

THE NEW PARADIGM OF MARITIME CONTRACT

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ABSTRACT

This paper at the beginning summarizes the present and future ships design and performance and describes current shipbuilding contracts. Next it elaborates the risk distribution, control, financing and the legal matters as well as the importance of the intended world class standard. At the end, the paper proposes a new type of contract. In the conclusions the plausible benefits of a new type of contract are listed. Contract should not only be codified as a list of responsibilities and prerogatives of partners, if such, in a shipbuilding process, it should also be a reflection of commercial environment and practices and also technical and technological developments at foreseeable future. In any case has to reflect period of time not less than, projected and expected life expectancy of the vessel. Risks involved in vessels design could be shared but also the responsibility of either of the participants during the whole process. Design should be commercially viable, and at a same time be safe and reliable to operate and must conform to the rules and regulations not only currently at force but should also be able to incorporate expected changes within the projected life span of the vessel. Commercial risks are not fully controllable since closely connected with the exceedingly volatile environment but could be listed and taxed. Production and quality control risks could and should be practically eliminated by using real time shared distance control and management. Commercially viable design combined with production quality control and responsible and sustainable financing should be reflected in a new type of international standard maritime contract – ISMC.

KEY WORDS

maritime contract, commercial environment, risks, control and management

1. INTRODUCTION

Necessity creates rational solutions, one of these solutions is the standard ship type suitable for modular construction which was introduced by the shipbuilding group Kaiser and brought to its pinnacle during WWII. Then for the first time the focus of shipbuilding strongly turned to the Pacific Coast where about 5,800 types of ships Liberty and Victory were built. The ship's assembly time was minimized to the hitherto hardly imaginable 26 days. It should be noted that the Croatian engineer Đuro Stipetić (Belamarić, 2013) who later worked

as a professor at the University of Zagreb already in 1916 promoted the modular construction building submarines. Croatian shipyard in Kraljevica – established 1729, mid-seventies 20th century built ferries on the same principle for only 47 days, from the keel laying to delivery. After the WWII there were relatively successful- unsuccessful attempts for replacing Liberty type. Best known such attempt was Austin & Pickersgill, mid-sixties of the 20th century the shelter deck project SD 14 (Žuvić, 2013), but according to many experts the best proposal for this ship type replacement was

the ship type Zagreb, designed by the Croatian engineer Igor Belamarić (Belamarić, 2017).

The project is defined as entrepreneurship while the design is defined as a drawing and/or description for shipbuilding, testing and delivery to the buyer, shipowner, shipping company or operator of the ship, which may not necessarily be the same legal entity.

The total modular principle in addition to the shipbuilding should be implemented and expanded to the whole process i.e. to the design and operation of the ship. One should discern contracts of purchase, construction, buying and leasing. When you change business environment you should also change the legal practice. Late fifties and/or early sixties of the 20th century the focus of commercial shipbuilding and shipbuilding activities, began to relocate from Europe to Asian Pacific coast. Once common practice changed from builder- buyer relationship where buyer had a final word not only in the pre-contract period but also throughout whole shipbuilding process it was exercised by authorized buyer's representatives in the shipyard who interfered the shipbuilding process and therefore the costs. For example, well-known incident in a Japanese shipyard where shipowner representatives were thrown overboard as a sign of a protest. In that particular shipyard the supervision of shipowner and/or his representatives abruptly ended. The rationale of this event raises the following question: When buying a car do you have a representative in the factory? You don't! So, it's the same when buying the ship.

But, how to deal with a new, innovative owner's design or with a design done by specialized design office being hired by the owner and/or operator of the ship. In this case you could have two situations, shipyard or its design reception which we often called the Project office and/or Technical department, must assess whether the design is compatible with the technical capabilities of the shipyard and whether such design can be carried out in a commercially acceptable manner. In a case the shipyard can fully accept the design and treat it as its own with all responsibilities for the technical specifications and the final ship performances.

Such a strong absorption capable shipyards will adapt the design and even improve it. However, in the case that the shipyard is just the assembly place for someone else's technical and technological solutions, then the shipbuilding supervision is not only desirable but is also necessary. The explosion, and then the partial implosion of shipbuilding capacities in China and Vietnam made it clear that the shipbuilding industry is not only primarily the shipyard as a platform for ship assembling, but is also dominantly thinking process.

2. PRESENT AND FUTURE SHIPS - PERFORMANCE MEASURES

Today ships for general commercial purposes i.e. general cargo ship evolved into a ship for transportation of quantum, modules or containers. We have several indicators that can be used for measuring the ship performance. In our opinion we think that the two parameters could and should be introduced as a key ones and indeed indispensable ones. The first one is of course economic parameter, whether the ship of particular type, size and speed will find a satisfactory long-term employment with the charter rates sufficient to pay off all costs, financial, building, depreciation and operating costs (Adum et al, 2010). The second parameter should be environmental sustainability, such as, for example greenhouse emissions and, and ballast water treatment and management. When the mandatory penalization will be introduced through increased port dues it will strengthen the environmental awareness.

Today it is not the time for mass production of ships series and many shipyards in the Far East will find themselves in financial difficulties due to overly aggressive policy of growth with no long-term sustainable investments, and lack of quality design. We must think innovatively and in non-standard manner, so just polishing the surface quality is not sufficient, although necessary.

3. EXISTING CONTRACTS AND SHIPBUILDING

The starting point of the contract is an agreement where the subject of the contract should always be

clearly and unambiguously defined. At first, existed verbal agreement, for e.g. build a ship like the XX or with the addition of increased poop, hold, hatch or cubic, for YY money that will be paid in the ZZ manner. Shipbuilders in the past were experienced and proven, the drawings existed but generally were not attached to the contract and were not an integral and inseparable part of it.

Shipbuilding industry, as a labour-intensive industry moved to the areas and countries with the lower labour costs. That created a phenomenon that ships are increasingly being built in the new shipyards without enough experience, knowledge and/or proven practices and quality control. Results were the ships that received infamous nickname "sisters in distress", unloved and unwilling ships that continuously broke down. Although, they were relatively young but in essence they were worn-out and useless. Such economic and business policy exacerbates management conditions and in essence permanently generates insecurity. Volatility is the substrate on which speculation prospers but which ultimately limits the meaningful and sustainable entrepreneurship. It is interesting that a sustainable as a term is often used as a slogan but it is rarely applied in practice.

We are buying ships at the discount price and quality, ships sub-standardly manned, frugally maintained and badly managed. Banks are increasingly insecure and aggressive in seeking quick and disproportional profits. Entire system inevitably generates excess aggressiveness and business acumen that leaves much to be desired. Maritime market is volatile and under the constant pressure to generate high yields, quick in and quick out. It is not inherently wrong to shorten capital recovery period in order to avoid market doldrums but it could generate unacceptable risks.

4. RISK DISTRIBUTION, CONTROL, FINANCING AND LAW

Plan should be a major, if not the most important part of the contract, instrument with which we control business process. Anticipated risks as the early warning system, alerts us that something could go wrong, giving us the time to react and

control the damage. Delayed or untimely reaction only minimizes the damage but it is not essentially risk management (Adum et al, 2013). We have all the means of shipbuilding standard contracts (Goldrein et al, 2012). Every country, supportive of shipbuilding industry, tries to impose their type of standard contract. Without going into the details which is better or more appropriate we believe that we should develop and adopt the new world standard, defining not only the contract subject i.e. ship, but also the practice of shipbuilding (Adum et al, 2014).

4.1. Supervision

Supervision refers to the shipbuilding and the ship service as well. By applying new and now widely available IT technology we could record and monitor all the shipbuilding process and ship operation in real time. Shipyard could have daily, constant, impartial and neutral control of a ship in service eliminating the need to have a guarantee engineer on board. By engaging advanced techniques we can reduce costs and improve quality. There is no valid reason not to extend the warranty period to minimum three or even five years with a classic condition "normal wear and tear excluded."

4.2. New way of financing

We should buy the ships on Bare Boat Hire Purchase (BBHP). How are risks shared? Shipyard and its bank in a year or two build a vessel and record a gain or loss, definitive and irreversible gain/loss. Shipowner and its bank and/or investment fund can throughout the period (20-25-40 years) of a vessel life span can generate profit and recover eventual losses. Shipowner's position may be reversible, shipyards position is definite and static. Due to volatility of the market shipowner's banks are seeking higher profits in order to compensate the risks involved.

Let us re-arrange the position of participants in such a way that instead of being parties to the contract they become partners to the contract. Banks that finance the shipyard and the shipowner should share the risks and profit during the whole period of shipbuilding and service. This would eliminate the finality and certainty of business on the verge of profitability and create a long-term partnership with the shipowner and the shipyard.

"Sisters in distress" would become "sisters of reputation", environmentally conscious and economically viable.

4.3. Law

English law prevailed in maritime matters, not only because the British Empire effectively ruled the waves but perhaps primarily because English law is most similar to the Roman law which is largely based on common sense. Does it need to be changed and do we have a suitable alternative? Assuming that Brexit means the abandoning of City is a compromise possible, to keep the English law and move courts somewhere else, e.g. Strasbourg or Frankfurt? Perhaps the most important difference in legal systems is the one dealing with mortgage but the difference between continental legal systems and English law which is immanently maritime, could be bridged by introducing shortcuts such as, but not exclusively, pledge of shares. One other possibility is pre-arranged and negotiated transfer of ownership for an agreed nominal sum, good and valuable consideration. The banks could be opponents instead participants. Coordination agreement should regulate and arrange relations between all participating banks.

5. WORLD CLASS STANDARD, CONSIDERATION/ HARMONIZED GLOBAL STANDARD

We have IACS standard rules (IACS-Bulk and Tanker, 2012) but this is sort of an illusion since there actually exist division on the global societies such as Lloyd's Register of Shipping, Bureau Veritas, DNV/GL and the others. Despite the global power of their states, neither American Bureau of Shipping nor Russian Maritime Register of Shipping are globally accepted as benchmarks. Adoption of Common Structural Rules is for sure something that must be commended but it should be noted that there is a hidden and widespread practice of tolerance that includes reduced stringency in the strict application of the rules. Hidden discounts in the form of less stringent obedience of the very spirit of the rules. National authorities, such e.g. Board of trade and similar will be undoubtedly the most powerful obstacle for harmonization of quality and international practice. Governments will

undoubtedly retain their right to apply their own rules which is considered "per se" as the very essence of sovereignty. However, there are no real conceptual obstacles for fulfilling common interest, harmonizing maritime safety legislation where possibly IMO should have a key role.

6. CUT THROUGH AND BRIDGING CLAUSES - SHORTCUTS AND LINKS

Changes in the market are the essence of the market and so is the speculation. The contract should foresee these situations and accurately, explicitly specify when they occur and how they manifest. We believe that arbitrations should be avoided, no matter how they were common and proven in practice. Surprises are always possible and so is the tendency that the money prevails. Strong and powerful always find a way to enforce their interest. If damage occurs a lot of time and money is needed to compensate it. Coordination agreement should govern the relationship of all the banks involved in the process. Register of ships under the construction as well as the mortgage on the ship under the construction should be in the same manner automatically conducted to enable effective transfer of new ownership. The new entity i.e. company that can continue with the contract by changing financing structure or by selling the company to anyone who is willing to finish vessel under the existing contract or to renege it. If the more ships are contracted simultaneously all in a single ship company system it is relatively easy to control it by mutual guarantees i.e. cross collateral security.

7. NEW TYPE CONTRACT

Beside usually and traditional parts of the contract such as Subject, Price and When, important part is How. This will create quality and safety. Beside the detailed ship description, specification and drawings it is necessary to add the detailed description of the procedures that will be applied in the shipbuilding process (for e.g., but not limited to steel processing, corrosion protection, etc.). Also, detailed and definite maker's list, as well as a detailed building plan that can and must be monitored via computer should be included. In

fact, there is no reason why client i.e. customer should not supervise the shipbuilding process by cameras mounted in a shipyard instead of employing large number of authorized representatives. Such camera recordings would be then effectively used instead of hardcopy records and everything can be conducted and supervised in the real time. In such a way the efficient and continuous quality control will be achieved.

The shipbuilding process recordings would be handed over at delivery as integral part of delivery documentation. This could be a significant cost saving on the of shipbuilding supervision and perhaps entirely eliminate it. In this way all shipyards will be somehow placed on an equal position, where for the well-developed and experienced shipyards it will not be any problem and for less developed this could be the a step forward to make an effort in unifying its practice with good ones. The shipyards would have continuous own supervision, client would have less supervision costs. Banks would have lesser risks and consequently could lower the interest rate. This is a classic "win, win" solution.

Shipbuilding plan mentioned in section 4 should answer the contract's fifth key parameter "when". The contract should in fact primarily, but not exclusively, answer the sequence of questions: 1. Who 2. What 3. Price, 4. How and 5. When. The plan is of course schedule but not exclusively, it is, or it should be, a logical and interdependent list of activities, which ultimately result in fulfilment of the contract. So-called Planned economy determined plan as the management for action. Today we can laugh at it, but today, when we have computers and IT techniques to use the Gantt charts as valid planning documents is ludicrous. We have algorithms such as Program evaluation and review technique (PERT) (Lawrence, 1966) that can be corrected on a daily basis and should be an integral part of any serious contract. Both contracted parties can, in the basic document stored on a "cloud service", make changes based on conducted activities and compare it. In such a way a coordinated and daily revised document will eliminate many sources of potential disputes. It is significant to point out that the PERT planning could be used not only for shipbuilding supervision,

but it would be desirable and logical to monitor all financial activities and financial transactions. In the same time this enables control of builder's cost and control of customer payments.

8. CONCLUSIONS

Risk cannot be eliminated but can be limited or shared in the same way as it is done with insurance, provided that the partners agree in advance how they will share the risks and profits. This is modular principle not only in building but also in financing and ship operation. Classical vertical organization doesn't give the best results. Why? It has inherent flaw not to select competitive and commercially viable components.

Mere surplus of energy, state money and support for shipbuilding is not good enough to make shipbuilding commercially viable. Such efforts didn't bear results not even in the most developed countries (Germany, Sweden, Japan). There is absolutely no reason to be successful anywhere else. Why? Not because they did not try hard enough or because they lacked the will but because it is a wrong principle. When something is wrong and does not work well, it must be disassembled into parts, defective parts should be replaced with new ones.

We take the best design, take the best developed existing shipyards with modern technology and then build the ships and supervise the quality in real time using all the benefits of IT technology, merge the client's and builder's banks by coordination agreement and incorporate all this in the International Maritime Shipbuilding Contract (IMSC).

In the system with much greater solidity and safety where the buyer is an established and registered in countries that have normal and transparent public fiscal system, meaning the non-tax haven countries, the additional insurance should be introduced. The company is liable with its all assets up to the total contract sum and agreed compensations, if any. We believe that such a system will substantially discourage speculative ordering, buying slot options in a rising market. If one is betting on the growth or decline of the

market he can bet on its own account and may take the risks, who has the profit has the risk. Merchant ships should not be built at all if one cannot earn on them.

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