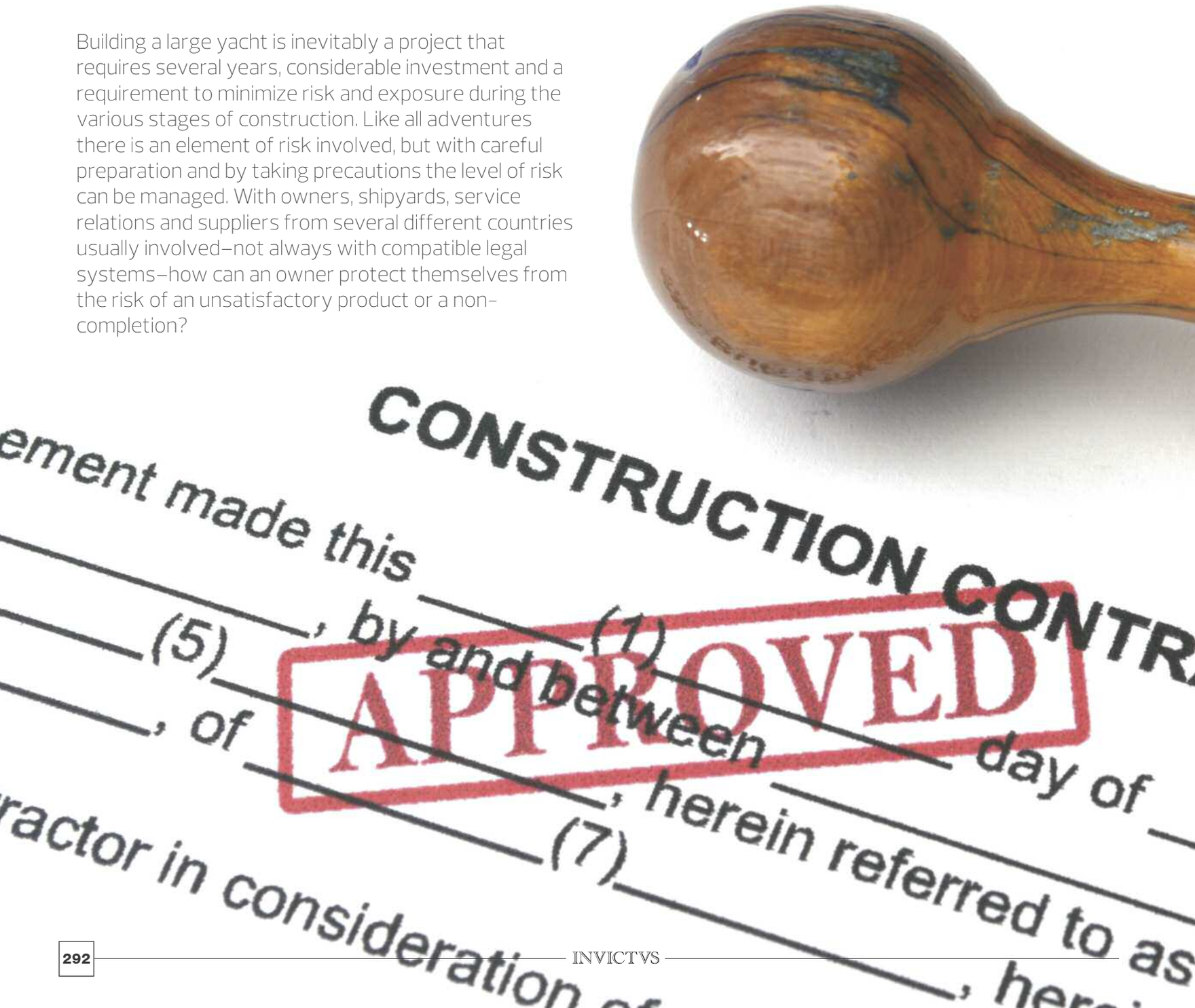
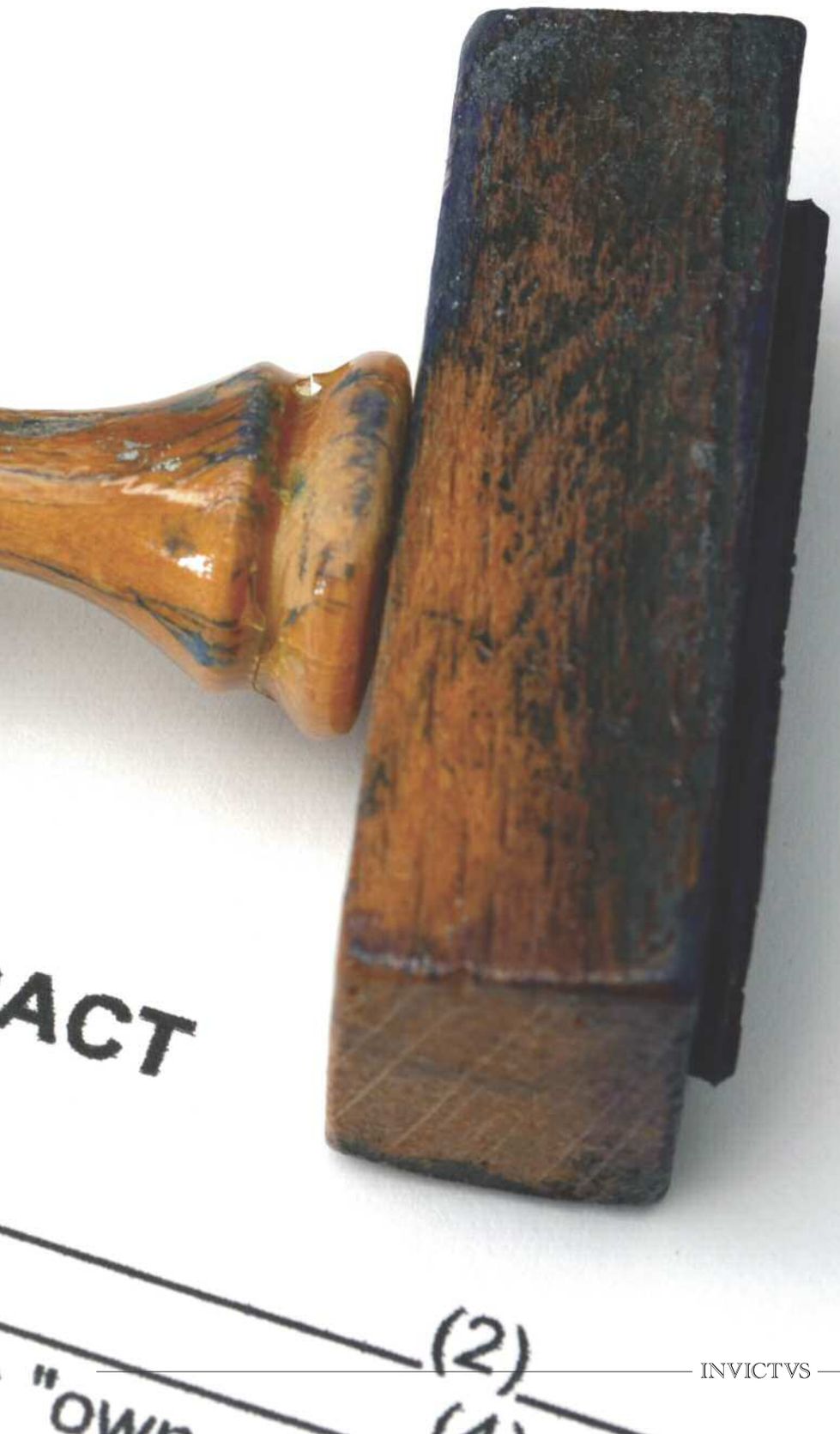
Legal considerations for yacht construction

Building Protection

Building a large yacht is inevitably a project that requires several years, considerable investment and a requirement to minimize risk and exposure during the various stages of construction. Like all adventures there is an element of risk involved, but with careful preparation and by taking precautions the level of risk can be managed. With owners, shipyards, service relations and suppliers from several different countries usually involved–not always with compatible legal systems–how can an owner protect themselves from the risk of an unsatisfactory product or a non-completion?





Throughout this article we'll endeavour to explain some of the challenges faced and solutions to address them. Perhaps the most likely question to arise, given the audience of this publication, is 'What is the protocol if an American citizen desires to enter into an agreement with a European shipyard for the construction of a superyacht? In all international business relations, this is one of the main questions according to the applicable law, because this simulates the regulatory framework with all consequences.

Let's first take a brief look at the legal situation concerning the purchase of a yacht in the USA:

The buyer in the USA lives in the jurisdiction of the American law, which only recognizes the poorly harmonized American state law, rather the often-differentiated law of the states on the contrary. The Purchase Law is one of the poorly harmonized legal aspects and standardized in Article 2 of the Uniform Commercial Code (UCC). Deviating from the term "Commercial Code," these provisions are not only applicable to traders, but also to goods purchase contracts concluded between a businessman and a consumer. The purchase of a yacht by a private owner would also be included in the UCC.

What is the situation for building a yacht? The private construction law is a part of the general civil law of the individual states. Only a few facets are covered by the UCC and only if the aspect of purchase of a business relation is the top priority in mixed contracts. This is often the case for a custom yacht designed and built according to the specifications and the plan of the owner, as the work performance and the service performance of the construction are predominant.

Nevertheless, the new American judiciary uses the general regulation of the UCC as far as possible for construction services, so that the UCC can be the legal basis entirely in applying the American law.

For the contract to materialize, the UCC requires the parties to sign an agreement together. Such an agreement practically represents the preliminary stage to the final conclusion. The parties shall be in a legal contract only if they have a recognizable completion contract.

By contrast, the Continental-European Law in several EU countries characterized by the Civil Law recognizes an extremely differentiated legal regulation of individual contract types. The law is highly codified and recognizes the finest of contract types and its nuances. Hence, the work contract is stipulated as a separate type of contract, where the success of the

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service–here the yacht in a clearly defined target state–is tracked and the consequences of service issues are precisely regulated.

If the parties are bound by two different national legal systems, they have an option to choose the legal system according to the international law. If no particular contractual legal system is chosen, the applicable law decides about the law applicable to the contractual obligations mostly according to the Agreement of Rome, which is replaced by the EU-Rome I decree from 17th December 2009.

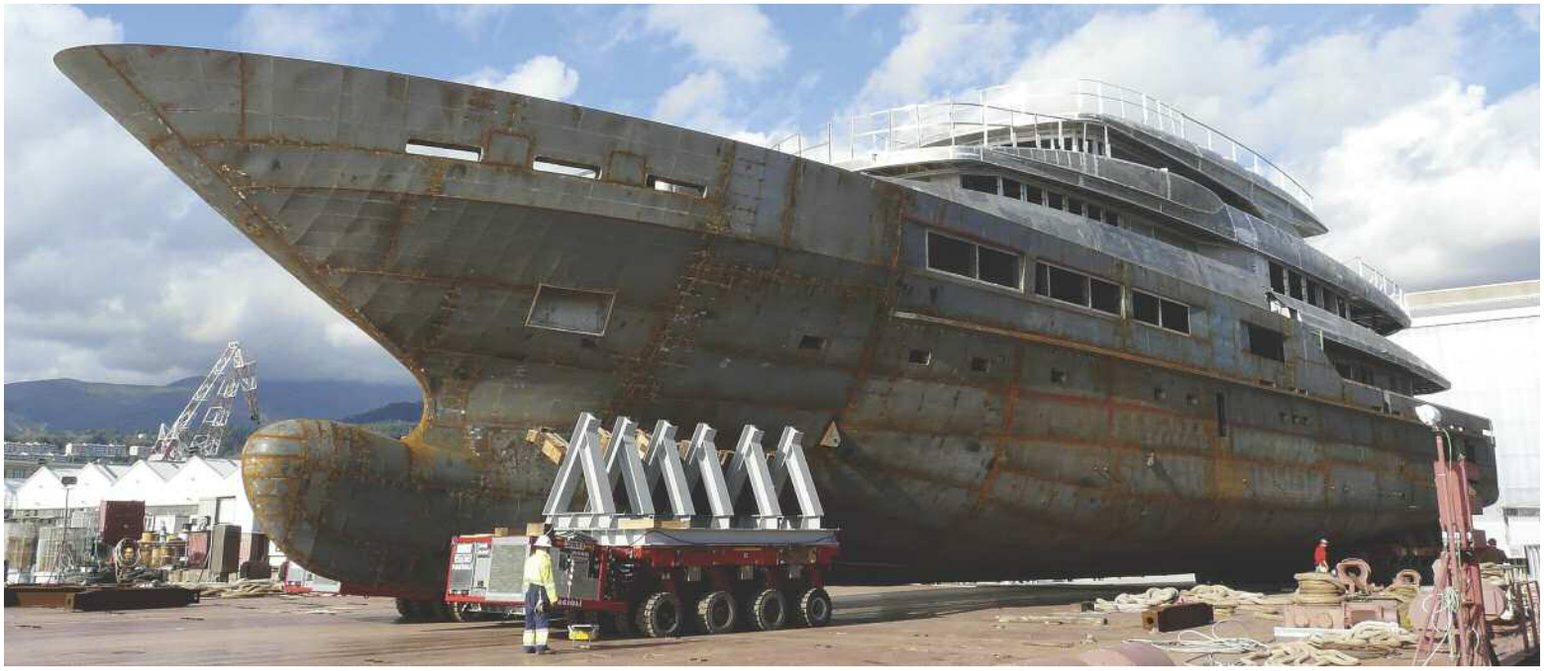
In an interesting judgement from 2010, the regulations of the applicable law for international work contracts were specified when the parties did not choose a law. Let's take a look at the case... In the following lawsuit, a French shipyard went to court against a Dutch company that had ordered the supply and assembly of two ship decks for two ships from France. The Dutch company became insolvent before the services were fully rendered. The French company was nevertheless sentenced to pay the compensation in the framework of an injunction before the French courts. In the legal proceedings, the French company asserted claims for damage compensation supported by the French Law, which is applicable on account of the place of fulfilment.

Which legal system should be employed in the event of a contractual issue between a US owner and EU shipyard? Prof. Schliessmann unravels the red tape.

The courts rejected the use of the French Law. As the parties did not choose an explicit or implicit law, the state law that the contract showed the closest association (as per ROME I decree) governed the contract. This always exists with the country in which the party providing the characteristic service has its usual residence or its head office at the time of concluding the contract. This presumption provision can be avoided only if a closer association with another country can be ascertained after considering the circumstances. Accordingly, the characteristic service that exists in the construction and delivery of the ship deck had to primarily be followed. As the Dutch company had to render this characteristic service in the Netherlands, the Dutch Law was applicable.

This was obviously a case between two countries existing within the EU community, but what if an American owner has a yacht built in EU, in Germany for example? In that case German Law would apply and specifically, the special provisions for service contract pursuant to §631 ff BGB.

There is no uniform law valid in the scope of



work/service contracts, which would state common, superordinate international provisions. The agreement of the United Nations regarding contracts for international sale of goods (in short: UN Purchase Law or CISG) is not applicable to work contracts. Applicability of a law applicable in both countries would in principle simplify law selection for the parties. The USA and most of the EU countries are partners of the CISG contract, which is then automatically the directly applicable law for international purchase contracts, unless otherwise explicitly specified. The rules of the UN Purchase law are a part of the material national law and have priority over the national legal provisions of the international private law. The advantage of validity of the law of a EU country, especially Germany, would be the detailed codification of work contracts. Therefore, the parties are required to regulate only individual special characteristics and can rely on the law as much as possible. If the parties would like to draw up a yacht construction contract following American law there are risks, primarily due to the underlying different approaches of the American and the European law of contract, mainly for the European party, hence the shipyard, amplified due to extensive casuistry of the American law of contract.

One the the most fundamental differences between the American and the highly codified European law of contract is the American law places emphasis on objective clarification value, with the other ascertainable, 'concurring intention of the party', taking second place. This can be seen particularly in the American 'Parol Evidence Rule', according to which evidences of negotiations and external circumstances before or while concluding the contract, that are suitable to justify an interpretation deviating from the objective clarification contents, are gener-

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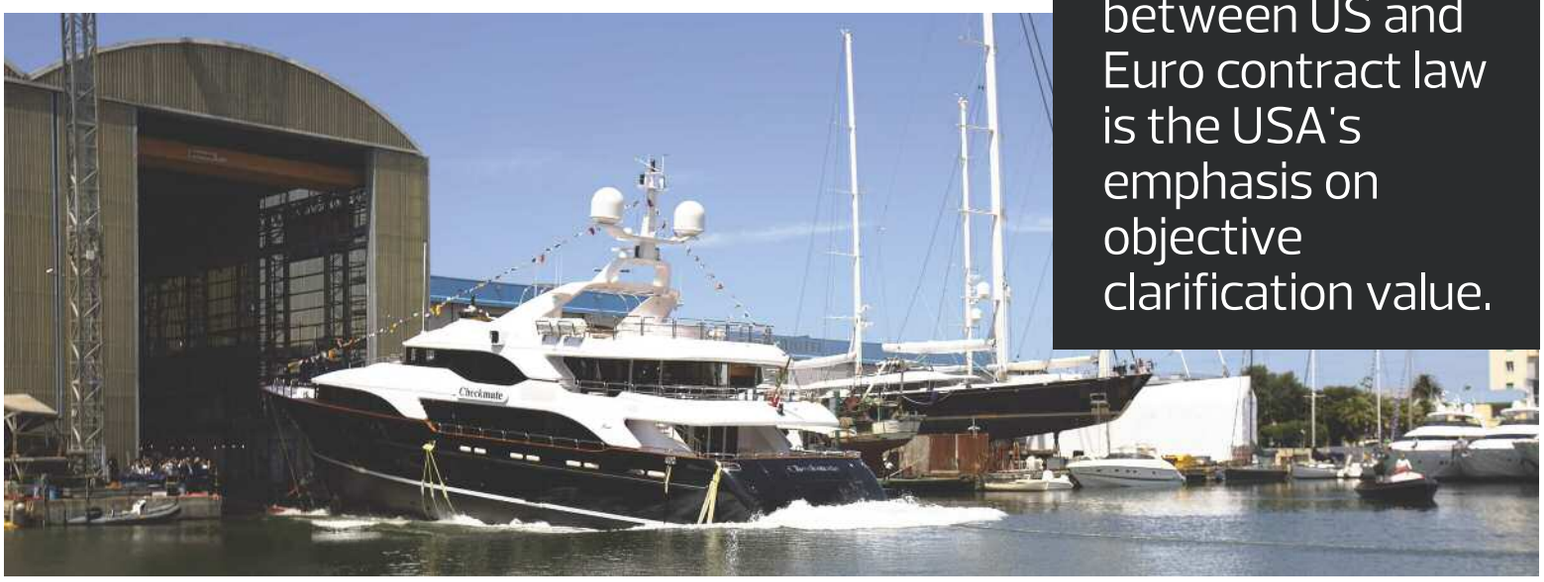
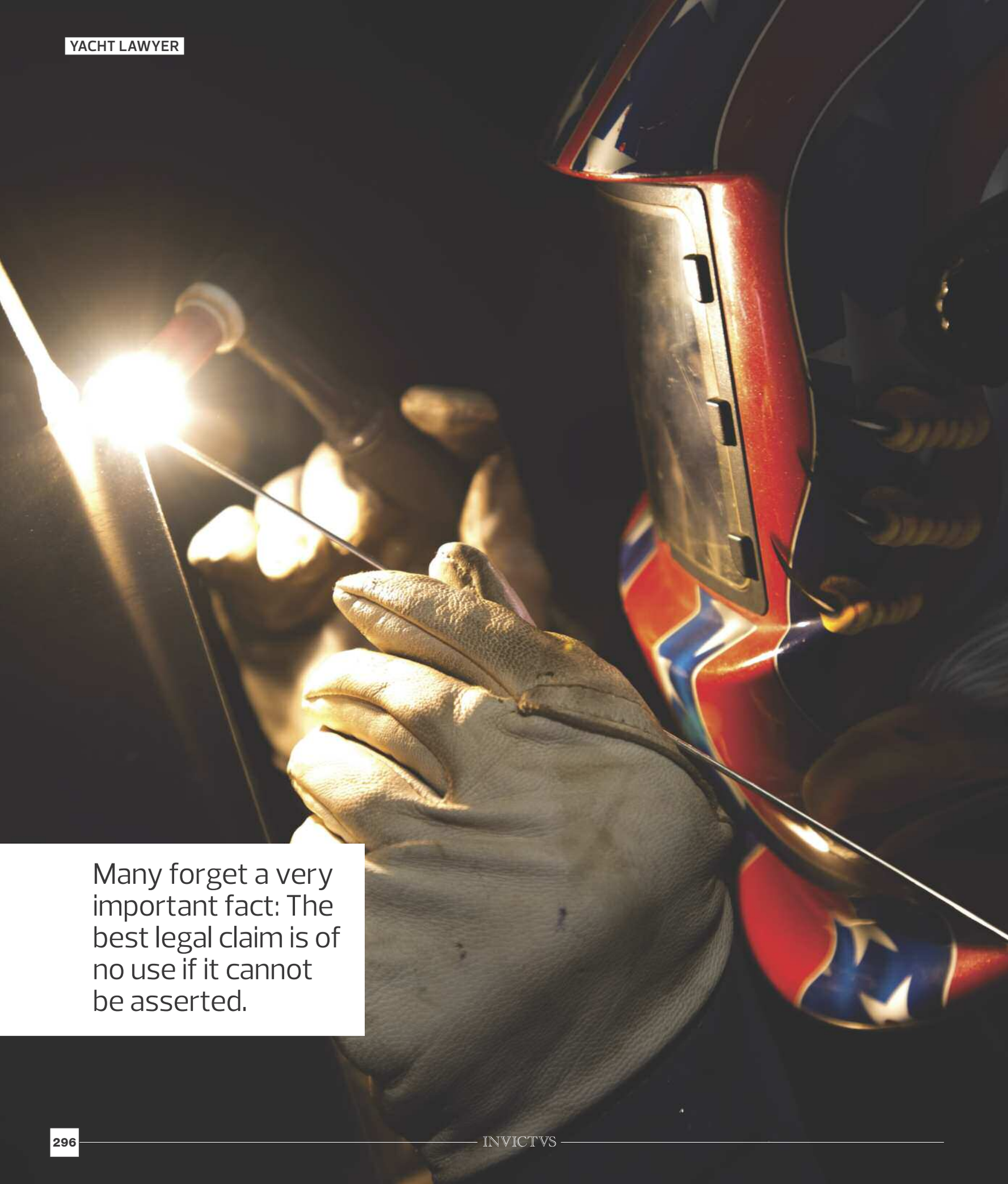




Many forget a very important fact: The best legal claim is of no use if it cannot be asserted.

For the provision of securities shipyards should have an agreement with a bank that undertakes the financial obligations in case of its inability to deliver.

ally excluded. American courts are often unprepared to allow a new interpretation of the contents of the contract, they rarely interpret according to the sense and the purpose, let alone analogies or extensions of the contract. All this leads to a disconnect between the desired results and the factual connection, and that which can be proved using evidence beyond the contract. Without a proper clarification in the contract, it is difficult to know afterwards if the actual desire arises only from the negotiation protocols.

A major problem arises from the use of American contract templates with an agreement of using another law system, in that the contract text is not set to the applicable law. Apart from the agreement of the actual service exchange, contracts serve the purpose of making agreements between parties, which deviate from the law applicable with a contractual agreement. Obviously, these deviating agreements are based on the law that it should commute. If these regulations are accepted unchanged by agreeing to use another law, it can result in regulations being accepted that do not lead to the desired results (or overlook the adding of regulations), which would be absurd according the American law but desirable, or even extremely necessary, according to the applicable law or even vice-versa.

The highly versatile promises of the contract parties in American contracts, create the impression of an extremely extensive protection among Europeans. For example, in American contracts in the instance of a violation according to the regulations, damage compensation is only acceptable in cash. An obligation of fulfilment or rectification would be recognized as an exception in American law only if damage compensation is not decided in cash, or payment is not suitable in any way to cover the damage. According to German law however, issues can be completely resolved in the case of defective condition, as the one who has given the assurance is obliged to rectify the condition. Hence, in the case of simple acceptance of the American contract draft rectification will be permitted according to German law, but the desired contractual purpose will not be fulfilled. In summary, when considering construction in Europe it can be said that caution is advised in concluding contracts according to the American law and in using contract templates based on American law.

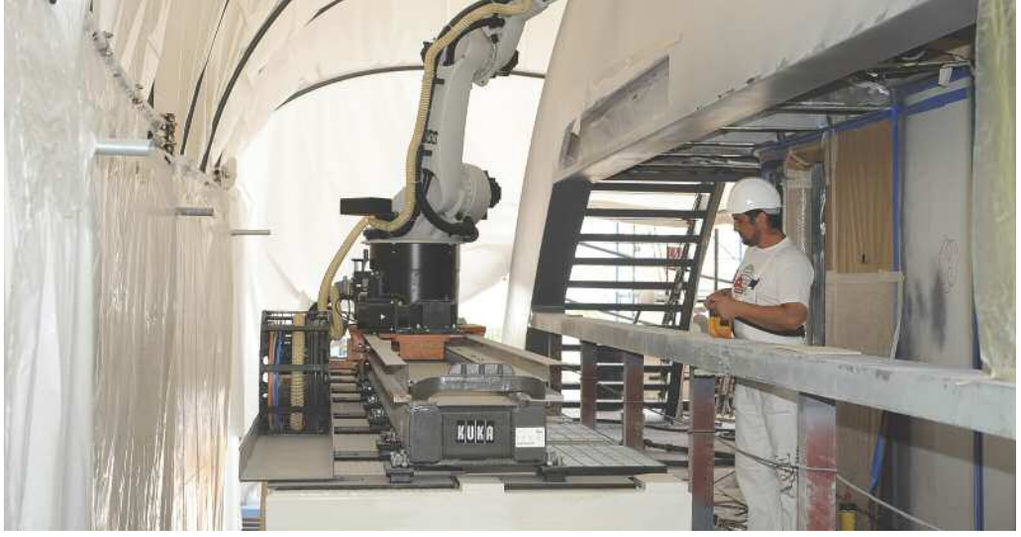
In yacht construction contract cases we often advise the choice of a practical law with dedicated regulations as a basis and to replace it with individual agreements or exclusions. This often leads to extremely well-balanced protection of the interests of the parties involved, because a win-win relationship must exist in case of a yacht construction contract and a long-term legal relationship, else conflicts would be inevitable. There is no patent solution, each individual case must be carefully considered and a suitable solution designed around that individual case.

The Contract

Having decided the legal framework within which the contract will be drawn, we then move on to the contract's contents... so what are the most important mandatory elements of a good yacht-building contract? A yacht building contract is a compendium that must cover all relevant regulation areas of a complex yacht build project, including:

- A project contract with all time schedules and milestones
- Part payment schedule
- Building contract with all specifications, surveys and approval modules
- Guarantee regulations, building insurances
- Regulations for international classification and for the following certificates to be provided by the shipyard: Engine Power Declaration, International Tonnage Certificate, Safety Construction Equipment, MCA Compliance, ISM System Classification certificates International, Suez Canal tonnage certificate, International load line certificate, Safety radio certificate, International oil pollution certificate, Shipboard oil pollution prevention plan, Certificate of Commercial Yacht Inspection, MCA code compliance, Radio Certificate, MARPOL Annex V Garbage Certificate, MARPOL Annex I, International Oil Pollution Prevention Certificate, MARPOL Annex IV, International Sewage Pollution Prevention Certificate, MARPOL Annex VI, International Air Pollution Prevention Certificate and Anti-Fouling Systems Certificate
- The General Terms and Conditions of Business.

Central idea-specific service contract law, like in Germany, is the necessary acceptance of the work as con-



Due to the complexity and intricacy, there are no ready-made yacht construction contracts. It requires a very competent, thorough and far-sighted analysis and collection of the facts important to the parties to secure their interests.

tractually compliant. Payment is only due if the passing of the risk is on the buyer and the guarantee period of a predetermined length commences. The shipyard is liable for fulfilment until acceptance as contract-compliant and has time to rework till the contract-compliant status is reached. In practice, part payments are made by the buyer of the service. That means the owner makes the already substantial payments until acceptance of the work, to be able to accept the ordered yacht at the end as contract-compliant. A lot can happen in the long run–from delay up to insolvency of the shipyard. To protect the buyer from this, there are regulations for the following special topics, apart from many other regulations:

Construction and performance security: During the warranty period, the shipyard should be under obligation to provide a security, for example a bank security, for the instalments to be paid plus 10 percent of total construction costs that would provide security in case of failure in (partial) rendering of service. Even when the yacht is sent for repairs, 10 percent is retained as security, especially from warranty obligations of the service provider, in accordance with the contract. In the worst-case scenario, a construction security protects the customer against being presented an unusable and unfinished yacht with no refund of his/her payments. For the provision of securities, the shipyard makes an agreement with a bank that undertakes the financial obligations in case of its inability to deliver. Furthermore, the customer is also secured against any possible transparency claims of subcontractors of the shipyard against the yacht customer.

Force Majeure: The issue of risk regulation in case of force majeure–such as fire, earthquake etc.–is an interesting one as should such an event happen it could cause major disruption and delays. For this the shipyards regularly contract construction insurances. However, it must be ensured that the customer is also included as a claim holder of the insurance benefit and the claims are passed on to him/her in case of insolvency of the shipyard.

Regulations regarding penalty for default in case of delays: This relates to the delay during construction, up to acceptance, as well as for warranty works and reworks after acceptance. With regards the construction phase, the maximum permissible duration of a delay, the circumstances in which delay is tolerable, and the duration of delay exceeding which the customer can duly assert the right to withdraw, must also be specified. A right of reverse transaction must also be proportionate in case of a yacht, i.e. the ultima ratio. Otherwise, provisions for discounts must be made. This is particularly important when the yacht cannot be accepted as specified in the contract because it does not fulfil certain agreed quality criteria, demonstrates defects or is not true to the specifications.

In case of necessary reworks after acceptance, it must be specified when and how the reworks will be carried out, when the execution by substitution of a third party can be contracted at the expense of shipyard, and when does the compensation for damages, if any, arise.

Community of joint creditors/third-party beneficiary contract: The shipyards often assign part of the work and work supplies to subcontractors. Here, the customer should obtain a direct claim to subrogation of rights against a subcontractor, which secures the customer if the shipyard should fail. This is important not only during the construction phase, but also after that, i.e. during the warranty period.

Extended warranty period: In yacht construction, the warranty period generally begins at the acceptance of the entire yacht and is not associated with partial construction phases. A contract to renew the warranty period after repairs or exchange of parts, e.g. motors, is advisable.

Additional guarantee: Due to defective performance, many legal claims in EU legal systems are applicable only if the defect in any work supplies was essentially already present at the time of acceptance. In an individual guarantee provision, the service provider guarantees that a particular service shall have a particular composition during the warranty period. Repairing site for a defective yacht: In German law, for instance, the Federal High Court of Justice has ruled that the place of fulfilment for repairing of a defect in the yacht is, in case of doubt, always the place where the object to be repaired–the yacht–is present, unless agreed otherwise by the parties. Thus, it seems logical from the owner's point of view to make distinct regulations in this regard.

Liability for resulting damage, indirect damage: Damage scenarios are rarely predictable. Contracts having Anglo-American characteristics often include the liability of a service provider for far-reaching resultant damages and indirect damages. As far as the yacht is concerned, one must think logically here as to what is practical, apart from the completion and proper functioning of the yacht. I had seen a case where the owner had invited 500 guests to a yacht's christening ceremony on Ibiza and organised a $-million dollar party, believing in the adherence to the completion date in the given time frame. A violation would have resulted in enormous penalties and damage compensation for the expended travel costs, etc. Here, the shipyard would have been obligated to bear these losses in case of delay.

Lastly, an effective jurisdiction clause or agreement to arbitrate is inevitable taking into account the enforceability of titles in case of international contracts. The best legal claim is of no use if it cannot be asserted.

Conclusion:

Due to the complexity and intricacy, there are no ready-made yacht construction contracts. It rather requires a very competent, thorough and far-sighted analysis and collection of the facts important to the parties to secure their interests. For a win-win situation, a regulation compendium should be prepared which regulates all the scenarios of work relationship in a foresighted manner and essentially defines clear solutions and responsibilities for the case of default or conflict.