in the oil and gas industry and in the windfarm industry frequently contain absolute warranties as to fitness for purpose or other similar warranties to achieve a particular purpose. Also in charter parties for vessels used in the offshore industry, owners' obligations often extend beyond simply providing a vessel; the scope of work may include engineering and construction elements and owners should be acutely aware of the potential exposure of such absolute warranties, which may well be tucked away in the technical documents in the tender package. The risk of such warranties being applied has now been clarified by the Supreme Court.





VESSEL RECYCLING – THE IMPACT OF THE EU SHIP RECYCLING REGULATION

A study done by the NGO “The Shipbreaking Platform” revealed that of a total of 835 ships that were dismantled in 2017, 543 were broken on tidal beaches.¹ Most of these ships would be regarded as hazardous waste and therefore subject to stringent regulations. Beaching vessels at sub-standard facilities in South East Asia will typically amount to a breach of various regulations thereby exposing Owners (and potentially their directors and officers) to both civil and criminal liability, as well as negative media attention.

On 20 November 2013 the European Parliament and the Council of the European Union adopted the “Ship Recycling Regulation” (“SRR”). Its purpose is to reduce the negative impact linked to the recycling of ships flying the flag of an EU Member State. The SRR is yet to fully enter into force, but will do so at the latest on 31 December 2018.

In this article we take a closer look at the SRR and the consequences it will have once it is in force.²

Increased focus on scrapping issues

During recent years the attention paid to how vessels are recycled or demolished has increased. This is evidenced by increased attention from NGOs and governments that enforce applicable regulations, as well as from investors and stakeholders in ship owning companies.

In February 2017, the vessel “Harrier” was arrested in Norway after the owners attempted to sail for Gadani, Pakistan to scrap the vessel. The Norwegian authorities were initially presented with what later turned out to be a false contract for repairs in Oman, and therefore approved the export of the vessel.

While attempting to leave Norway the vessel suffered engine problems and had to be salvaged by the Norwegian Coast Guard. Following the salvage effort, the local police discovered that the vessel was in fact destined for demolition in Pakistan.

The “Harrier” has remained under arrest and will not be



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allowed to leave until the Norwegian authorities are presented with documentation showing that the vessel will be recycled in accordance with Norwegian law - based on the EU Waste Shipment Regulation (“WSR”).

Also noteworthy is the recent development from The Netherlands where three executives from Seatrade are facing criminal charges following the sale of four reefer vessels for scrapping in India, Bangladesh and Turkey back in 2012. The public prosecutor in The Netherlands has called for jail sentences for the three executives in criminal proceedings which were concluded on March 15.³ In the judgment that was handed down that day, the Rotterdam District Court sentenced two of the executives that were found guilty in violation of the WSR to a fine of EUR 50,000 and a ban from being professionally involved with a shipowning company or a related company for a period of one year. The companies within the Seatrade group that were found guilty were sentenced to fines in the range from EUR 100,000 to EUR 750,000. At the date of this article, it is likely but unknown whether the case will be appealed.

The EU Ship Recycling Regulation (SRR) and the EU Waste Shipment Regulation (WSR)

At the outset it is important to understand the relationship between the SRR and the existing WSR. It follows from Article 32 of the SRR that it shall apply from the earliest of either (i) 6 months after the date that the combined maximum annual ship recycling output of the ship recycling facilities included in the “European List” constitutes not less than 2,5 million LDT, or (ii) 31 December 2018. The EU published the European List on 19 December 2016, but the total output in these facilities has yet to reach the necessary 2,5 million LDT. Therefore, only part of the SRR is currently in force, being the part dealing with how yards shall apply and be included in the European List (articles 13 – 16). Also, worth noting is that Article 5 (2) second subparagraph is applicable, setting out that vessels that are going for recycling shall “*as far as practicable*” have onboard an Inventory of Hazardous Materials.

Whilst awaiting the SRR, the WSR continues to prohibit export of both hazardous waste and regular waste to non-OECD countries by reason of incorporating the provisions of the Basel Convention, with

certain extensions.² The scope of application of the SRR and WSR is not identical, such that the WSR will in certain circumstances be applicable even after the SRR enters into force.

The essence of the WSR is that it prohibits the export of *waste* destined for disposal outside of the EU Community, whilst allowing export of *waste* destined for recovery in OECD-countries in certain situations. In both systems a notification regime must be adhered to for obtaining permission from the exporting and importing countries.

Applicability of the SRR and the WSR

Article 2 of the SRR sets out that the SRR applies to “*ships flying the flag of a Member State*”. In the same article, it is stated that Article 12 of the SRR also applies to any “*ships flying the flag of a third country calling at a port or anchorage of a Member State*”.

Article 12 of the SRR imposes a requirement for vessels flying the flag of a third country to have onboard an inventory of hazardous materials, compliant with Article 5 (2).

The WSR, as per Article 1, applies to any “*shipment of waste*”;

- between Member States, within the Community or with transit through third countries;
- imported into the Community from third countries;
- exported from the Community to third countries; or
- in transit through the Community, on the way from and to third countries.

The SRR is therefore applicable to vessels flying the flag of an EU Member State - regardless of the vessel’s location. The WSR, however is only applicable if the vessel, irrespective of flag: (i) may be regarded as *waste*, and (ii) is being exported either from or via an EU Member State. In other words, the location of the vessel, rather than flag is the decisive factor.

Contents of the SRR

Upon its entry into force, the SRR will impose important restrictions with regard to how vessels flagged in an EU Member State may be recycled. The most important restriction is that only certain pre-qualified yards can be used when deciding to recycle the vessel. As per Article 6 (2) (a), the owner of the vessel is

required to ensure that a vessel sent for recycling is only recycled at “*ship facilities that are included in the European List*”. The European list, as published on 19 December 2016, only contains 18 yards located in the EU Member States. Yards located outside the EU may also eventually be included, provided that they fulfill the requirements as laid down in the SRR.⁴

Yet another important requirement following the SRR is the necessity to carry onboard the vessel an “Inventory of Hazardous Materials” (“IHM”). Under the SRR, the requirement is strict for new vessels, whilst in the case of existing EU flagged vessels the IHM must be on board latest on 31 December 2020.⁵ New vessels are defined as either (i) vessels for which the building contract is entered into after the date of the SRR becomes applicable, (ii) in the absence of a building contract, the keel is laid six months after the date of the SRR becoming applicable, or (iii) the delivery takes place thirty months or more after the date of the SRR becomes applicable. Any vessel that is covered by the SRR will nonetheless need to have on board an IHM when she is headed for recycling – this requirement is also strict and will apply regardless of the vessel’s age.

Important to note for vessels not flying the flag of an EU Member State is that the requirement of having onboard an IHM is also extended to ships from third countries that call at ports or anchorages in EU Member States, with compliance required from 31 December 2020.⁶

Lastly, we mention that ship recycling yards will, in accordance with Article 7 of the SRR, be required to develop a “*ship recycling plan*” before the vessel may be sent for recycling. A ship that is due for recycling must hold a “*ready for recycling certificate*”. Each Member State will need to designate a national authority that shall be authorized to issue both the ship recycling plan certificate and the ready for recycling certificate.

Relevance of WSR after SRR enters fully into force

As referred to above the WSR will still be applicable to vessels that are not flying the flag of an EU Member State, provided that the vessel is (i) present in an EU Member State or passing through an EU Member State, and (ii) the vessel in question may be defined as “*waste*”. If so, the WSR ban on export-

ing waste for disposal outside the EU Community applies. Moreover, any export from an EU Member State will require that the exporter adheres to the stringent notification regime laid down in the WSR.

The classification of the vessel as “waste” is the decisive point under the WSR. The WSR has general applicability to “*waste*” and is defined as “... *any substance or object ... which the holder discards or intends or is required to discard.*” It is thus sufficient that the object is *intended* to be discarded by the owners. A vessel will therefore be regarded as waste under the WSR once her owners have formed the intention to discard her. The example of the “Harrier” illustrates that the Norwegian authorities are enforcing the regulations based on evidence of the owners intention to discard the vessel. In the Seatrade-case, the Rotterdam District Court held that the intention when the relevant vessels left Europe was to dismantle the vessels in India, and the fact that three of the four vessels ended up in a different country was not decisive.

The intention criterium expands the scope of WSR considerably. A vessel that is sold for scrap when present in the EU Community will normally be regarded as *waste*, and thereby covered by the WSR. Whether a vessel will be regarded as waste in case she is sold to a cash buyer that intends to scrap her is more unclear, but the better view is probably that the vessel will also in these circumstances be regarded as waste thereby triggering the applicability of the WSR.

The Hong Kong Convention and its relevance

The Hong Kong Convention for the Safe and Environmentally Sound Recycling of Ships was adopted on 15 May 2009, but is yet to enter into force. The Convention will only enter into force 24 months after:

- The Convention has been ratified by no less than 15 States,
- The combined merchant fleet of those States constitute not less than 40 % of the gross tonnage of the world’s merchant shipping, and
- The combined maximum annual ship recycling volume of those States during the preceding 10 years constitutes not less than 3 % of the gross tonnage of the combined merchant shipping of the same States.

In March 2018, only Norway, Congo, France,

Belgium, Panama and Denmark have acceded to the Convention.⁷

A common misunderstanding seems to be that if a yard is reported as in compliance with the Hong Kong Convention, then recycling at the said yard may not represent a breach of the WSR. This is incorrect. The prohibition of exporting waste from the EU Community applies regardless of where the waste is headed, and it will bring the Owner in compliance to show that the vessel will be scrapped at a “Hong Kong Convention compliant” yard.

This will also be the position once the SRR enters fully into force. There is no automatic acceptance of any “Hong Kong Convention compliant yard” into the European List.

Although compliance with the provisions found in the Hong Kong Convention is positive, this is not sufficient in order to comply with neither the WSR nor the SRR.

Summary and conclusion

The law concerning ship recycling and demolition is complex and must take into account its international character. As both the SRR and WSR set minimum standards, one may also experience that stricter requirements may be imposed in certain jurisdictions. The risks associated with non-compliance may be severe- as recently demonstrated in the Netherlands, so shipowners must exercise great caution when taking decisions regarding the recycling of their vessels. It must be recognized that information about ships being sent to beaches in South East Asia is readily available in today’s transparent world. Thus, the best course of action is to seek timely legal advice. In this regard, we stand ready to assist.

Footnotes:

1 - <http://www.shipbreakingplatform.org/press-release-platform-publishes-list-of-ships-dismantled-worldwide-in-20162017/>

2 - In this article, we study the SRR and WSR respectively. If the vessel is neither flying the flag of an EU Member State, nor present in the waters of an EU Member State when the decision is made for the vessel to be scrapped (and will not transit through such waters), then the SRR and WSR are both inapplicable. In such circumstances, due attention must

be given to the Basel Convention to see whether the exporting country is a party.

3 - <http://www.tradewindsnews.com/le-gal/1431631/seatrade-execs-face-jail-over-demo-deal>

4 - As of the date of this Circular, all pre-approved yards are located within the EU Community.

5 - EMSA Guidance on IHM p. 22

6- See Article 5 (2) referring to Article 32 (2) in the SRR

7 - <http://www.classnk.or.jp/hp/en/activities/statutory/shiprecycle/index.html>

