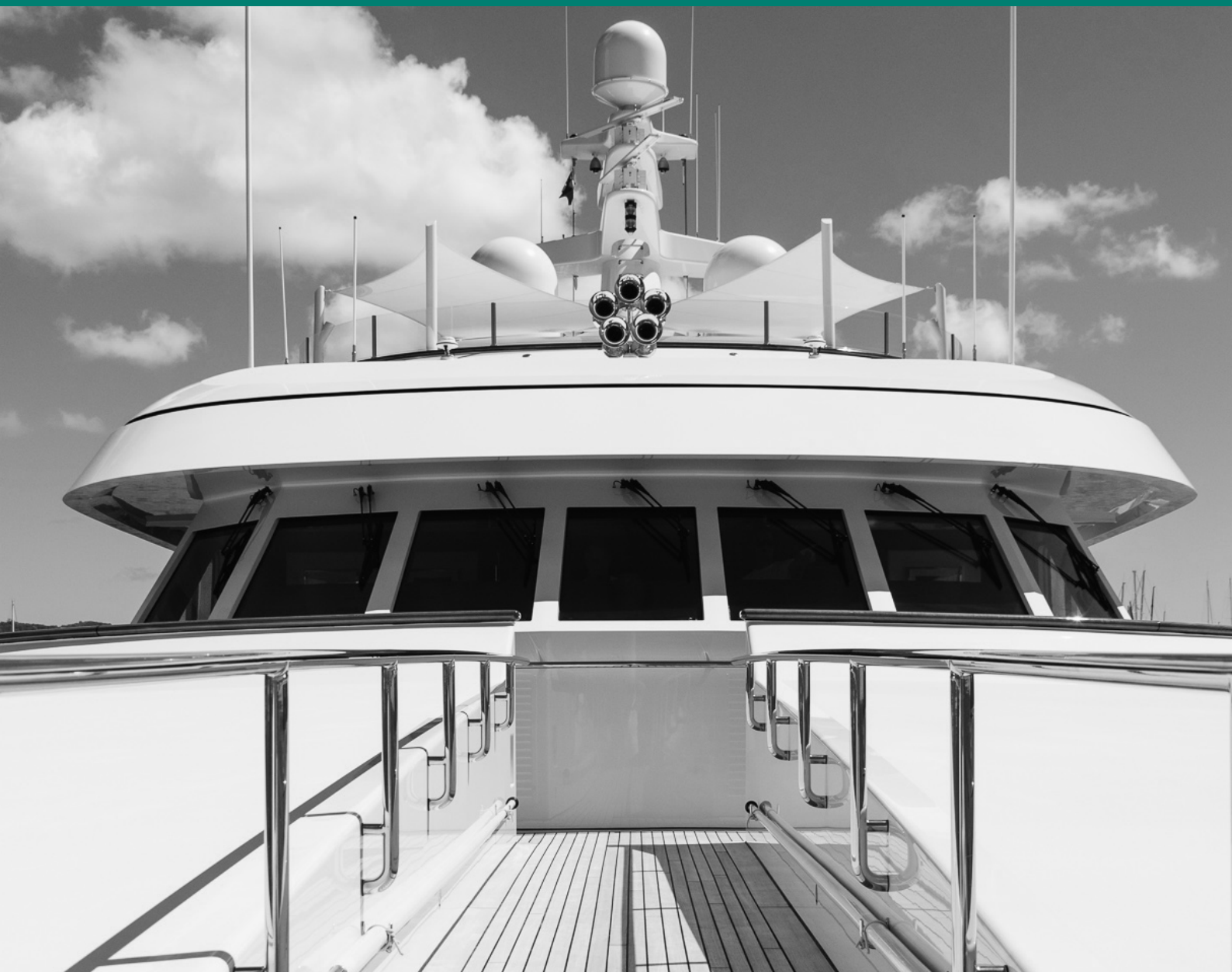
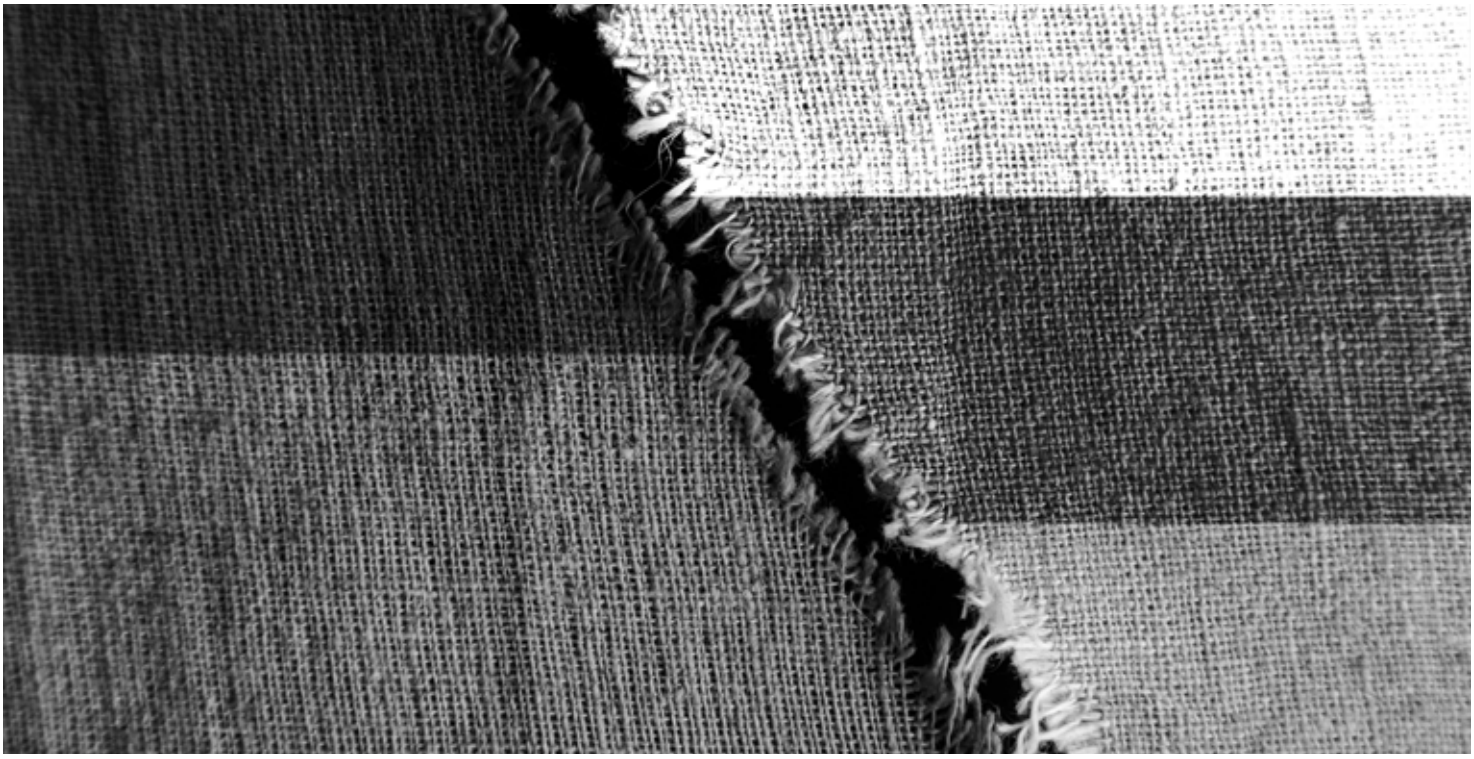


COMPREHENSIVELY YACHTS
HFW YACHTING INDUSTRY BRIEFING



Our yacht team remains busy on all fronts; however, the impact of Russian sanctions has been felt everywhere. Supported by our global regulatory team, we have been actively advising, often on an extremely time pressured and sensitive basis, a wide cross-section of stakeholders in the yachting industry on the application of the complex international framework of sanctions related rules and regulations and the mitigation of their impact on their businesses and operations. It is therefore natural that we begin this briefing with an overview of the international Russian sanctions framework and its impact on the yachting industry.

The market in second-hand yachts remains active, albeit with the limited supply of vessels available for purchase, particularly in Europe, impacting its prospects for 2022. It is against this backdrop that we review the Mediterranean Yacht Brokers Association's long-awaited and recently published update to their standard form memorandum of agreement.

The fallout from Brexit continues to impact the yachting industry and next we analyse its particular consequences for marine insurance.

Moving across the Atlantic, in the wake of a recent change to Brazil's import tax rules, we share a brief update from our Brazilian colleagues on the Brazilian yacht market. Finally, sticking with the Americas, we take a look at the prospects for the recently launched United States Virgin Islands international ship registry.

As ever, should you have any questions on the content of this briefing or any other matter, please do not hesitate to make contact with a member of the HFW yacht team.

“Sanctions have been imposed in a series of waves in the weeks since the invasion and it is expected that they will continue to be expanded. It is likely that they will remain in place for some time to come.”

Russian Sanctions and the Yachting Industry

As the readers of this briefing will be only too aware, the UK, EU, US and other countries including Australia, Japan and Canada have imposed unprecedented measures against Russia in response to the invasion of Ukraine and subsequent events.

Sanctions have been imposed in a series of waves in the weeks since the invasion and it is expected that they will continue to be expanded. It is likely that they will remain in place for some time to come.

The West’s response has led to the development of many new sanctions measures, and regulators have been deploying whatever tools they might have at their disposal. These include targeted actions against the alleged kleptocracy of specific individuals, wide ranging regulations restricting the sale of goods and technical services, and port bans for all vessels legally or beneficially owned by Russian entities or nationals. Some of these moves specifically target Russian oligarchs, whilst others are more generally aimed at disrupting the Russian economy. The yachting industry has been particularly, though not uniquely, hard hit and those servicing it have had to navigate a raft of unintended consequences. A significant number of important contracts have been suspended or terminated and job losses have already been reported. It is anticipated that further consequences will be felt by the industry in the weeks and months to come.

Sanctions

The UK’s sanctions regime is based on the UK’s Russia (Sanctions) (EU Exit) Regulations 2019 (the **Regulations**), which amongst other things impose an asset freeze on the assets of designated persons, by making it an offence to deal with the funds or economic resources owned, held or controlled by a designated person. Those who find themselves holding funds belonging to or suspected of belonging to a designated individual or otherwise providing services in breach of a sanctions regime should take immediate advice.

The Regulations also prohibit the provision of “technical assistance” for the benefit of a designated person in respect of an aircraft or ship. Of course, there have been questions on what constitutes technical assistance and this is something that must be looked at carefully on a case by case basis.

The Regulations apply to all UK persons, no matter where in the world they are based and all conduct in the UK. The same can largely be said of the sanctions regimes of other jurisdictions. Whilst most companies are ready to comply with the rules of the jurisdiction in which they are incorporated, regard should also be had to the rules of any other jurisdiction in which they operate and the jurisdictions from which their employees originate.

For example, UK persons providing yacht management services to a yacht in the ultimate beneficial ownership of a designated individual whilst in the course of their employment by or directorship of a yacht management company would likely be in breach of the Regulations, whether or not the management company itself was subject to their jurisdiction.

Crew

Equally, UK persons serving as crew in technical roles on board yachts belonging to designated individuals may well find themselves in beach of the Regulations. We are not aware of any exemptions or carve outs being granted by the UK for UK seafarers and accordingly any UK person still serving on a yacht ultimately beneficially owned by a designated individual should take legal advice as a matter of urgency.

Those serving on the yachts of designated individuals have faced

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real difficulty getting paid their wages. No manager is able to lawfully disperse the funds of a designated individual and, equally, no bank is likely to act on such instructions to pay or otherwise release any such funds to the intended recipient without a licence being granted by the competent authorities. Those looking to secure payment for services rendered may need the support of appropriately qualified legal counsel.

What are the consequences of a breach of sanctions?

The consequences of failing to comply with such regimes are varied but in all cases serious. Those in breach of UK sanctions find themselves exposed to the risk of either criminal liability, including, depending on the offence, imprisonment of up to 10 years for trade sanctions and 7 years for financial sanctions and / or unlimited fines. Civil penalties may also be imposed. The penalties for breaching EU sanctions vary across EU member states, but breaches are in most instances criminal offences. The EU is currently developing proposals to make sanctions evasion an EU crime allowing for the ready confiscation of assets. The US takes an active approach to enforcement and has powers to impose substantial civil fines and custodial sentences of up to 30 years.

Due Diligence

With the complex ownership structures employed in yachting, the current situation has prompted many to re-assess who their client really is. Under the Regulations, the offence occurs where the UK person has reasonable cause to suspect that they are dealing with the funds or economic resources of a designated person. A yacht is likely to be considered an economic resource. When assessing the situation, regard should be had not just to the title chain but also to whom instructions are received from, who makes or on whose behalf is payment made and who uses the yacht. At the time of writing, the UK is shortly due to implement a strict liability regime for the imposition of civil penalties for breaches of the UK financial sanctions. This will make it all the more important to undertake substantive due diligence. It will no longer be a complete defence to not have known or not had reasonable cause to suspect that you were dealing with a sanctioned person.

There is much speculation that the situation may have long-term implications for the yachting industry, with, in the future, a greater focus on transparency and, at least in some quarters, a reduced appetite for taking on clients from those jurisdictions perceived as being more high-risk, so called “de-risking”.

Contractual Impact

Whilst a handful of sale and purchase transactions fell away in the early days of the war as buyers baulked at purchasing Russian yachts or sanctions otherwise prevented the deals from proceeding, we are now seeing plenty of buyers interested in taking advantage of what they anticipate will be the bargains to come. However, we are not seeing large numbers of Russian yachts come to the market and this, combined with the difficulties of putting together such deals (for example, few are currently willing to act as stakeholder in such a deal), will likely limit the number of buying opportunities for the time being.

The situation has been far more difficult for those shipyards with ongoing newbuilding and refit and repair projects. The impact of any sanctions designation depends on the jurisdiction making such designation, whether the project or significant suppliers to the project are based in that jurisdiction and the governing law of the project’s contracts. For example, it might not be illegal as a matter of EU law to continue the construction of a

yacht in Germany, but where the UK Government has sanctioned the ultimate beneficial owner of that project and the contract is subject to English law, such a designation will result in that contract being frustrated and thus automatically terminated.

In addition, the EU's prohibition on (among other things) the supply of vessels to persons, entities or bodies in Russia, or for use in Russia,

has impacted on the delivery of a number of projects, with some still suspended, whilst others were delayed while the shipyards and subcontractors sought the consent of local authorities to continue.

We have not yet seen the Ukraine war and ensuing sanctions prompt the widespread cancellation of charters that we saw in response to the pandemic. However, a range of other contracts including refit and repair contracts, ship building contracts, yacht and crew management agreements and design agreements have been affected. As the waves of sanctions continue, more and more shipyards, yacht managers or other service providers are likely to find themselves in the position of having their clients sanctioned. Where this does occur, robust legal advice should immediately be obtained on their obligations and the winding down of any affected contracts. Whether directly affected or not, many of those who do not already include sanctions clauses in their contracts are now taking steps to do so.

Insurance

We have seen the widespread cancellation of hull and machinery cover for Russian owned yachts, with owners given limited notice within which to procure alternative cover. With little spare capacity in the London and European market, many owners have had to look to alternative markets to procure cover or otherwise elect to self-insure. Of course, self-insurance is not an option for P&I cover and though P&I clubs have to date been slower to unilaterally withdraw cover, where the owner of a yacht is sanctioned, we would expect all cover (including P&I) to be cancelled on a contractual basis. In the absence of a contractual right of cancellation, the asset freeze would likely prohibit the receipt of premium and payment of claims. Where an insurer is unable to pay as a result of sanctions affecting the insured, the insurer's obligation to pay is suspended until the applicable sanctions have been lifted and such suspension will not serve to extend the time bar on claims (which is likely to be 6 years).

Seizure

Large yachts belonging to wealthy Russians have attracted a disproportionate amount of attention from the authorities, the press and the public. We have seen yachts detained in jurisdictions as widespread as Croatia, Italy, France, Fiji, Germany, Gibraltar, Spain, the Dominican Republic, the Netherlands and the UK.

The language used variously describes such yachts as being seized, detained, confiscated or arrested but the effect in each case is broadly similar. Local authorities have stepped in for a range of reasons but in each case, by one means or another, prevented a yacht from sailing. We are not aware of any such actions, to date, amounting to the forfeiture or confiscation of a yacht, which in most jurisdictions would likely require a change in law and certainly mark a fundamental change of approach to the application of sanctions. As discussed above, however, the EU appears to be taking steps through the creation of a new 'EU crime' of sanctions evasion and its 'Freeze and Seize' task force to move away from the historically non-confiscatory nature of sanctions. How this will translate in practice (and in law) remains to be seen.

> “The new MYBA MOA represents a big step in the development of the yacht industry and the changes are significant.”

However, most of these yachts are likely to find themselves idle for some time to come and in some cases their maintenance, especially in the case of those yachts actually subject to sanctions, is likely to become an increasing headache for the local authorities and the owners of any facilities in which such yachts are located.

Conclusion

The impact of the West’s response to the Russian invasion of Ukraine is likely to go on being felt by the yachting industry for some time to come. Indeed, if, as is to be expected, more and more high net wealth Russians are added to the lists of individuals designated by the US, EU and UK, that impact is likely to increase as are the unforeseen consequences for those servicing the industry and the accompanying need to take extreme care not to be caught on the wrong side of the law.

A new MOA for Yachting

It was in 2008 (prior to the global financial crisis), when MYBA last published an update to the MYBA Memorandum of Agreement (MOA), the standard form sale and purchase agreement used in the yacht industry. The years since 2008 have seen significant changes in the regulatory framework applicable to banks, brokers and other professional advisers involved in yachting transactions. They have also seen the industry subjected to varying economic cycles and the effects these have on the supply and demand for yachts. The 2008 MYBA MOA, which was drafted in the context of a less stringent regulatory regime and a less developed market for legal services within the yacht industry, has increasingly felt out of step with the reality of the sale and purchase process, so there was some anticipation when MYBA announced the publication of an updated form of its MOA. The new MYBA MOA represents a big step in the development of the yacht industry and the changes are significant. We analyse a selection of the key changes to the contract below:

Seller’s Warranty

The seller’s warranty has been extended to expressly include a warranty that the yacht is not subject to a VAT liability or to any claims from charterers arising prior to the time of its delivery. Presumably, a corresponding update to the MYBA form of Personal Guarantee will also be published at some stage so that the two documents dovetail in this respect.

Inventory

The inventory must now be agreed by the parties at the point of contract signature. This has the disadvantage that the buyer must agree the inventory before it has had the opportunity to Sea Trial the yacht, but it does, at least, reduce the scope for an inventory dispute to arise post-contract signature, as was the case under previous versions. For many buyers, an exclusion list of items which are not included in the sale would be more informative than the inventory itself and it is a shame that the current update did not take the opportunity to address this. It is also unclear why the MOA specifies that the inventory shall not include the ‘personal effects’ of the yacht’s beneficial owner. Given that the MOA no longer contains the requirement that the inventory should include ‘everything belonging to the Vessel’, these two changes combined mean that sellers are at liberty to exclude whatever they want from the sale.

Risk

The update takes the opportunity to make clear that the yacht may be used following the buyer’s Sea Trial for such things as positioning her for the Condition Survey or for the trip to the agreed place of delivery. While these points were certainly implied under previous versions, these are sensible clarifications which reflect logistical realities.

Condition Survey

The MOA now allows the buyer to collect oil samples as soon as the deposit has been paid. This addresses a practical issue which frequently arises under the previous form of MYBA MOA, in that the analyses of oil samples which are collected only at the commencement of the Condition Survey are often not available by the time the buyer must give its post-survey notice.

The contract also now expressly provides that, where the buyer rejects the yacht, it must pay the fuel costs incurred by the seller in positioning the yacht for the Condition Survey and in any operational trials carried out during such survey. While this was impliedly a buyer's cost under the previous MOA, in practice these costs were rarely recovered by sellers. The merits of underlining that these fuel costs are for the buyer's account are debatable in circumstances where the buyer will effectively be rejecting the yacht due to a defect of some severity, of which it was not aware when making its offer for the vessel. This clause also looks set to increase the administrative burden on stakeholders and the likelihood of disputes arising around deductions made when it comes to the return of the buyer's deposit.

Curiously, one area where the MOA has not been developed is in relation to the inspection regime and the associated ability of a buyer to reject a yacht following the Condition Survey. In this regard, the buyer's right to reject a yacht (or alternatively to notify defects discovered during survey) is still predicated upon the buyer's surveyor certifying that the yacht suffers from a defect which, in the opinion of that surveyor, sufficiently impacts its seaworthiness or 'operational integrity'. During periods when it has been a buyer's market, buyers have frequently required that the discretionary right to reject the yacht should be maintained until after the Condition Survey has been completed – a position which is entirely standard in the US market. Many practitioners had previously proposed that the standard form contract could easily be amended to provide for two alternative clauses (in the manner that anyone who uses the shipping industry's standard form contracts produced by BIMCO will be familiar with), allowing the parties to agree which regime should apply to their transaction. Perhaps, unsurprisingly, given that this is a brokers' form, the MOA sticks with the previous formulation, which is the arrangement most likely to keep a buyer 'on the hook'!

Force Majeure

The MOA now significantly increases the notification requirements imposed on a party seeking to rely on force majeure and makes that party's right to the benefit of a force majeure delay conditional upon the timely notice having been given. The MOA also sets out that, where the Completion Date is extended by more than 30 days due to force majeure, the unaffected party shall have the right to terminate the MOA.

Stakeholder

The protection given to the stakeholder in respect of its dealings with the deposit is now significantly increased, although the update stops short of providing that (other than where the deposit is released to the seller upon completion of the sale) the stakeholder should act in accordance with the joint instructions of the parties. Some further support for stakeholders, placed in the invidious position of having to try to reconcile the contractual provisions with the facts of a case, in circumstances of conflicting instructions from the parties would have been welcome.

Due Diligence Documentation

Greater support for stakeholders and other industry professionals is to be found in the form of a long overdue

“While the UK formally left the EU over two years ago, and the transition period expired nearly 18 months ago, insurers and intermediaries in both the UK and the EU are still feeling the implications of Brexit.”

amendment obliging the seller and the buyer to provide the various ‘Know-Your-Client’ documents that have become customary to anyone involved in the industry. This move towards greater transparency will help to head-off the difficult and sometimes irreconcilable requests for these documents that we have all encountered from banks and others involved in transactions very late in the day, possibly even subsequent to completion having occurred.

It will additionally assist participants in the industry when meeting resistance from clients who have yet to adapt to today’s more stringent regulatory environment. The flipside of this is that stakeholders (and more pertinently their compliance departments) are now under a duty to confirm to the parties within a specified deadline whether their due diligence requirements have been satisfied, failing which the MOA will automatically become cancelled. With these amendments and the heightened obligations and risk involved in holding funds under the MOA, it seems inevitable that (outside of the brokerage community) the practice of stakeholders making a separate charge for their services and documenting their services in a standalone stakeholder agreement (both of which are standard in the commercial shipping industry) will become more widespread.

In short, the new MYBA MOA represents a significant change from the previous standard form but, as is perhaps understandable, the change is not as wholesale or wide reaching as it might have been.

Brexit Consequences for Yacht Insurance

While the UK formally left the EU over two years ago, and the transition period expired nearly 18 months ago, insurers and intermediaries in both the UK and the EU are still feeling the implications of Brexit.

One of these implications is the cessation of “passporting” between the UK and EEA countries. “Passporting” previously allowed an insurer or its intermediary located in the EEA to do business in the UK without need for a separate authorisation. An insurer or intermediary which was authorised in, for example, Spain that wanted to do business in the UK could simply “passport” its Spanish authorisation to the UK, instead of having to apply for separate UK authorisation.

As a result of “passporting” ceasing at the end of the transition period, EEA insurers and intermediaries must now consider carefully whether they need to apply for separate authorisation in the UK in order to carry on activities in the UK. UK insurers and intermediaries will need to do the same in respect of activities in the EEA.

The circumstances in which authorisation is required differ from jurisdiction to jurisdiction. The UK regulations require an insurer or intermediary to be authorised in the UK only if it carries on regulated activities in the UK. The fact that a risk is situated in the UK or that the yacht in question is registered in the UK does not determine whether UK authorisation is required. However, the reverse position applies in certain EEA jurisdictions.

The question of where an insurer or intermediary “carries on” regulated activities is a technical one,and is not as straightforward as whether or not an insurer or intermediary is physically in the UK. In addition, even if an insurer or intermediary is within the scope of UK regulation, exemptions/exclusions can apply in certain situations. It is this uncertainty that has caused a number of yacht owners and their brokers real difficulty when placing new or renewing existing insurance cover. This has caused frustration on occasion but until the dust settles on the new arrangements, insurers or their intermediaries should continue to take legal advice when they think that they may be undertaking activities in the UK (or the EEA) without the necessary authorisation.

Brazilian Update

With its attractive climate, beautiful cruising grounds and diverse sights, Brazil has long been a destination for yachts exploring from the northern hemisphere. It is, however, far more than just a destination and there have been a number of efforts over the years by members of the international yachting industry to access Brazil's large and growing domestic yachting market.

Some of those efforts have been more successful than others but one of the major barriers for anyone looking to sell yachts to the Brazilian domestic market has always been the 20% import tax levied on all yachts under 30 years old imported into Brazil. The Brazilian Federal Government's inclusion, in late 2021, of sailing boats of all sizes, including those with auxiliary engines, in Brazil's List of Import Tax Exceptions will therefore be welcomed both by Brazilian sailors and those building sailing yachts outside of Brazil. The aim of the exemption is to stimulate Brazil's maritime tourism industry and accordingly the exemption also includes jet-skis and a range of other water toys.

The exemption does not apply to motor yachts and it remains to be seen whether the Government has the appetite for a further expansion of the exemption list. In the meantime, many Brazilians will go on owning and operating their motor yachts outside of Brazil and though internationally owned motor yachts may continue to enjoy all that Brazil has to offer provided they hold a temporary admission permit, they cannot stay within Brazilian territorial waters for more than 180 days and should not be sold whilst in Brazil, nor undertake any commercial activity whilst there.

With offices in Rio de Janeiro and Sao Paolo, we are well placed to assist anyone with any yacht related matters in Brazil.

A US Open Registry?

On 1 February 2022 the Governor of the U.S. Virgin Islands (the USVI) signed an agreement with the Center for Ocean Policy and Economics (COPE), run by the Massachusetts based private maritime college, Northeast Maritime Institute, to establish and run the US' first open or international ship registry.

The US coastwise trade laws, commonly known as the Jones Act, require that vessels engaged in the coastwise trade meet specific US ownership, build and manning requirements. As such, foreign registered vessels cannot conduct coastwise trade.

Whilst the Jones Act is most commonly associated with the commercial shipping industry, the Jones Act would also apply to yachts engaged in commercial operation in the US. As such, there are comparatively few large yachts registered in the US.

While the USVI registry is still in infancy, this new registry is key to the implementation of COPE's Revitalization Plan for US Maritime Trade, Commerce and Strategic Competition and is the first of the six proposals they make for how the US commercial maritime sector might be revitalised. For full details of the plan see: A Revitalization Plan for U.S. Maritime Trade, Commerce, and Strategic Competition - COPE° (thecope.org).

The new registry is distinct from the existing US registry maintained by the US Coast Guard and its establishment raises some interesting legal questions. Indeed some commentators have questioned whether US law permits such move. However, as a US territory and not a US state, the USVI do not act under the authority of the US Federal Government and may be entitled to develop such a registry. However, it is not clear whether the US Federal Government, the US Coast Guard and, indeed, the Classification

Societies and insurers are supportive of such a development.

Private pleasure yachts may cruise US territorial waters, if in possession of a cruising licence, but commercially operated yachts may only do so where they are compliant with the Jones Act. The Jones Act prohibits transportation of merchandise or passengers between coastwise points in the US on any vessel that is not: (1) owned by US citizens; (2) built in the US; (3) documented under the laws of the US; and (4) crewed by US licensed mariners. This effectively closes the commercial operation of large yachts between US ports to all but a handful of vessels.

Though the Jones Act carves out an exception for the USVI, which allows the transportation of merchandise and passengers between the USVI and US ports on non-US flagged vessels without a coastwise trade endorsement, in the absence of a change in US law vessels registered in the USVI would not be entitled to engage in US coastwise trade in the US.

With a range of established international registries already available, until the USVI as a jurisdiction for registration becomes more attractive to the owners of yachts and commercial ships than those existing international registries, for example by granting them the ability to operate more freely in the US than they can under the flag of one of the existing international registries, the USVI may find it hard to attract the owners it needs to get this project off the ground.

If you would like to discuss any of the matters raised in this edition of Comprehensively Yachts, please contact your usual partner at HFW or any of the team below.

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The HFW yacht team has been an integral part of the yacht industry for over 30 years and has a physical presence in many of the major yachting jurisdictions. The enduring relationships developed with the owners, builders, designers, financiers, insurers, brokers and managers of yachts, our in-depth knowledge of the yacht industry and our international reach ensure we are pre-eminent in the field. For more information on HFW's yacht team and the services we offer, please see **www.hfwyachts.com**