



How to waste money by getting your yacht newbuild contract horribly wrong

Question: How do I make a small fortune?

Answer: Start with a large fortune and buy a yacht

Not that original as jokes go, but knowledgeable owners sometimes think along these lines – and they would be right to do so.

Most owners appreciate that yacht ownership is an expensive business, yet where newbuilds are concerned, there are a few common and easily made “mistakes” that could catch out the unwary.

And that is just the beginning.

Here are a few examples.

1. Currency Risk

Many top yards charge in Euros. Many potential owners may have their wealth in another currency. A typical newbuild might take 4 years or so to complete, and stage payments could involve currency risk for the owner.

Transaction risks can be hedged with financial instruments, including currency futures, swaps, or options, but be aware of the risk and take steps to mitigate it.

Many top yards are based in the Eurozone. During the ongoing COVID pandemic, we have seen a flight to the Japanese Yen, US Dollar and Swiss Franc.

Depending on how the owner's wealth is managed, currency risk can be controlled but, over the life of a newbuild project, probably not eliminated.

2. Credit Risk

For yards, they are taking a risk on the credit worthiness of an owner. For the owner, they are taking a credit risk on the yard.

Now of course, the owner usually has title in the part-built yacht, and its equipment, transferred to the owner, which is usually an SPV. They will additionally be provided with performance and refund guarantees covering the stages before the yacht is completed, and the registration of the yacht under construction.

In an earlier article, “*What Does a Superyacht Lawyer Do?*” I identified the payment schedule as a key component of financial risk, and wrote:

"Payment will be made by instalment throughout the build contract. This will be "front loaded" by the Builder, so my job... [i]s to ensure it was a little more "back loaded..."

It [is] also key to make sure the trigger points for stage payment were defined by reference to actual events, not dates".

Avoid a front-loaded payment schedule; it is commercially a bad idea and increases credit risk.

Also, make sure that the trigger for payment is completion of a milestone, and that milestone is verified in writing by your classification society. Your build contract should make this clear, but the draft contract you receive from some yards may be anything but clear.

3. Insolvency Risk

Linked to the payment schedule is the issue of insolvency. It is not unheard of for a yard to go bust with part-built yachts in its shed, and an owner will need appropriate safeguards to be put in place to protect his or her interests.

These risks are all the more real in an environment where business has been interrupted by a pandemic.

There are at least five key elements to the protection:

- As mentioned above, a prudent owner will require provision of a good refund guarantee from a bank or (at least) the reputable parent company of the yard (assuming that parent is worth the money) covering the first two stage payments. This is necessary because in the early stages of a newbuild project, the owner has to stump up a lot of cash, but the yacht will be little more than plans and plating.
- Second, on receipt of the third stage payment, a bank or other financial institution of repute should be required to provide a performance guarantee, obliging it to "step in" to ensure delivery of the yacht, or adequate compensation if that is not possible.
- Third, title in the uncompleted yacht – make sure it's yours from the earliest moment. This is essential. But by itself it may not be sufficient and might require further steps be taken. I would describe that as enforcement risk, which I will consider further below.
- Fourth, and as the construction advances, the part built yacht acquires some value and provisions can be included in the build contract to ensure title in the part-built yacht is passed to the owner. However, without further rights to remove the yacht, the yard's creditors might rank ahead of an owner.

In Holland, arguably the home of fine superyacht building, it is necessary to register the Yacht with the Ships' Registry held by the Service for the Public Registers and the Land Registration Office (*Dienst voor Openbare Registers en het Kadaster*) as a seagoing vessel under construction (*Zeeschip in aanbouw*). It is also possible to register the yacht under construction in other registries, e.g. Cayman – check the position with your lawyer.

- Fifth, a right to take possession of, and remove and/or use the yard's facilities to complete the yacht. Whether or not such a clause is enforceable will depend upon the place where the yacht is being contracted. It is something of a last resort.

4. Force Majeure Risk

This is a late entrant, but for yards, a highly relevant one.

A poorly drafted force majeure clause could have significant financial consequences for either the owner, the yard, or both.

Almost every build contract I have recently seen has included modified and strengthened wording intended to protect the yard from what might broadly be described as pandemic risk, consequent upon COVID-19 experience.

If you are an owner facing a force majeure claim by a yard, such events which might be covered are delay to building resulting from breaks in the supply chain, labour shortages or other such events. However the way COVID-19 had impacted yacht building has been finely nuanced.

As I said in my article, "[COVID-19 – are you sure it is a force majeure event?](#)" published in our Spring 2020 newsletter:

"The exceptional circumstances surrounding the COVID-19 pandemic would appear to be a classic example of a Force Majeure event that would suspend the performance of the contractor's obligations, but the language used needs to be checked to see if that is the case. A lot may ride on the clause"

Both owners and yards need to know where they stand, yet force majeure clauses are opaquely drafted in many cases.

When was the last time you checked your force majeure provisions?

5. Permissible Delay Risk

Force majeure and permissible delay are often inextricably linked. But permissible delay can be all the more insidious because it may be drafted so as not require any actual delay to the construction.

Building a yacht is a long and complex task, and many are delivered late. If the delay to delivery is more than, say, a grace period of 2-3 months, then punitive liquidated damages provisions will kick in to compensate the owner for each day delivery is delayed.

Obviously, if a yard can avoid some of that cost, it will do so, and the best way of doing so is to characterise as many events along the way as "*permissible delay*". I have seen yards try to include wording that would allow a claim for permissible delay, extending the delivery date years hence, regardless of whether there is any *actual delay* to the project. They simply bank the additional time.

Given the consequences of late delivery to an owner hoping to charter the yacht and make money, millions of USD / Euro may ride on the interpretation of a permissible delay clause.

In next quarter's article, I will consider post-delivery risks and how owners might protect themselves against them.



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