

# THE YACHT

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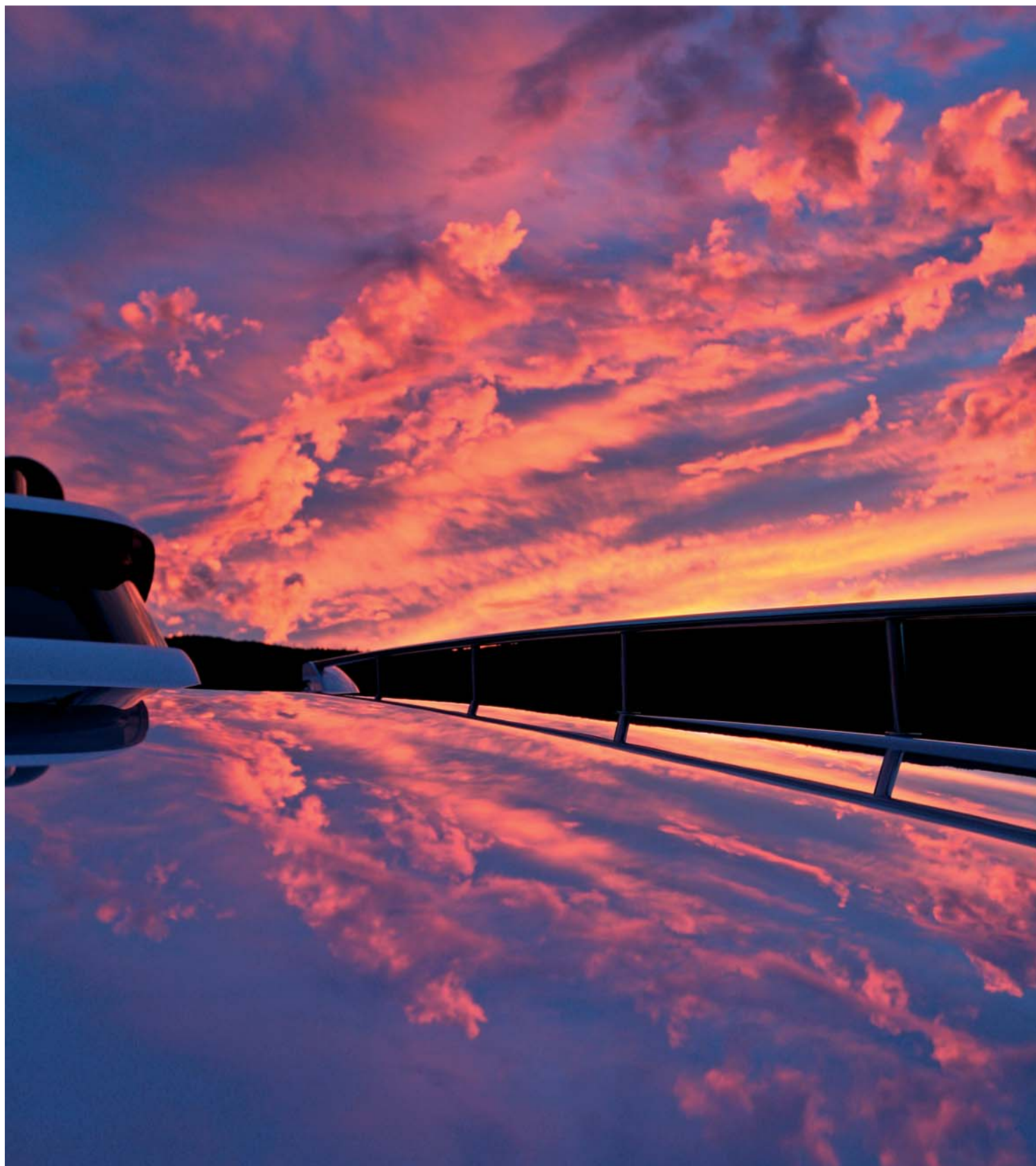
# report

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# Beware Sharp Clause(s)

## AVOIDING PITFALLS IN YACHT CONTRACTS

Two of the more useful tools used in the construction of the superyacht are the spec and contract. Elsewhere on page 121 we have two academics' conclusions on our industry drawn from three years of research within which they discovered how subtle even sociological aspects of cooperative ventures like yacht building work (or don't). Here we have the considered view of a legal professional on the documents that provide (or should provide) strict and accurate definitions of the yacht and responsibilities of all involved with contract and spec. We discover what to look out for in contracts and though this subject will be well understood by our legal colleagues it is a more obscure subject – even a black art – for those outside of the legal profession. Dr Stefan Schrandt-Zimmer of Dabelstein & Passehl in Hamburg gives an overview of these aspects and attempts de-mystification of one half of the contract/spec duo.



Shipowners and shipyards find themselves in a unique situation prior to, and in the course of, the construction of a superyacht. On one hand the yard faces severe competition almost worldwide, on the other the Owner must clarify his demands and pick the right yard for the project he intends to build. In the ideal case, both sides join forces and establish a product the Owner and the yard are happy with – the yard having the

additional bonus of strengthening its market position. Before such successful outcome, both parties will have to identify what is to be built and develop a contractual relationship that suits them and reflects their individual positions. This article, in the form of a very short review, intends to identify the core elements of such contractual relation and to explain how the mechanisms work to achieve a satisfactory result.

## Particulars and Principal Characteristics of the Yacht

Any design of a yacht will require of the yard, as a contractual responsibility, to engage in a comprehensive evaluation. In consequence, the yard will be responsible for the technical design development and the structural design, (usually) including the hull shape design provided this isn't something that the shipyard won't do. At an early stage the Owner will decide who to retain for the aesthetic design (and conceptual styling) of the yacht. It may still be an option for the Owner to convince the yard to assume overall responsibility including the aesthetic side; however, Owners may prefer to maintain full control over the exterior and interior design during construction. Owners will be aware of the interface that is created as a result of their contractual relation in two directions, one with the yard and the other with their designers.

If the yard has excluded the aesthetic elements from its design responsibility under the building contract, it will have to ensure that the Owner's architects and designers provide their styling and designs on time. Owners must ensure that the yard is under an obligation to give them notice if any aspect of the design provided is likely to adversely affect the construction, for example giving rise to permissible delays, which will have time and cost implications.

The rules of the classification society and the applicable laws of the flag administration in force or published on the date of the building contract are other guidelines for the construction. Provided that the yacht is not designed to carry more than 12 passengers or is greater than 3,000 grt, then both parties have to ensure that the yacht is designed (if for commercial use) in compliance with the current MCA code of practice (and not as a passenger ship). It is of vital importance that the Owner understands the latest MCA regulations. If the yacht is more than 3,000 grt then the shipyard must understand and be able to build to SOLAS. Furthermore, the Owner must also understand the restrictions of SOLAS.

The principal characteristics of the yacht will be defined in detail under the specification. The careful and professional preparation and negotiation of such a document is of vital importance. It is understandable that any yard will specify its work as detailed as possible and practicable in order to make sure that the contract is fulfilled. An Owner, though, may prefer a more general description of technical requirements and demands. Both parties are well advised to apply professional scrutiny not only to the contract but also to the technical specification. As a matter of fact, this document contains contractually relevant wording, and may therefore give rise to endless discussions and legal disputes if not

drafted carefully. It is important that there is no language either in the contract or the specification, which conflicts with each other. It is not uncommon for a poorly drafted specification to contain contractual obligations which are either not contemplated in the contract or add confusion to what is already in the contract.

The Owner is well advised to define clearly the quality requirements by qualifying each part of the yacht according to the highest international yacht standards, and additionally to refer to a reference vessel (or ideally multiple ones) reflecting such standards, and selecting the right suppliers within the maker's list to be agreed with the shipyard; however, international yacht standards and reference yachts are not fool proof. Reference yachts can disappear, change beyond recognition and their value can be diminished at the time when they are most needed. Equally the phrase "international yacht standards" is a pretty meaningless phrase. At the end of the day the Owner's technical advisors should attempt as best they can to provide for the Owner object measurable standards of quality, which can be tested by a third party – paint being the obvious example. In the alternative, provided all parties are agreed, reference samples can be built and kept to check future work.

In respect of the latter, the parties may negotiate the procedure should the Owner prefer a particular supplier other than the one named by the shipyard. Any cost, performance or schedule changes as a result hereof will be identified by the shipyard as being for the Owner's account unless otherwise agreed. The Owner will secure his position by leaving sufficient space and time for a change of decisions during the construction period. It is stipulated in most contracts that the Owner shall not be in direct contact with the suppliers; however, he will rely on his experience and preferences in relation to the major components anyway.

## Approval of Drawings including Design

To the extent Owner's approval is required for the construction drawings and further technical information of machinery and equipment, the yard will allow a certain period of time for Owner's assessment, failing which the drawings will be deemed approved. The shipyard will limit any comments and supplements by referring them to the modification clause under the yacht contract. Such questions should not be at the sole discretion of the yard, and in case of any dispute in the approval procedure, the Owner and its supervisors will do their utmost to convince the yard to incorporate the supplements. If the Owner's team does not prevail the yard may continue to build the yacht based on the original drawings; however, the shipyard should not

unreasonably ignore reasonable changes by the Owner and continue to build based on the original drawings. There would be a danger for the shipyard that they may be required to re-do work they have already undertaken in order to incorporate the demands of the Owner and the shipyard would risk losing any claims for permissible delays.

The shipyard will define the construction process and the specific activities through a master construction schedule and a detailed action list. These documents, *inter alia*, require the timely provision of all exterior and interior design drawings. The yard will seek permissible delays as a result of any delay in delivery of such drawings and also for additional costs caused by such delay. For the Owner it is essential to work out a suitable procedure for the approval/adjustment/rejection of the overall and detailed design supplied by his contract designers. The right to reject should be limited to a clear and material non-conformity with the specification and the construction drawings, otherwise



the yard will, again, be entitled to permissible delays for any deviation caused by the designers. Again, if the dispute continues and is not settled within a few days, it should be referred to an expert's final and binding decision. Until then the yard may continue with the construction on the basis of its own assessment, without considering the designer's position. It is important to clarify in advance which consequences may arise should the dates shown in the yard's progress documents not be met.

Generally the yard will ask for permissible delays and the Owner may secure his position by specifying the action requirements and limiting any further liability in relation to costs. It goes without saying that the contracted designers will have to comply with the action lists and other yard requirements if practicable. But this is a different story.

## Delivery Condition

Close to the delivery date, the Owner has to satisfy himself that the yacht is built in compliance with the expected requirements. As good practice, both shipyard and Owner will sign a delivery protocol, attaching a rectification list of defective components to be remedied or compensated commercially. Apart from this, Owners may be entitled to refuse to take delivery if the performance, function or appearance of the yacht materially constrains the Owner's use and enjoyment of the yacht. Both sides will secure their well-understood positions in this context with a suitable and mutually agreed definition of what "material" should mean. It is clear from the outset that where the safe operation or seaworthiness is adversely affected the Owner will reject the vessel. The same applies to the classification society not issuing its certificate or if the flag administration determining non-conformity with its rules and refusing registration.

Apart from decisions made by class or flag, the Owner and his supervision experts may identify significant (material) failures which leave behind a very frustrated Owner. Thus the contract may include a cost limitation for remedying defects beyond which the Owner is entitled to reject. The sum will normally be below €1.0 million, considering both the Owner's and the yard's background. Occasionally an Owner may seek to reject or, to be more accurate, delay delivery where there are so many minor defects that when taken together they compromise the Owner's use and enjoyment of the yacht. This could be, for example, if the Owner's shower does not work, if there are cracks in the marble, or screws loose etc, which as individual items would not give right to a delay but if all together the overall effect is to diminish the utility of the yacht, then the Owner will not accept delivery. This is a rather controversial view and one that shipyards will often fight to exclude from a contract.

Another common quality issue is the paint finish. A defective finish normally entitles the Owner to refuse to take delivery. In case of deviating opinions between the parties the paint finish should be referred to the decision of two independent experts to unanimously determine whether the paint finish of the yacht meets the specification standards. If it does not the shipyard will be obliged to rectify any sub-standard paint and will also be exposed to the Owner's right to reject in total if the experts identify visible detachments of topcoat or a significant deviation in colour or gloss (from the parameters to be specified).

Again, the yard will ask for permissible delays as a result of any dispute and rectification efforts (plus liability for costs). Owners, however, are in a good position to

require fulfilment of the specification (including paint finish) prior to delivery without granting the yard's request.

## Allowances and Modifications

It is at the ultimate discretion of the Owner whether to accept allowances or PC sums. The shipyard, in close cooperation with its (experienced) suppliers, may identify areas of work which do require a budget; however, if the Owner chose an experienced shipyard he needs to be convinced as to why allowances should be given. A good example is the audio visual equipment (as well as galley equipment, carpeting and wall coverings or other special effects) which some Owners may prefer to order by themselves to maintain control of suppliers and their results. If Owners believe they have safeguarded their position by relying on a detailed description of the relevant area of work, they may be surprised in the end when the bill is presented for the extras beyond the allowance given. On the other hand the shipyard, facing comprehensive requirements from the Owner and his designers sometimes, has no alternative other than asking for an allowance. It is an issue to be carefully considered and developed prior to and in the course of the construction period.

Modification or change orders are another core element of any yacht contract. Although it may be said that the parties are doing better without any modification, change orders are a reality and should be handled with great care on both sides. Needless to say that no change order should be implemented without a prior written agreement comprising costs, time and other consequences. Sometimes as a matter of fact, certain "undesired" mechanisms may work between technicians on both sides consenting on a technical level without giving consideration to the commercial aspects and implications for the client or yard. The outcome of this will almost always be for the benefit of the yacht; but regarding costs, project managers on both sides will have to keep tabs on this as well.

There are many examples where Owner and shipyard are discussing the *need* for a change order. Why is this? The answer can be given after closer look at the specification. The wording of this document is often quite general, leaving space for interpretation and dispute. One of the best ways to control change orders is to review the original specification several times to make sure that all the items, components and quality expectations are described correctly.

## Liquidated Damages and Warranties

*(For those who may not know, the term, liquidated damages are damages in which the amount recoverable in the event of a specified breach – for example late performance – is agreed at the date of the contract.*

*It is wrong to talk about penalties – the courts will not enforce a penalty, they will enforce a genuine pre-estimate of loss, which is effectively what liquidated damages are – Ed*). Shipyards will be prepared to agree on the terms of liquidated damages for *delay, speed deficiency, range and noise and vibration deficiencies*. Particularly, the latter will have to meet – literally – Owners’ expectations for quiet enjoyment. A further important decision is necessary when it comes to determining the overall aggregate limitation for liquidated damages; shipyards keep this in the range of a percentage of the contract price. Within the range of deficiencies where liquidated damages are payable, the Owner will not be entitled to reject the yacht. As regards delay in delivery, the circumstances of *force majeure* are intensively discussed. Shipyards will negotiate to extend the possible cases of “further” circumstances beyond their control, whereas Owners have to make sure that those are to be qualified in the context of the enumerated cases (“Acts of God”). The parties may further agree that faults in heavy casting or forging or damage to the vessel which is not directly attributable to the shipyard, may be regarded as a *force majeure* circumstance.

The shipyard's warranty should include a maximum warranty period, also depending on what the subcontractors are willing to agree. The shipyard itself may

limit its responsibility to the repair or replacement of defective part; however, special attention is to be given to costs of dry docking (normally borne by the shipyard with some exceptions) and the issue of *paint warranty* which should include the making good of defects in the exterior coatings (for example blistering, discolouration, defective finish). Both parties should finally be aware of the consequences if they agree on terms of limiting warranty claims including direct or indirect damages.

## Summary

The parties must satisfy themselves of the rights and obligations of the yacht contract at an early stage when carefully considering and addressing the core aspects outlined above. If it is clear from the outset and during construction what both parties intend to achieve and expect from the other side, superyacht newbuilding has a well-founded contractual basis, which will sustain both parties in a professional relationship beyond the construction period.

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**Dabelstein & Passehl**

**(and John Leonida from Clyde & Co. for his additional expertise)**

Opening image: istock.com

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