

IS A SHIPBUILDING CONTRACT CONSIDERED A SALE OF SHIP CONTRACT? THE MALAYSIAN LAW PERSPECTIVE

Introduction

The Malaysian shipping industry has been in decline with the steady reduction in Malaysian shipping tonnage and increasing number of shipping businesses in distress. This may be attributable, among others, to the weak global shipping market and the insufficiency of fiscal and legislative measures to address domestic shipping concerns. To address this issue, the Ministry of Transport of Malaysia with the support of various shipping organizations such as the Marine Department Malaysia, Malaysia Shipowners' Association and Ikhtisas Kelautan Malaysia had established the Malaysia Shipping Master Plan ("**MSMP**") aimed to run from 2017 to 2022,[1] which has currently been extended to 2025.[2]

The vessel sale market plays a significant role in reaching the objectives set out in the MSMP. Generally, acquisition of a vessel may be done by way of purchasing a second-hand vessel via a sale and purchase agreement, or employing a builder to construct a new ship from scratch vide a shipbuilding agreement (new build), which will be tailor-made according to the purchaser's needs and specifications. Although these may be two different types of contracts, they may be regarded as the same category of contracts under Malaysian law. We will proceed to discuss this issue in this article.

Shipbuilding Contract

A shipbuilding contract, which is typically an agreement between the builder and the shipowner (purchaser), usually outlines the terms encompassing the design, building, commissioning and sale stage.

This type of contract is generally an industry norm as the shipping industry is a niche one, and purchasers would usually need customized ship specifications/features according to the different functions (e.g. cargo ships, oil tankers, or operational support vessels). The terms of such contracts would be more complex and akin to a full-blown construction agreement typically used for construction of buildings.

For instance, the payment terms would stipulate submission of progress reports and claims, verifications of progress reports and claims, and payment of the said progress claims according to the construction milestones. The purchaser would need to provide the relevant data / specifications / drawings for the construction process, and may also designate its officer to be a supervisor of the construction works. In addition, the builder would have to provide warranties as to equipment and workmanship and take out insurance policies such as builder's risk insurance to cover the construction period, amongst others.

Although there is no standard form of shipbuilding contract in Malaysia (as opposed to say, the Public Works Department (PWD) or Pertubuhan Arkitek Malaysia (PAM) contracts for building construction), several universal / regional standards forms may be used and modified accordingly, such as the Shipbuilders' Association of Japan 1974 Standard Contract (SAJ Form), the Standard Newbuilding Contract (NEWBUILDCON) introduced by the Baltic and International Maritime Council (BIMCO) and the Norwegian Standard Form of Shipbuilding Contract (Norwegian Form).

Sale of Second-Hand Ship Contract

This type of contract, where the subject matter is a ship that has been registered and used before, would be a more straightforward contract resembling sale and purchase contracts of other movable assets. The benefit of this type of transaction would be the time and cost effectiveness.

The usual terms would touch on matters such as conditions precedent, representations and warranties by both parties, delivery, pre-delivery inspection, payment (which is usually pre-divided into deposit and balance purchase price or a few tranches), and liquidated damages for late delivery.

The technical specifications would also be fixed as opposed to tailor-made to the purchaser's needs. There are several stages for the sale and purchase of a vessel, i.e. the negotiation and contract stage; the inspections stage; and completion. The completion stage usually includes the delivery of documents and the ship upon payment of the balance of the contract price.

The sale and purchase contract must also be accompanied by a Bill of Sale containing the description of the ship as in the certificate of registry or any description sufficient to identify the ship to the satisfaction of the registrar, which must be executed by the seller and purchaser, and duly attested by two witnesses.[3]

Legal Position

From a legal standpoint, contracts for the sale of second-hand ships are easily categorized into a contract of sale of goods, which would then be governed under the Sale of Goods Act 1957 ("**SOGA**"). On the other hand, the grey area would be shipbuilding contracts, the terms of which are similar to a building contract.

Despite such differences in the nature of the two types of contracts, in England, shipbuilding contracts have historically been regarded as a sale of goods contract under the English Sale of Goods Act 1979 and Sale and Supply of Goods Act 1994.

This is because "goods" under English law mean personal chattel and other properties which can be detached from land. In the case of shipbuilding, it is categorised as an agreement to sell future goods by description, as at the time of execution of the contract, the ship is not in existence yet.[4]

This position was illustrated in several landmark English cases (which have been referred by the Malaysian courts) such as **Re Blyth Shipbuilding and Dry Dock Company Limited [1926] 1 Ch 494**, **Hyundai Heavy Industries Co v Papadopoulos and Others [1980] 2 All ER 29 (HL)**, and **Stocznia Gdanska SA v Latvian Shipping Co, Latreefer Inc and Others [1998] UKHL 9**. However, the English courts have taken judicial notice that the contents of the shipbuilding contract are more akin to regular building contracts, such as in **McDougall v Aeromarine of Emsworth Ltd (1958)**.

This common law categorization has only recently been recognized by the Malaysian courts. In the case of **NGV Tech Sdn Bhd & Anor v Kerajaan Malaysia [2016] 8 CLJ 280** ("**NGV Tech**"), the High Court held that the impugned contract, an agreement for the purchase of vessels to be constructed by the Plaintiff, was subject to the SOGA (and is therefore not a construction contract), as a ship fell within the meaning of goods i.e. "every kind of movable property." This definition was approved by the Court of Appeal, even though the High Court's decision in this case was overturned on appeal.

This classification was also adopted in a subsequent case, **Mir Valve Sdn Bhd v TH Heavy Engineering Berhad [2017] 8 CLJ 208** ("**Mir Valve**"), where the court held that a ship building contract is essentially a "supply of goods" contract and agreed with the position of the NGV Tech case.

This categorization means that the regulations set out in the SOGA would govern shipbuilding contracts (even the contract does not expressly state the application of the SOGA), such as conditions relating to the duties of the sellers and buyers, delivery, fitness / qualities of the goods, and transfer of title. However, as at the date of this article, only the above two reported cases touch on this issue and there is no statutory provision or apex court case yet which clarifies or approves this position. As such, the above-mentioned legal position may be subject to change if new cases are argued before the courts.

Conclusion

To summarise the discussion above, a contract for the sale of a second hand ship is legally categorized as a sale of goods contract and are governed under the SOGA, whilst the legal position of shipbuilding contracts is still somewhat unclear in Malaysia.

However, the cases of **NGV Tech Sdn Bhd, Mir Valve Sdn Bhd** and the English cases referred can be taken as guidance to conclude that shipbuilding contracts are also considered as sale of goods contracts and similarly, provisions of the SOGA would be applicable in such contracts should any dispute arise.

As such, parties to shipbuilding contracts should be mindful of the provisions of the SOGA which govern their respective dealings under such contracts.

-
1. "Malaysia Shipping Master Plan 2017-2022: Revitalizing Shipping for a Stronger Economy" Ministry of Transport (Available on: https://opuskinetic.org/wpcontent/uploads/2019/01/malaysiashippingmasterplan_booklet-v6-min.pdf)
 2. 2 "Malaysian Shipping Struggling to Catch Up, While Ports 'Anchors Aweigh' From Troubled Waters" Bernama, 4 December 2022.
 3. Section 34 Merchant Shipping Ordinance 1952.
 4. Curtis, S. (1996). The Law of Shipbuilding Contracts (2nd ed.). Hartnolds Ltd.

Written by:



Fairuz Hanim Abdul Latiff
Associate
fairuz.hanime@azmilaw.com



Irdina Abdul Jamal
Trainee Solicitor
irdina@azmilaw.com

Corporate Communications
Azmi & Associates
13 December 2023