The Importance of time limits in Shipbuilding Contracts – Seller’s action time-barred due to failure to institute arbitration proceedings timeously

Background

A Shipbuilding Contract typically provides for arbitration instead of litigation as its dispute resolution mechanism. Further, in the event the Buyer cancels or terminates the Shipbuilding Contract, there is usually also a contractual timeframe within which the Seller is required to institute arbitration proceedings in order to dispute the Buyer’s cancellation and/or termination of the said Contract.

In Nanjing Tianshun Shipbuilding Co. Ltd, Jiangsu Skyrun International Group Co. Ltd v Orchard Tankers Pte Ltd [2011] EWHC 164 (Comm), Justice David Steel was asked to consider whether failure by the Seller to institute arbitration proceedings to dispute the Buyer’s cancellation and/or termination of the Shipbuilding Contract within the time period stipulated in the Contract barred the Seller from subsequently commencing litigation in this regard.

Facts

The Shipbuilding Contract was in a fairly conventional form, stating inter alia, that the Contract Price was payable by way of instalments. These payments were in the nature of advances to the Seller and in the event of cancellation of the Contract, the instalments were refundable with interest. The Seller was to procure a Refund Guarantee in favour of the Buyer to secure the advance payments. In the event of delay in delivery beyond the permitted contractual timeframe, the Buyer was entitled to terminate the Contract in accordance with Article X.

Article X provided that if the Buyer terminates or cancels the Shipbuilding Contract, the Buyer shall be entitled to make a demand under the Refund Guarantee for a refund of the instalments paid to the Seller. The Seller shall have the right to dispute the Buyer’s termination or rescission of the Shipbuilding Contract by instituting arbitration within thirty (30) days of the Buyer’s cancellation and/or rescission. If the Seller commenced arbitration proceedings as aforesaid, the Seller would not have to refund the Buyer until an arbitration award (or if applicable, a final court order if the arbitral award went to appeal) in favour of the Buyer is issued. Upon refund of the relevant amounts, all obligations, duties and liabilities of each of the parties inter se under the Shipbuilding Contract shall be completely discharged.

What was unusual in this case was Article XIII of the Shipbuilding Contract. Article XIII.1 and XIII.2 provided for disputes relating to the construction of the Vessel to be submitted for determination by either the head office of the Classification Society or London arbitration. However, Article XIII.3 further stated that any dispute not falling within the ambit of Articles XIII.1 and XIII.2 shall be submitted to the English Courts for determination.

The Buyer paid the first four instalments under the Shipbuilding Contract and a Refund Guarantee was issued by a Chinese Bank in the form prescribed by the Contract. The Refund Guarantee followed the above contractual mechanism for the institution of arbitration and withholding and deferment of the refund to the Buyer. The wording of the Refund Guarantee also stipulated that in the event of arbitration proceedings being commenced by either party before the expiration of the Refund Guarantee, the validity of the Refund Guarantee would be automatically extended until 90 days after the date of issue of a final arbitration award or in case of appeal, 90 days after the issuance of a final court order in the Buyer’s favour.
On 2 February 2010, the Buyer notified the Seller that they were exercising their right to terminate or cancel the Shipbuilding Contract pursuant to Article X by reason of delay in delivery.

Although the Seller disputed the Buyer’s entitlement to terminate or cancel the Shipbuilding contract, the Seller failed to institute arbitration proceedings until shortly after the prescribed 30-day period in Article X. The Buyer therefore contended that the Seller’s claim was time-barred.

The Seller however, contended that its failure to institute arbitration proceedings timeously did not bar its right to dispute the Buyer’s cancellation of the Shipbuilding Contract, but merely barred the remedy to be obtained by way of an arbitral award. In other words, even if the Seller is time-barred from instituting arbitration, their claim per se is not time-barred and they remain entitled to litigate their claim before the English Courts.

Decision

The Court held in favour of the Buyer and found as follows:

1. A party’s failure to comply with the contractual time-limit for the commencement of arbitration is ‘claim-barring’ rather than merely ‘remedy-barring’.

2. The Buyer’s entitlement to a refund can only be deferred if an arbitration was commenced within 30 days, the said arbitration being “in accordance with Article XIII” – it is only in that arbitration that the Seller can dispute the Buyer’s cancellation of the Shipbuilding Contract.

3. By virtue of Article X, a refund of the instalments discharges all the obligations of the parties. It would be inconsistent and a bizarre outcome if the liabilities of the Buyer were retained after the Buyer received a refund.

4. It is difficult to discern any commercial purpose in granting the Seller an option either to be able to institute a private arbitration within 30 days or, whether by choice or indolence, to be able to institute public litigation after 30 days but within 6 years.

5. The absence of express words in the Contract barring a party’s right of suit did not affect the stipulated time-bar when the Seller failed to institute arbitration in accordance with the terms of the Shipbuilding Contract.

6. Articles X and XIII should not be read separately. Article X (and the wording of the Refund Guarantee) clearly referred back to arbitration, which was in turn governed by Article XIII. Article X did not contain a specific right to arbitration separate from Article XIII in respect of issues falling outside Articles XIII.1 and XIII.2. The availability of two separate facilities for arbitration would create undue complication in determining which scheme had to be invoked with wildly disparate time limits, and accordingly is a construction that must be resisted.

7. The failure to invoke arbitration under Article X did not leave intact the jurisdiction agreement under Article XIII.3. Article XIII.3 is merely a catch-all clause for any disputes outside the arbitration regime set out in Articles X and XIII.

Significance

Where various key provisions in the Shipbuilding Contract and accompanying Refund Guarantee make references to arbitration as the default dispute resolution mechanism and set out the procedure to be followed in the event of a dispute, this judgment illustrates the impact of a party’s failure to commence arbitration within the stipulated time limit – failure to do so, whether by choice or negligence, would result in that party’s claim being time-barred.

The Court’s strong stance on the above issues highlights the crucial importance for the parties to scrutinise the terms of the Shipbuilding Contract and accompanying Refund Guarantee carefully and the need to abide by the contractual time-limits stipulated therein to ensure that arbitration is validly commenced.