



## Avoiding and Defending Against Shipyard Claims

### Understanding the Problem

Over the last twenty years shipyards have grown more reliant on contract change negotiations and claims to provide a high percentage of total contract profit, almost as if it were an integral part of the construction or repair contract. This situation was brought on by two primary factors. First, shrinking market conditions forced shipyards to cut bids to the bone, leaving little profit in the bid price if they really wanted to win the contract. In fact, some yards appear to bid the job with no profit when their experience with the job type indicates that a significant amount of change is probable. Second, the success of major shipyards with claims against the U. S. Government since the late seventies has encouraged the smaller yards to try similar tactics, first for their own government contracts and then for their commercial contracts as well.

Of course there is also the everyday possibility that your job will be simply mismanaged by some element of the shipyard's operations that will result in cost overruns and delays for the shipyard. The shipyard might also try to recover these costs by incorrectly linking them to contract changes and other actions or inactions of the owner. Frequently, the pricing and rationale for changes or claims is an inexplicable weave of both valid and invalid claims for contract adjustments that is so confusing that it provides little basis for the owner to make a sound judgment as to entitlement. When this situation occurs, it is usually the beginning of a breakdown in the working relationship between owner and shipyard that is essential to the owner receiving a quality product.

### Pre-contract Considerations

When an owner solicits bids for ship construction, overhaul, or repair, he is looking for the best price he can find for a quality product. If it becomes necessary to sometimes make a tradeoff between quality level of a desired component and the cost of installing that component, that is the type of management decision which owners are frequently called upon to make and offers little problem. However, when the quality issues are broader ones such as dimensional control, welding processes, testing procedures, etc., they are most often left to the general specification requirements and inspection of the Coast Guard or the appropriate ship classification society. While this approach might lead to an acceptable end product by the shipyard, it might also lead to cost overruns and project delays if the shipyard lacks adequate skilled craftsmen, equipment, planning, or management, or even when it possesses such capabilities but fails to apply them to your contract.

Before a shipyard is selected to perform your work, a careful inspection of its physical facilities, production processes, skills availability, planning procedures, testing procedures, quality assurance procedures, and management procedures will provide much needed selection criteria for the procurement selection process. If the shipyard is lacking in its capabilities in these areas, there is a good possibility that you will not have a productive contract experience. Even if it



has the necessary capabilities to perform your work, you must be careful that those capabilities will be applied to your contract when required rather than to some other job in the shipyard. This requires a thorough examination of the existing and projected workload for the shipyard during the period of planned performance for your contract and a comparison of that workload against the shipyard's capabilities. If the shipyard over-commits its physical or personnel capabilities during the performance of your contract, you can be sure that your contract will suffer.

## Structuring the Contract

To mitigate the possibility of inflated change order requests or contract claims by the shipyard, it is essential to structure your ship construction, overhaul, or repair contract in such a manner that it will first, restrict the shipyard's ability to come forward with such contract demands and will second, provide essential data for equitably resolving those disputes which do arise. This is accomplished primarily through attention to three critical contract areas:

- Technical Specifications
- All Clauses Pertaining to Contract Changes
- Scheduling and Progress Reporting Requirements

All too frequently the preparation of technical specifications is left to the design agent or the operations engineer. This will usually result in a specification containing the necessary technical detail for the contract work, but these groups are sometimes not sensitive to the care which must be taken to assure that the specification is concise yet unambiguous, comprehensive but not too restrictive, stands alone or properly references other sections but does not conflict with other requirements, etc. A careful review of the specification before seeking contract bids can save the owner much more than the effort costs.

Contract change clauses need to provide a complete definition of allowable changes, how they are to be documented, what procedure is to be followed for approval, and how they will be incorporated into the contract. When the owner anticipates situations which will lead to growth in the contract, such planned growth can be an integral part of the contract at signing and therefore limit his exposure to unacceptable cost growth during contract performance.

Shipyards are frequently late in completing contract work. This is primarily due to the difficulty of keeping both physical and personnel resources evenly and therefore productively employed in a business where the workload is not constant (particularly in shipyards where a large part of the work is repair and overhaul). Owners usually try to mitigate the probability of late completion by imposing large liquidated damage penalties in the contract, which can be effective when changes are kept to a minimum. However, sometimes with a single change but almost certainly when a large number of changes are experienced, the shipyard will be able to build a case for delay which is owner responsible and therefore not subject to liquidated damages.



To make sure the shipyard is unable to claim more owner-responsible delay than is equitable and to provide a solid projection for when the contract work will be completed (a revenue relevant question for most owners), the contract should require a key event work schedule at contract award and an expanded schedule within a specified time that has been prepared using a state-of-the-art scheduling and progressing computer program. Properly executed by the shipyard and monitored by the owner, this will force the shipyard to adhere to the original schedule except where he can clearly demonstrate a cause-and-effect relationship of a contract change to an increase in the contract performance period.

### Monitoring Progress

A state-of-the-art scheduling and progressing system automatically produces a wide variety of reports with which, when required as a deliverable item in the contract, the owner can follow and project likely contract completion. A well designed and progressed schedule is important to both the owner and the shipyard. When problems arise during the course of the contract, as they inevitably do, a computerized schedule allows the owner and the shipyard to work together in solving or mitigating such problems. To do this, a properly designed, maintained, and progressed schedule is essential. Such a schedule will allow the owner and the shipyard to evaluate the potential impact of various solutions by introducing the work change, work-around-plan, resource allocation change, etc. into the current schedule and having the computer reschedule all remaining events.

Most shipyard contracts of any size are accompanied by a progress payment schedule of some type. This allows the shipyard, most of which are very cash flow sensitive, to receive incremental payments based on a predetermined percentage of progress. If at all possible, the owner should seek to structure his payment clause on easy to determine key event completions rather than on a percentage of completion basis, but this is not always possible, particularly for repair and overhaul work. When this is not feasible, a computerized scheduling and progressing system can provide the most reliable method for accurate assessment. When subjective progress assessment methods are called for in the contract, it frequently results in an overstatement of progress on the part of the shipyard. Such an overstatement leads to a diversion of both shipyard and owner management attention and effectively removes the owner's best tool, payment, in assuring that the shipyard is making its best effort on behalf of the contract.

### Administering the Contract

The primary consideration for the owner in administering the contract is to provide timely responses to the shipyard. This applies to any owner furnished materials called for in the contract and answers to interrogatories of any type. The contract should contain realistic turn-around times for technical inquiries, change requests, inspections, etc. The turn-around time should work both ways,



but the owner should seek to fix a response time period that he will be comfortable in meeting. If the owner is supplying the engineering or other support through contractors independently under contract to the owner or owner designated subcontractors, the same response time period must also be imposed on such contractors and/or subcontractors. If the owner, his other contractors, or his designated subcontractors fail to meet a contractual obligation to provide materials or information in a timely manner, the owner immediately opens himself to charges of adversely impacting contract performance.

Closely following the importance of timely response is the necessity for structured approval procedures which provide for the maintenance of concise and fully traceable documentation by date and specific individual for all requests and approvals. This documentation is essential in change negotiation and in countering contract claims should they arise. To a large extent, this documentation requirement can be included as a requirement of the shipyard by so stating in the contract, but some records must be maintained independently by the owner.

## Claims Defense

By carefully selecting the shipyard, structuring the contract to avoid conflicts, instituting a rigorous progress monitoring system, and developing strict procedures to assure timely approvals and their documentation, the owner will greatly improve his chances of being able to settle changes and disputes with the shipyard in an equitable manner. This should always be the first line of claims defense -- ***avoid claims whenever possible.***

Should an owner be unfortunate enough to have a contract claim arise as the result of an inability of the parties to negotiate an agreement on a critical subject, contract provisions usually determine whether that dispute will be settled by arbitration or the courts. Either way, it is frequently an expensive and time consuming effort during a time when the owner wants to concentrate its efforts on the efficient completion and utilization of its new or refurbished vessel.

The details of the shipyard's claim would determine the approach needed by the owner to counter the claim's allegations. Usually this would require an independent analysis of project data to at least the depth utilized by the shipyard. Such an analysis would either verify the shipyard's allegations, conclusions, and impact assessment or provide the buyer with its own impact pricing for negotiations or for presentation in arbitration or court proceedings. Whatever course any claims defense might pursue, its success would be greatly enhanced by the structured interface and data collection detailed in the paragraphs above.

## Contralytics Can Help

Contralytics has a wide range of ship construction and repair expertise. The company's specialty, as its name implies, is contract analysis, from the initial structuring of contracts to all forms of dispute resolution. Our personnel have a



broad range of hands-on expertise that makes us confident we can assist you in all contract dispute related areas of development, management, and completion of your construction, overhaul, and repair contracts.