Security for Shipbuilding Projects

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Security - most often in the form of guarantees - is a cornerstone of shipbuilding projects. Below are key types of security typically seen in these projects and the main considerations for Builders and Buyers (or their financiers) with reference to the recent decision of the commercial court in *Chugga Chugg Pty Ltd v. Privinvest Holding SAL* [2025].

Builder security

Refund guarantee

Typically shipbuilding contracts will require the Builder to provide a refund guarantee from a bank or other acceptable financial institution to secure the Buyer's pre-delivery payments. This is especially vital when the Buyer is financing those instalments. Interestingly, the SAJ

form doesn't impose a mandatory refund guarantee, while NEWBUILDCON includes such an obligation with a template form.

The guarantee is usually a condition precedent to the shipbuilding contract's effectiveness or to payment of the first instalment of the contract price. Where the timing is ambiguous, it should be provided within a reasonable period, as highlighted in *Covington Marine Corporation v. Xiamen Shipbuilding Industry* [2006].

Parent company guarantee

In the rare context where there is no refund guarantee or in offshore projects where there is no warranty guarantee, the Buyer may want the Builder to provide a parent company guarantee to secure its pre-delivery instalments and, if applicable, the Builder's post-delivery warranty obligations. Sometimes, such a guarantee also covers reliance and expectation losses resulting from Builder default. This guarantee usually comes from a more substantial parent company or export credit agency. It's crucial to ensure whether the guarantee operates as a surety or as an on-demand guarantee (see below) to reflect the commercial bargain.

Post-delivery warranty bond

In offshore projects, it's common for the Builder to provide a 'warranty bank guarantee' or performance bond covering its maximum liability under the warranty regime. This is particularly required when it would be more sensible for the Buyer (or oil company) to conduct offshore repairs promptly, reducing downtime, and claim costs back from the Builder. And so the Builder's liability is often secured by such a bond.

Buyer security

Although less common, Buyers may need to provide a payment guarantee - often if the Buyer is a special purpose vehicle (SPV) paying most of the price pre-delivery. A more common structure is for the more financially substantial parent to enter into the shipbuilding contract and later nominate the SPV as Buyer to mitigate Builder's credit risk.

Common pitfalls

(1) Nature of the guarantee

The type of guarantee - whether a "see to it" (surety) or an on-demand (performance bond)—is vital but is common to see heavily negotiated guarantees containing inconsistent terminology which can lead to disputes and unexpected outcomes.

A "see to it" guarantee is a secondary obligation; it can only be enforced after the Buyer's/ Builder's liability is established and the guarantor is typically able to seek to defend itself by reference to the terms of the shipbuilding contract. An on-demand guarantee, by contrast, requires payment upon receipt of a valid demand as per its terms and the guarantor is typically not able to defend itself by reference to the terms of the shipbuilding contract.

The recent case of *Chugga Chugg Pty Ltd v. Privinvest Holding SAL* [2025] addressed this distinction. The court found that the absence of terms like "absolute and unconditional" or a clear reference to guarantor being a "primary obligor" indicated a secondary obligation. This builds on *Shanghai Shipyard v. Reignwood International Investment* [2021], emphasizing that the wording and context of each guarantee are critical.

Standard forms exist (see the SAJ form (buyer guarantee) and NEWBUILDCON), but many guarantees result from bespoke commercial negotiations. Inconsistent terminology is often used which can lead to disputes when the guarantee is called upon. Particular attention should be paid to ensure the wording is consistent and reflects the commercial intent.

(2) Indemnities

Some beneficiaries may also request that indemnities be included within the terms of the "guarantee" in order to strengthen their security in case the guarantee is held to not be valid and/or to provide additional rights of recourse. The substance rather than the heading of the document is key to determining whether it is a "guarantee" or a "guarantee and indemnity". Further, it is important to keep in mind that claims under the indemnity clauses will be dependent on the terms of the indemnity clauses; unless the terms require it then it may not be necessary to establish any breach or negligence for there to be a valid indemnity claim. Also, it is important to keep in mind that indemnity claims are not subject to the same rules on foreseeability and remoteness than govern ordinary damages claims.

(3) Caps

Builders are generally expected to provide a guarantee (usually a refund guarantee), but limits on liability, typically capped at pre-delivery instalment(s) amounts plus agreed interest, are common. Guarantors would in no event want to be liable more than the Builder would have been liable under the shipbuilding contract.

(4) Duration

Guarantors usually require an expiration date, which the Buyer should ensure aligns with permissible contract extensions.

While the Buyer would resist it, guarantors typically insist on such a long-stop expiration date. From the Buyer's standpoint it is key to have correct wording to provide that any permissible extensions under the shipbuilding contract would also extend this expiration date. It is always prudent to obtain the guarantors acknowledgment for any extensions or substantial amendments to the shipbuilding contract.

(5) Procedural requirements

Procedural requirements also matter. In *Shanghai Shipyard v. Reignwood*, a key issue was whether the proper demand procedure had been followed. Similarly, in *SFL Ace 2 Company Inc v. DCW Management Ltd*[2024], the court upheld a valid and enforceable guarantee evidenced in the recap terms without the need for a formal signed document, satisfying the Statute of Frauds Act 1677.

(6) Local Law

It is essential to consider local legal requirements when dealing with non-English guarantors to ensure the enforceability of English law guarantees.

Conclusion

Guarantees, usually governed by English law, are central to shipbuilding project security. Whether from a Builder or Buyer (or their parents, financiers or third parties such as export credit agencies), each form must be carefully negotiated, drafted, and, when needed,

properly enforced in accordance with its terms.

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