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Exculpatory Clauses in Shipyard Contracts

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A vessel owner bringing a vessel into a shipyard for repairs is often presented with a work order or contract purporting to exonerate the shipyard from liability for damage to the vessel. The work order or contract may also provide for a limitation of the shipyard's liability. This article addresses exculpatory clauses in shipyard contracts.

As a general rule, maritime law recognizes the rights of parties to enter into maritime contracts on the terms they choose. However, not all the terms they choose are enforceable under every circumstance. Some may be recognized and enforced as the product of bargaining between the parties to the contract. Others may be invalidated as against public policy regardless of the parties' agreement.

When a shipyard enters into a contract to repair a vessel, it is exposed to three different types of liability if the repairs are not properly made. It can be liable for breach of contract, that is, the failure to perform the work as stated in the contract. It can be liable for breach of the implied warranty of workmanlike performance. And, it can be liable for negligence. Because of the potential financial consequences to the shipyard and/or its insurer for improper repairs, shipyards more often than not put clauses commonly known as "red letter" clauses in their contracts, which disclaim or limit liability. Unfortunately, the courts around the US have not taken a uniform approach when determining whether such clauses are valid.

The California approach

The California Supreme Court addressed exculpatory clauses in shipyard contracts in *Fahey v. Gledhill,* 33 Cal.3d 884 (1983). It recognized that under maritime law, parties of equal bargaining strength could agree to allocate the risk of loss or damage to the vessel while in the shipyard. When doing so, the parties had to use clear and unequivocal language to reflect their intent. In *Fahey*, the work order signed by the vessel owner had a clause relieving the shipyard from loss or damage "from any cause whatsoever". The California Supreme Court held the clause unenforceable because among other things, it did not specifically mention the negligence of the shipyard and its employees.

The Ninth Circuit approach

Like the California Supreme Court, the federal Ninth Circuit Court of Appeals, which encompasses the West Coast, has held an exculpatory clause in a shipyard contract may totally relieve the shipyard from liability for its ordinary negligence. However, it has also held a shipyard cannot use an exculpatory clause to relieve itself of liability for its gross negligence.

In *Morton v. Zidell Explorations*, 695 F.2d 347 (9th Cir. 1982), the owners of a tugboat contracted with Zidell to convert the tugboat into a fish processor. The contract contained a clause purporting to exculpate Zidell from "all risks of loss or damage…under any circumstances whatsoever." The vessel was damaged due to the negligence of Zidell's employee while welding. The Ninth Circuit agreed with the trial judge's view that the exculpatory clause was valid in the absence of any evidence of overreaching by Zidell.

In *Royal Ins. Co. of America v. Southwest Marine, et al.* 1999 AMC 2873 (9th Cir. 1999), the Ninth Circuit considered the "unresolved issue" of whether an exculpatory clause could relieve a shipyard for liability resulting from its gross negligence, or "the want of even scant care or an extreme departure from the ordinary standard of conduct". It concluded public policy does not permit a party to contractually relieve itself of liability for intentionally or recklessly caused harm.

In *Royal*, Garthwaite entered into a contract with Southwest Marine, a ship-repair facility, in connection with the renovation of his yacht. The contract had an exculpatory clause that relieved Southwest Marine of all liability, using very broad language.

Southwest Marine's crane lifted Garthwaite's yacht from the water and placed it into a cradle without incident. Southwest's crane was later used to return the yacht to the water. As the crane lifted the yacht, the winch
drum cracked and the yacht dropped a few inches but did not suffer any damage. The crane, however, suffered serious damage.

The crane was repaired and Southwest Marine attempted to re-launch Garthwaite's yacht the day after the repairs were completed. The wire rope snapped, the yacht dropped several feet to the water, and the crane's boom crashed onto the yacht's deck. The evidence suggested Southwest Marine had used the yacht as a test weight despite a request from the yacht's captain that it not be so used.

The Ninth Circuit held the exculpatory clause in the contract to be effective to shield Southwest Marine from liability for its ordinary negligence. However, it also held the exculpatory clause did not shield Southwest Marine from liability for its gross negligence. It recognized the possibility a jury could find Southwest Marine grossly negligent if, in fact, it used the yacht as a test weight. The Ninth Circuit also held certain limitations in the contract such as time limits on claims and waivers of subrogation would not be enforceable if the shipyard were grossly negligent.

The First Circuit approach
Not all circuits follow the Ninth Circuit principle that exculpatory clauses in shipyard contracts generally are enforceable in the absence of overreaching. The First Circuit, which encompasses part of New England including Massachusetts and Maine, follows the opposite principle, that is, clauses attempting to totally exculpate the shipyard generally are not enforceable.

In *La Esperanza de P.R. v. Perez* 1998 AMC 21 (1st Cir. 1997), the ***S/V La Esperanza*** was brought to a shipyard for a retrofit as a passenger-carrying vessel. The retrofit contract provided the shipyard would make good at its own expense any defective work or materials or pay for the cost of repair. The contract also provided the shipyard would not be responsible for "any loss of use or profit of the vessel." The retrofit was not done properly resulting in extensive damage to the vessel.

The First Circuit agreed with the trial court's denial of loss of use damages to the vessel owner. It reasoned a clause totally absolving the shipyard from liability should not be enforceable because the prospect of liability would deter negligence but a clause limiting the shipyard's liability would be enforceable in the absence of overreaching. Because the shipyard's contract only relieved the shipyard of liability for a particular type of damages, i.e. loss of use, the clause was held valid. The First Circuit also held gross negligence vitiates an otherwise valid exculpatory or limitation clause.

The Fifth Circuit approach
The Fifth Circuit, which encompasses Texas, Louisiana, and Mississippi, has also rejected clauses in shipyard contracts that purport to totally exonerate a shipyard for its negligence but enforced clauses limiting the shipyard's liability.

In *Alcoa Steamship Co, Inc. v. Charles Ferran & Co. Inc*. 383 F.2d 46 (5th Cir. 1967), Alcoa's

vessel was damaged by a fire caused by the negligence of Ferran's employee. Alcoa sought damages of $1,000,000.

Alcoa and Ferran had a prior course of dealing and Ferran's invoice, customarily issued after completion of repairs, was the only document between the parties containing a "red letter" clause. The clause provided Ferran would not be liable for damage to the vessel unless caused by its negligence and further provided "and in no event shall our aggregate liability …exceed the sum of $300,000."

Alcoa argued the clause should not be enforced because it never was part of a repair contract in the past and was only in the invoices issued after the repairs were completed. The Fifth Circuit held the trial court was correct in limiting Ferran's liability to $300,000 finding the parties had equal bargaining strength, Alcoa had notice of the limitation amount from the prior dealings, and the limitation amount was significant enough to deter negligence.

In *Todd Shipyards Corp. v. Turbine Service, Inc.* 674 F.2d 401 (5th Cir. 1982), a "red letter" clause in the shipyard's contract purported to relieve the shipyard of liability for damage to the vessel "unless the same is cause solely by the negligence of one of our employees". The shipyard argued it should be relieved of liability for damage suffered by the vessel during work at the shipyard because its subcontractor actually caused the damage. The Fifth Circuit rejected the argument and held the "sole negligence" language invalid, reasoning such interpretation would lead to the "preposterous" result that a shipyard could relieve itself of liability by subcontracting out the work.

A shipyard's location is a significant factor in determining whether it can contractually avoid liability for damage to a vessel at its facility. In California and the Ninth Circuit, liability for ordinary negligence but not gross negligence may be avoided if the contract is carefully drafted and the customer has notice of and expressly or impliedly agrees to the exculpatory language. In other parts of the country, a shipyard may not be able to totally avoid liability for its ordinary or gross negligence but may be able to limit its liability for ordinary negligence.