

LEGAL ISSUES IN SHIP ACQUISITION AND SHIP BUILDING

1. INTRODUCTION

The topic assigned to me appears to cover the shipbuilding industry as an enterprise as well as the acquisition of ship through the purchase of new or old buildings. For the purposes of this presentation, the scope would be limited to the legal processes of acquiring ownership of a ship with a focus on the sale and purchase of new and old buildings. The word ship even though it appears straightforward often has different meanings to different people. We would in this Paper adopt the meaning given to a ship by the **Merchant Shipping Act Cap 224, LFN, 1990** and the **Coastal and Inland Shipping (Cabotage) Act, 2003 (“Cabotage Act”)**.

The MSA in Section 2 defines a ship as “any vessel other than a vessel propelled solely by oars or paddles”. This definition was adopted from the United Kingdom (U.K.) Merchant Shipping Act of 1894. The meaning of the word “ship” has changed incrementally over the years. The amended U.K. MSA 1921 extended the meaning of ship to include any barges, lighters or alike vessels used in navigation unless exclusively used in non-tidal waters except harbours. A further amendment of the Act in 1993 eliminated the distinction between ship and vessel and the words “not propelled by oars” were removed. U.K MSA 1995 consolidated all previous amendments, repealed the definition of a ship in the 1894 and 1921 Acts. S.313 of MSA 1995 simply defines a ship to cover every description of vessel used in navigation.

The definition of a vessel in the Cabotage Act seems to reflect the current position in other jurisdictions. Section 2 of the Cabotage Act states that a vessel “includes any description of vessel, ship, boat, hovercraft or craft, including air cushion vehicles and dynamically supported craft, designed, used or capable of being used solely or partly for marine navigation and used for the carriage on, through or under water of persons or property without regard to method or lack of propulsion”.

MSA provides that persons qualified to own Nigerian registered ships are Commonwealth citizens or bodies corporate established under the Laws of a Commonwealth country.

2. OVERVIEW OF NIGERIAN TONNAGE AND THE SHIPBUILDING INDUSTRY

This section presents an overview of Nigerian tonnage and shipbuilding industry. It further highlights commercial issues that would assist an entrepreneur to decide whether or not to invest in the shipping industry.

Everyone associated with the shipping administration in Nigeria is familiar with the lack of reliable up-to-date data from the Nigerian Ship Registry. A study carried out by the International Maritime Organization (“**IMO**”) on Nigeria’s maritime industry in April 1999 reported that only 97 vessels excluding fishing vessels were registered under the Nigerian flag. Of the 97 vessels 66 were tankers, 20 were cargo vessels and 1 passenger vessel. An unconfirmed data from the office of the Registrar of Ships in 2002 indicated that the Registry has 98 tankers and 26 cargo vessels. This means that between 1997 and 2002 Nigeria recorded an increase of only 32 tankers and 6 cargo vessels. The office of the Registrar of ships is currently undertaking an inventory of registered vessels which are still operational and flying the Nigerian flag.

Section 3 of the Cabotage Act reserves the carriage of goods within Nigerian coastal waters to vessels owned by Nigerian citizens and built in Nigeria except where such vessels are not available in the market. It is thus hoped that by reserving the coastal trade to Nigerians, there would be an increase in ship acquisition by Nigerians and indeed a boost for the ship building and repair.

For an entrepreneur this is a dream come true. A market for vessels is already in existence especially for the types of vessels used in the offshore exploration and

exploitation industry (supply boats, crew vessels, barges, tug boats, tankers etc) The market for Nigerian built vessel is not only created but is protected under the Act. Conscious of the capacity of the industry in this respect, Nigerian built vessel is defined to include vessels rebuilt i.e. refurbished in Nigeria or where “the construction of any major component of the hull or superstructure are fabricates or assembled in Nigeria.” Most importantly there is no ownership requirement for the ship building and ship repair companies. This means that Nigerians could partner with foreigners who are willing to inject foreign capital to take advantage of the captive market and develop Nigeria’s shipbuilding industry.

Nigerian ship building industry is at an infancy stage. To be quite candid, we do not have a shipbuilding industry. Reference to shipbuilding by some people erroneously includes ship repair yards. Ship building yard as the name connotes is for the construction of a new building while a ship repair yard is for dry docking or afloat repairs (repair and maintenance). If we were to limit ourselves to purely shipbuilding industry then my job would be finished in the next one minute.

What we do have in sizeable number are ship repair yards. Available data indicates that Nigeria has about 19 ship repair yards. Ship repair yards basically provide services such as drydocking for repairs, inspections, refurbishment, maintenance and alterations. They sometimes build small vessels such as barges and tug boat. Ship repair yards also carry out afloat repairs for example hull and machinery repairs, welding, blasting and painting services. A study of Table 1 reveals that about 85% of them are not operational.

Table 1- Ship Repair Yards in Nigeria

S/N	Name	Facility	Location	Remarks
1	Nigerdock	30,000T, Dry-dock plus 3,000 tons Floating Dock	Lagos	Not Functional
2	Damen	180T, Syncrolift Non functional	Lagos	Partially functional
3.	Continental Shipyards	6,000T, Floating Dock	Lagos	Functional
4.	Naval Dockyard	Grave Dock	Lagos	Functional
5.	Nigeria ship Builders	150T, Slipway	Port-Harcourt	Temporarily
6.	Naval Shipyards	150T, Slipway	Port-Harcourt	Partially functional
7.	W.A. Drydocks Ltd	2500T, Floating Dock	Onne	Functional
8.	Nigerian Ports Plc	100T, Slipway	Port-Harcourt	Not functional
9.	Technitrade	250T, Floating Dock	Warri	Functional
10.	Nigerian Ports Authority	Slipway	Warri	Not functional
11.	Nigerian Ports Authority	Slipway	Burutu	Not functional
12.	Nigerian Ports Authority	Graving Dock	Calabar	Not functional
13.	Starzs Shipyards	Floating Dock 500T	Onne	Functional
14.	Ed-Zachariah	-	Port-Harcourt	No information
15.	Oscar Marine Limited	700T	Warri	“
16.	Steelways Limited	1,200T	Warri	“
17.	Niger Benue Transport Co	400T	Warri	“
18.	Python Engineering,	1,000T	Lagos	“
19.	Ijora Fisheries,	100T	Lagos	“
20.	Taraba	100T	Port Harcourt	“
21.	Atlantic Star Shrimpers	100T	Lagos	“
22.	Underwater Engr.	1,000T	Lagos	“

Greg Ogbeifun “Cabotage - How Prepared are our Shipyards”

3. SHIP ACQUISITION - SHIP SALE AND PURCHASE

We proceed from the premise that an entrepreneur having surveyed the market and is convinced that it is wise to invest in shipping would require some knowledge of the issues involved. In the same vein and maybe even more important, lawyers need to be conversant with the legal issues involved and the processes for acquiring a vessel from commencement of negotiation to closure because ideally lawyers, indeed maritime lawyers should drive the entire process for the prospective shipowner.

3.1 Options Available for Ship Acquisition

One could acquire a ship in one or a combination of the methods described in this section. The principal method of owning a ship is the purchase of a new or existing ship. Another method is through a sale of ship done pursuant to an Order of Court. As stated earlier we would dwell on ship sale and purchase.

Unlike the manufacture and sale of cars where particular models are manufactured in several numbers and put on display by the manufacturers or car dealers, for a prospective buyer to inspect and buy, the processes for the purchase of vessels are totally different. The options are to either buy a new vessel or a second hand vessel. Purchase of a new vessel has issues of legal significance that are different from the case of an old vessel and both are discussed in detail below

4 PURCHASE OF A NEW VESSEL

The practice is for the Buyer to place an order with the shipyard for the construction of a specific type and size of vessel. Contracts for shipbuilding is usually expressed on Standard Forms which incorporate internationally accepted terms such as the Shipbuilding Contract of Shipowners Association of Japan (“SAJ”). In the case of existing vessels, parties express their agreement in Memorandum of Agreement

(“MOA”) which incorporates standard terms like the Norwegian Sale Form. As expected the terms contained in Standard Forms are usually weighed in favour of the shipyard. A Buyer may negotiate the terms and his chances of success are subject to the amount of work the shipyard has. I understand it is currently a low season for shipbuilding so it might be a good time for anyone interested to place order for a new building now.

4.1 Shipbuilding Contract

Like every contract, a shipbuilding contract defines rights and obligations of parties and also allocates risks to be borne by the parties. The Japanese Shipowners Form is annexed to this paper as Annex 1 but a few salient issues in a typical shipbuilding contract is itemized hereunder.

- 1) **Obligation of Builder** – The Builder is expected to
 - build the vessel to specification for a fixed price and to
 - deliver the vessel on time

- 2) **Obligation of Buyer** – The Buyer is expected to
 - pay the price which is usually a fixed price and to
 - accept delivery if the vessel is built to specification and delivered on the agreed time

- 3) **Allocation of risks**
 - (a) **market risks:**
 - price fluctuation, charter rates
 - costs of labour and materials

 - (b) **technical risks:**
 - may cost more to achieve specification and to meet timely delivery
 - poor performance after delivery

 - (c) **risk of physical loss or damage**
 - accident in yard or during trials etc.

 - (d) **non performance**

- 4) **Ancillary contracts**
 - specification is set out
 - guarantees, refund, guarantees to refund of installments,

- performance bond to cover installmental payments etc

5. PURCHASE OF AN OLD VESSEL

Contract for sale or purchase of a second hand ship is usually negotiated by ship brokers acting as agents of both the buyer and the seller. Negotiation is most often carried out by telex and the agreed terms are written down in a Norwegian Shipbroker's Association Memorandum of Agreement for Sale and Purchase of Ships ("**NSF**") being the standard form most widely used for the sale and purchase of old buildings. Norwegian Sale Form 1993 is annexed to this paper as Annex 2.

The content of and stages of transaction is somewhat different from that of a new building. The entire process comprises of three phases namely pre-delivery, delivery and post delivery

1st Phase - Pre-delivery

- Essential documents are collected from both seller and buyer by the brokers
- Drafting of MOA
- Buyer pays deposit (usually 10% of the purchase price)
- Inspection of the vessel
- Timeline and sequence of closing is agreed upon
- Seller makes arrangement to terminate insurance, discharge mortgages if any and arranges for deletion of vessel from existing flag
- Seller gives advance notice of readiness for delivery of vessel by seller
- Buyer makes arrangement for insurance, registration of vessel with classification society, crew, bunkers and registration of vessel.

2nd Phase - Delivery (physical delivery on board ship and documentary delivery ashore)

a) Place of delivery - safely afloat.

- possessory lien on vessel if price is not paid. This lien has priority over buyer and mortgagee's claims.
- Sales tax. Parties may agree to deliver in international waters to avoid sales tax at port or accepting delivery in a repair yard
- Seller to arrange facility for inspection

b) Documentary Delivery

- Lawyers, agents, brokers and bankers meet ashore for the delivery of documents
- final inspection
- trading certificate and other documents ready to be handed over with the ship
- simultaneous payment of purchase price by Buyer, discharge of Seller's mortgage and transfer of title by Seller to Buyer
- Seller then instructs their representatives on board to deliver the ship to Buyer

c) Post Delivery

- Buyer registers ship in his own name,
- Buyer changes from temporary registration to permanent registration.

5.1 Problem areas in Sale and Purchase of Secondhand Vessels

Disputes often times arise between the seller and buyer and the Courts would be required to determine on the following issues:

- whether or not the MOA is a binding contract (where MOA subject to details or contract)
- when property passes from seller to buyer (MOA signed when vessel is in undeliverable state)
- whether sale by NSF is a sale by description (specific inspection obligation)

The Court generally regards the MOA as a binding document except where it is expressly made subject to contract or subject to further details being provided. In *Star Steamship Society v Beogradska Plouidba (The “Junior K”) (1998) Vol 2 LLR* the Court held that the MOA did not constitute a binding agreement because it contained the words “subject to gencon CP” which could be reasonably construed to mean subject to further details.

6. CHECK LIST FOR DUE DILIGENCE PRIOR TO CLOSING OF A PURCHASE

We assume here that our smart entrepreneur has engaged the services of a maritime lawyer for the purchase of a vessel. Below are some matters that needs to be taken care of and having a simple to-do-list might be of assistance to the Solicitor.

1. Search the Register and obtain a Transcript of Registry to confirm the ownership of the ship and to ascertain if there are any mortgages registered against the ship.
2. Search in the Corporate Affairs Commission (“CAC”) or its equivalent to ascertain that the seller is duly incorporated under the laws of the country in which it is located.

3. Check if there are any mortgages, debentures or floating charges registered against the seller at the CAC or its equivalent which relate to the ship.
4. Check the memorandum and articles of the seller or the equivalent statutory documents if the seller is an overseas company to confirm that the seller has power to sell the ship.
5. Check that the seller has taken all required corporate action, for example passing a board resolution to approve the sale.
6. Check that no winding up or bankruptcy petition has been presented against the seller.
7. Search in the Admiralty Registry to see if any in rem claims have been issued against the ship. The Admiralty Registry will search to ascertain if a claim in rem has been issued against a ship if the applicant gives a sufficient reason for requiring this information.
8. Check with the port authority whether the ship is under arrest or detention or whether there is an arrest warrant against the ship at the port where she is to be delivered.
9. If the sale contract so provides, arrange for the pre-delivery survey to confirm that the ship conforms to the requirements of the sale contract.
10. Check the documents to be handed over on closing:
 - (1) Bill of Sale
 - (2) Transcript of Registry or Certificate of Ownership showing no mortgages.
 - (3) Class confirmation Certificate

- (4) Certified board resolutions of the seller
- (5) Power of Attorney of the seller
- (6) Commercial invoice for the ship
- (7) Commercial invoice for bunkers, lubricating oil and other items.
- (8) Safety and International Trading Certificates:
 - ISM Certificate
 - International Loading Certificate
 - International Tonnage Certificate
 - International Safety Equipment Certificate
 - International Safety Construction Certificate
 - International Safety Radio Certificate
 - ISPS Code compliance documents
- (9) Certificate of Deletion – if ship has to be deleted from its current Register or letter of undertaking to deliver a Certificate of Deletion within a specified time.
- (10) Protocol of Delivery and Acceptance.

7. APPLICABLE LAW ON SHIP BUILDING CONTRACT

To the builder, shipbuilding contract is a construction contract (work and material) but from a buyer's point of view especially if it is a new ship it is a contract for the purchase of a ship i.e. sale of goods contract. The problem for the courts is therefore to decide whether it is a sale of goods contract or a construction contract.

The uncertainty is understandable because the law defines a contract of sale as a contract where the seller transfers or agrees to transfer the property in goods (usually ascertained goods) to a buyer for a price – *Section 3 Sale of Goods Law Cap 174, Laws of Lagos State, 1994*. The Court would have to determine whether an agreement to construct a building, in this instance a vessel, can properly be regarded as a contract of sale where the subject matter is unascertained. This confusion is applicable only to a contract for a new

building. Sale and purchase of an existing ship falls squarely under the sales of goods contract since the second hand vessel is an ascertained and specific good.

Historically, English law treated shipbuilding contracts as sale of goods contracts and thus the principles of contract law governed the obligations and liabilities of parties. See *McDougall v Aeromarine of Emsworth [1958] 2 LR 345* where a yacht delivered by builder to buyer was held not to be seaworthy or of merchantable quality. Applying the principle of contract for sale of goods, the court held that the Buyer was entitled to rescind the shipbuilding contract and that the builder was not entitled to any further installment rather the Buyer was entitled to the refund of the purchase price. However, English Courts have in recent times recognized common features between ship building contracts and construction contracts. In *Stocznia v Latvian Shipping [1995] 2 LR 592* where the facts were similar to McDougall, it was held that the second installment remained due to the Builder despite the cancellation of the contract because there was no total failure of consideration. The court applying construction laws held that the contract was not merely for the sale of the hull but for construction and sale of the hull and that the construction was part of the consideration.

The practice now is that the courts will look at particular issues to be addressed and apply either sale or construction principles or both as may be appropriate. Generally when the issue is on title or passing of property, sale of goods law is applied but if the issue is on construction or installmental payment then it is treated as construction contract. The consensus though is that shipbuilding contract falls squarely under the law of contract albeit of a “hybrid nature”.

The Merchant Shipping Act requires a formal evidence of transfer of ownership by way of a Bill of Sale as evidence of ownership. The sale may affect third party rights, but will not affect maritime liens or mortgages as these attaches to the vessel and survives transfer of title with the exception of judicial sale. The seller usually warrants or guarantees that there are no encumbrances.

8. OTHER METHODS OF ACQUIRING OWNERSHIP OF SHIP

8.1 Order of Court

Ownership in a vessel could be acquired through an Order of Court in various circumstances. The most familiar one is Order the sale of a ship where the sale is to satisfy a judgement. Ownership could also be acquired by transmission e.g. bankruptcy and also where the vessel is subject to forfeiture.

8.2 Order for Sale

Admiralty Jurisdiction Decree 1991 vests jurisdiction over the sale of ships in the Federal High Court. The court is empowered to make Orders for a sale of ship where the claimant establishes a valid maritime claim on the ship against the ship in satisfaction of the court's judgement for the claimant. Honourable Justice Belgore as he then was granted an Order for the sale of M. V. Rhodian Trader in *Joseph Eustace Fernando & Ors v The Owners of M.V Rhodian Trader, NSC 1985, Vol 4 p,339* where it was held that the plaintiffs had a lien on the vessel and were thus entitled to its sale in satisfaction of their wages.

For proper title to pass to any purchaser of a ship subject to the sale Order of the court, **Order 14 of the Admiralty Jurisdiction Procedure Rules of 1993**, provides that the sale must be conducted by an Admiralty Marshall and held by public auction 21 days after advertisements in two national newspapers.

9. CONCLUSION

Having listened to commercial and legal issues to be dealt with in shipbuilding, ship sale and purchase, the next crucial issue in the mind of an investor is that of funds to finance the acquisition. The Banker steps in at this point to advise the investor on the available options for financing.

The legal and commercial environment is ripe for investment in ship yards. The Cabotage Act has created a protected market for wholly Nigerian owned vessels and for vessels built in Nigeria. A boom in demand for vessels is expected and it is hoped that this Paper would be of assistance to the investor and their Counsel.

Thank you for your attention.

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