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# The Superyacht OWNER

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# AGREEING THE BUILD

*– WORDS BY ARNOLD VAN STEENDEREN, VAN STEENDEREN MAINPORT LAWYERS*

When it comes to the majority of commercial new building, including superyachts, construction invariably demands substantial funds and it will take the yard considerable time to deliver the vessel under the Building Agreement with the buyer. Van Steenderen Mainport Lawyers answer some of the most pressing questions surrounding the subject.

**IDEALLY, AS A CLIENT, YOU SHOULD NOT BE PUT IN A POSITION WHERE YOU HAVE OVERPAID THE YARD IN TERMS OF VALUE CREATED DURING CONSTRUCTION.**

**When will the purchase price for a vessel be payable?**
In many cases, the first instalment of the purchase price will be payable before construction starts and subsequent instalments will become due following completion of particular stages of construction (milestones), with a final instalment due on delivery. The completion of a stage of construction, for example keel-laying, hull completion, installation of main engines, start of joinery work or launching, will have to be confirmed by a senior surveyor of the classification society. It is a well known fact that shipyards are not heavily capitalised. Any assets they may have are separated from their operational business. In most cases, employees and trade creditors are put in one legal entity and the real estate from which they are operating is put in a separate other entity. This sort of structure exposes an owner or buyer to substantial financial risks if a Shipbuilding Agreement is front-loaded.

**Will the various payments be equal?**
Builders will always try to maximise the percentage of the upfront instalments, reducing the amount payable from launching until delivery. Whatever the milestone payment schedule, it will be the result of much negotiation and, in our experience, potential buyers should not easily compromise simply to close a deal. Ideally, as a client, you should not be put in a position where you have overpaid the yard in terms of value created during construction.

**How should I protect myself when purchasing a vessel?**
In recent years, a number of shipyards have had to suddenly restructure, suspend their activities, find a composition with their creditors for lack of liquidity or even gone bankrupt. Given such circumstances, it is extremely important for buyers to ensure that certain contractual provisions are in place to overcome the situation of a builder defaulting in the performance of his obligations. Depending on the jurisdiction where the construction site of the new build is located and on the law chosen in the Shipbuilding Agreement, there are various ways to protect the interests of a buyer.

**TITLE AND RISK**

**Who should be liable for any loss or damage during vessel construction?**
First of all, project risk should always remain with the builder until the time of delivery and acceptance of the yacht.

**That seems a little unfair on the builder. Can the builder protect his position in any way?**
To cover the risks involved, the builder should take out an acceptable Builder's Risks Insurance, including coverage for owner's supplies that are incorporated or installed during the time of construction. The buyer should keep an eye on timely payment of the premium and pay special attention to the routing of payment should the yacht under construction be damaged. The buyer should make sure that he is named as a co-insured in the insurance policy and should arrange for the insurance money to go to him instead of to the builder should the project become an actual or constructive total loss.

**When is the vessel actually owned by the buyer?**
With regards to the title – or ownership – of the yacht under construction, there are various possibilities, depending on the location of the yacht during construction. These possibilities can be:

- Title to the yacht remaining vested in the builder until its completion and delivery to the buyer and payment in full of the purchase price
- Title to the yacht passing to the buyer during the course of construction at various stages of construction as and when the instalments are paid (subject to a possessory lien of the builder)
- Passing of title and registration thereof in the Ships Register from the moment the keel is laid (also subject to a builder's possessory lien)

The Netherlands has a robust system of recording title interests and securities on yachts under construction in the Dutch jurisdiction, for example. As from keel-laying, it is possible for the buyer to register the yacht in his name, provided the Shipbuilding Agreement allows for that. ☞

**IN THE EVENT THAT THE BUILDER SERIOUSLY BREACHES THE SHIPBUILDING AGREEMENT, THE BUYER IS ENTITLED TO SET ASIDE THE CONTRACT IN WHOLE OR IN PART.**

## DEFICIENCIES AND DEFAULTS

**What if things don't go to plan and the construction quality isn't as good as it should be?**
A Shipbuilding Agreement will define certain events as entitling the buyer to take some remedial action. The project management on behalf of the buyer may come across discrepancies between the guaranteed performance criteria of the Building Agreement and the construction performance by the yard. We have been involved in cases where the owner's representative, even before the launching of the hull, noted that the yacht upon completion would be too heavy to meet the contractual specifications.

**What if the builder's yard isn't able to complete the build because of financial difficulties?**
There may sometimes be a situation where the yard runs into financial difficulties despite the buyer's prompt payment of the agreed instalments. If construction is going slow or is halted at all, or if the yacht under construction has deficiencies outside the agreed tolerances, the question arises: what remedies does a buyer have to protect his interest in the project? Does the owner want to have the yacht finished (performance), or does he want to walk away from the project after recovering what he has paid plus compensation for damages (rescission of the contract)?

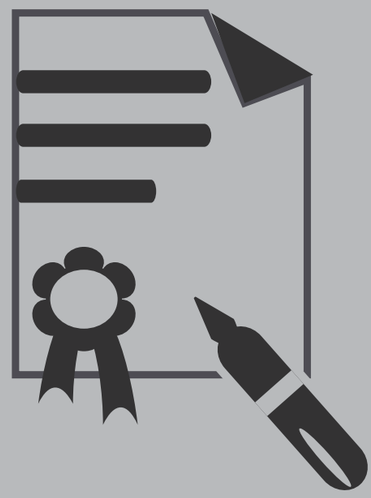
**How can the buyer get a satisfactory outcome if the vessel construction is not completed?**
Instead of performance, the buyer may choose from a catalogue of remedies for non-performance, the most important of which are damages and, in the case of synallagmatic contracts (reciprocal contracts where each party is bound to provide something to the other party), the setting aside of the contract, invoking the consequences of discharge by breach. In this connection, different modes of non-performance should be distinguished. If a non-performance (breach) is attributable to the builder (for example if the yacht is too heavy to meet the contractual specifications), he will also be responsible for the consequences. If the breach, however, is not attributable to the builder (for example, in case of force majeure), he is not responsible. This distinction is of great importance since in the latter case no action applies for damages.

**So what if the builder isn't responsible?**
The only options when the builder is not responsible are to seek performance (only if performance is still possible) and setting aside of the contract.

**How can I let the builder know that I am looking to seek performance?**
It should be noted that, except where performance is already impossible, the builder is only fully responsible when it is put in default and, in general, defaulting requires a default notice. This written notice should give the builder a reasonable period for the performance. A notice in writing will suffice. It will not be necessary to have the notice served to the builder by a sheriff or bailiff. The function of a default notice is primarily to specify a window for which timely performance is still possible. The builder will be in default when performance is not achievable in the period specified in the default notice.

**Is this the only way for the builder to default under the contract – if he defaults on performance?**
No, there are certain cases where the debtor defaults without the formality of a default notice being required. Examples of this are where a performance of obligation term expires without the obligation having been performed or when the buyer can conclude from communication from the builder that the latter will fail in the performance of the obligation. Moreover, default commences without default notice where the language of the Shipbuilding Agreement already makes this clear (i.e. if this sets out that in the event of x happening/not happening, then the builder will be in default automatically), or where the builder has communicated to the buyer that it is not necessary to send a default notice.

**What if the builder has breached the contract so badly that I don't want the building contract to be completed?**
In the event that the builder seriously breaches the Shipbuilding Agreement, the buyer is entitled to set aside the contract in whole or in part. A breach of minor importance does not justify the setting aside of the contract and the consequences flowing therefrom.



**Do I have to wait until the contract is breached to become entitled to set the contract aside?**
The parties can agree that in the event of a certain defined breach in the performance on the builder's side, the buyer will be entitled to withdraw, bringing the contract to an end.
Many cases have been reported in the Netherlands where courts have been tasked with deciding whether a failure in the performance by the yard was of minor significance or was serious enough to entitle the buyer to rescind the contract in whole or in part. For instance, judgments have been made around the following breaches: draught exceeding the agreed maximum draught (which was already clear during hull construction), the size of cabins not in conformity with the agreement, delamination of composite material of the hull on 13 yachts.

**There is a lot of reference here to contracts governed by the law of the Netherlands. Is there another law that can be applied to govern the contract? And do any disagreements have to go to court or can we look to mediate?**
The parties to a Building Agreement are at liberty to choose the law applicable to their relationship and they are also free to make a choice in favour of arbitration, rather than leaving the decision of any disputes to the state courts.

**What if I need quick action to be taken?**
We cannot go into too much detail in regards to the advantages and disadvantages of arbitration, but in many cases even a choice in favour of arbitration will still leave open the possibility for the buyer to seek interim measures from a state court in the region where the yard is located. Sometimes the Arbitration Rules also foresee the possibility of interim measures. At any rate, it should be noted here that a clear breach of contract by the builder, one that is admitted by the yard or that can be proven by the buyer in a well-documented form, allows the buyer to seek the remedy of specific performance; i.e. an order that the builder in breach should promptly fulfil its contractual obligations. Such an order can be obtained quickly in injunction proceedings and it is a powerful tool during construction, losing the buyer the minimum amount of time.
If a Building Agreement is subject to the laws of the Netherlands the above will apply. If, however, the chosen law of the contract is English law, specific performance is a discretionary remedy and is granted only exceptionally. This remedy is not normally available to the buyer under a Shipbuilding Agreement to compel the yard to complete and deliver the yacht. This leaves a buyer with no other choice than to claim damages instead. The choice of law made in the building contract is therefore an issue of major importance when it comes to the resolution of issues such as a breach of the contract on the builder's side.

Before entering into a Building Agreement, a buyer should therefore carefully consider whether a law suggested to him to become applicable on the Building Agreement will be suitable if it comes to enforcement of rights and remedies available to him.

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