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Vessel Donations Increasing with a Recovering Economy

We have recently experienced in our transactional practice an increase in the number of clients, with the guidance and input of their trusted brokers, seeking to donate their vessels. We believe the charitable contribution option has garnered increased attraction from our clients and their brokers in that it may ultimately present either (1) a better value for their yacht or (2) a more efficient disposition for their yacht. For the yacht brokers that may be involved in such vessel donations (and especially for those that coordinate and complete the paperwork), we simply wanted to highlight herein some of the important considerations that should be made as well as potential issues that we have seen in our recent yacht donation transactions.

1. Qualified Organizations: Although a simple concept, a vessel donor must donate its vessel to a qualified organization recognized by the Internal Revenue Service ("IRS"). A qualified organization generally includes the common non-profit 501(c) (3) organizations, but may also include foundations operated exclusively for educational purposes. The IRS publishes and maintains a current list of such qualified organizations – it is best to quickly check and verify that the organization with which you are dealing is in fact a recognized qualified organization.

2. Qualified Appraisal by a Qualified Appraiser: Assuming that a vessel owner is donating a vessel that is valued at more than \$5,000, the donor must obtain a qualified written appraisal of the vessel by a qualified appraiser. Although the IRS code expounds somewhat on the meaning of "qualified", a vessel donor and their broker must carefully consider the qualifications of the surveyor and the quality of the resulting appraisal. We have seen in the very recent past a vessel donor's deduction disallowed for this very reason.

3. Vessel Donation Agreement and Requisite IRS Forms: A vessel donation agreement between the vessel donor and the charity is essential as it confirms each party's responsibilities and terms and conditions under which the vessel donation is being effectuated. Further, several IRS forms and a charity generated form must be properly completed and filed with both the charity and the IRS; and there are filing deadlines on each of the forms which vary depending on the facts and circumstances of each vessel donation.

4. Significant Intervening Use and/or Material Improvement: Invariably these terms are mentioned when talking about vessel donations, and rightfully so. Per IRS guidelines, if a donor donates a boat (a qualified vehicle) to a charity (qualified organization) and the donor claims a deduction of more than \$500 (generally the case with yacht donations), then the donor can deduct the smaller of (1) the gross proceeds from the sale of the vessel by the charity or (2) the vessel's fair market value on the date of the contribution, with the EXCEPTION that if the charity makes a significant intervening use of or a material

improvement to the vessel before transferring it, then the donor can generally deduct the vessel's fair market value at the time of the contribution.

The obvious question of course is: what constitutes a significant intervening use or a material improvement? The answer: it is a fact based analysis that hinges upon the unique facts and circumstances of each vessel donation and the charity's plan for the vessel. You often hear of charities leasing (chartering) their donated vessels for a time certain and providing options to purchase upon/near the conclusion of the lease (charter). Depending on the leasing structure and operation of the vessel (i.e. activity/use during the charter), such a structure may draw scrutiny from the IRS, and could lead to an IRS audit and potential deduction disallowances.

Depending on the facts and circumstances, vessel donations can be a very attractive alternative to an outright sale (which, depending on the yacht, could take a measureable amount of time), and we commend the brokers presenting this option to their clients. As we have highlighted above, there are a number of considerations that must be made and details that cannot be overlooked. Please feel free to give us a call to discuss the facts and circumstances of any potential vessel donations, and we are happy to answer any questions or queries generated by our summary above.

By Steven A. Clark (sclark@bohannon.com)

Basic Overview - Maritime Liens and Rank

A maritime lien, with the exception of a preferred ships mortgage, is a secret lien that arises by operation of law automatically and gives the lienholder a property right in maritime property (for example, vessels) and the right to foreclose the lien in admiralty. It is not created consensually and there is no requirement that a maritime lien be recorded or otherwise perfected by any filing. A preferred ships mortgage, on the other hand, is a maritime lien that is created consensually, must comply with the requirements of Title 46 of the United States Code and must be recorded at the National Vessel Documentation Center. If a vessel is eligible for federal documentation, the preferred ships mortgage offers the best achievable protection to a lender requiring collateral to secure a debtor's obligations. That protection is not absolute, however, and certain classes of maritime liens, "preferred maritime liens", rank ahead of a preferred ships mortgage.

Generally, competing maritime lien claims are first ranked according to class. The classes are, from highest priority to lowest, the following:

1. Expenses of justice during *custodia legis*—expenses arising from the care and operation of the ship while it is in the custody of the Court through the U.S. Marshal (not regarded as a lien, but given priority).
2. Seamen's liens (including those of the Master) for wages, maintenance and cure; and wages of longshoremen directly employed by the vessel.
3. Salvage and general average liens.
4. Tort liens, including personal injuries.
5. Preferred ship mortgage liens (U.S. flag vessels).

6. Liens for necessities under 46 U.S.C. §§ 31301(4), 31341 and 31342
7. State—created liens of maritime nature.
8. Maritime liens for penalties and forfeiture for violation of Federal Statutes.
9. Perfected non-maritime liens, including tax liens.
10. Attachment liens in causes of action within the admiralty and maritime jurisdiction (foreign attachment).
11. Maritime liens in bankruptcy. See United States v. One (1) 254 Ft. Freighter, M/V Andoria, 570 F. Supp. 413 (E.D. La. 1983).

The rules governing ranking of maritime liens were originally entirely created by the common law of the federal courts. Later legislation has modified, but not replaced, common law ranking rules. See 46 U.S.C. § 31301 (5) (defining preferred maritime liens as a maritime lien on a vessel that arose before recording of a ship's mortgage or items 2 through 4 on the ranking list); See also USC § 31326 which provides:

“the preferred mortgage lien, including a preferred mortgage lien on a foreign vessel whose mortgage has been guaranteed under chapter 537 of this title, has priority over all claims against the vessel (except for expenses and fees allowed by the court, costs imposed by the court, and preferred maritime liens)...”

Accordingly, four categories of maritime liens rank higher than a preferred ship's mortgage and liens which are “nonmaritime” (see item 9 above) rank behind a preferred ship's mortgage. Item 9 includes liens arising under the Uniform Commercial Code, vessel mortgages that do not fulfill the qualifications of a preferred ship mortgage under the Ship Mortgage Act, and federal tax liens as well.

It is essential for parties involved with the transaction of vessels, both new and used to have a thorough understanding of claims and/or competing claims of interests for vessels in commerce. The above gives you a very basic outline of classes and ranking of maritime claims of lien. We have a broad base of knowledge and experience representing brokers, lenders, builders, retailers and owners of vessels domestically and internationally, and would be pleased to assist you and your group with any maritime lien issues.

By David M. Bohannon (david@bohannon.com)

Advising Yacht Owners – Teamwork is Key

Our goal in this industry is to provide to our clients the very best in service and guidance, and ultimately gain each client's continued confidence and trust. Meeting the objectives of the specific transaction in a timely and cost effective way is paramount. The quintessential key to accomplishing this goal is establishing a trusted team of advisors that can address each of the many facets of ownership and operation that face both new and seasoned yacht owners. Our firm recently co-hosted a Connecticut Shoreline Yacht Summit with some well known and highly regarded industry constituents, and

overarching theme of each of the presentations was the combined teamwork of each of these integral team members:

1. Yacht Broker – introduces the client to the yachting experience; provides guidance and confidence throughout the yacht finding, purchasing, owning and selling experience.
2. Documentation Specialist – ensures proper documentation/registration of the yacht and the recording of a lender's mortgage; provides annual renewals and follow-up.
3. Insurance Specialist – recommends and secures proper coverage for the ownership and operation of the yacht.
4. Lender – provides expertise, guidance, and options for clients in marine vessel financing both in construction and for purchase.
5. Yacht Management – provides both the smaller and larger yacht owner with the comprehensive guidance for the operation and maintenance of the yacht.
6. Captain and Crew – an experienced and knowledgeable captain and crew can maximize the owner's and its guests' use and pleasure of the yacht.
7. Legal Counsel – Marine Industry recognized counsel maintains oversight in all legal aspects of the construction, purchase, sale, documentation/registration, financing, insurance, management, taxation and operation of the yacht.
8. Survey- an experienced and industry recognized marine surveyor is of course critical for the required due diligence for any condition review of a vessel as appropriate. Surveyors have specific expertise and should not be charged beyond their credentials or specific expertise.

The continued interaction and collaboration by the team members should provide to yacht owners more cost-effective and comprehensive guidance throughout the client's ownership and operation of their yacht. Expertise and disciplines are distinct as generally outlined above and the best interests of the client are not served when an advisor exceeds their qualifications to offer advice or direction outside of expertise albeit with the best intentions. "As heard on the dock" may not be the most accurate information to pass on to a client or rely upon.

Constituents to a transaction are serving the best interest of their client Buyer or Seller and need to be mindful of their duty of loyalty. In our experience, regardless of client engagement, team members can call upon other team members at any given time to pose questions or secure guidance – a collaborative system which ultimately supports the overall strength of our industry and the level of expertise that we can offer to both current and potential yacht owners.

By David M. Bohannon & Steven Clark

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NOAA's Right Whale Ship Strike Reduction Rule – Recent Federal Enforcement Efforts Against Private Yachts

The National Oceanic and Atmospheric Administration (NOAA) recently issued an informal notice of violation letter to the former manager of a recreational yacht for alleged violation of the Right Whale Ship Strike Reduction Rule. NOAA passed the Rule in 2008 to protect endangered North Atlantic right whales. The Rule requires all vessels 65 feet and longer to travel at a speed of 10 knots or less in specific areas along the East Coast of the United States during certain times of the year. The only instance in which a vessel may exceed the 10-knot speed limit is if the yacht needs to go faster to maintain a safe maneuvering speed. If this is done, the vessel pilot/master must be sure to enter the action in the logbook with the specific information as proscribed by the Rule.

The speed restrictions apply in areas defined as Seasonal Management Areas (SMAs), some of which extend out to 20 nautical miles in and around major ports, including but not limited to Cape Cod (Great South Channel SMA), Block Island Sound, Montauk Point, Ports of New York/New Jersey, Delaware Bay, Chesapeake Bay entrance, and the continuous area between Wilmington, North Carolina to Brunswick, Georgia (Mid-Atlantic SMAs). SMAs were established for calving and nursery grounds, including the area bounded to the north by latitude 31°27'N; to the south by latitude 29°45'N; and to the east by longitude 080°51'36"W (Southeast SMA). NOAA's Compliance Guide includes precise coordinates for the SMAs boundaries and the corresponding time frames which apply to each SMA. The guidance can be reviewed at http://www.nmfs.noaa.gov/pr/pdfs/shipstrike/compliance_guide.pdf.

While the Rule itself is not new, NOAA's enforcement efforts against a recreational yacht are a recent development. After the issuance of the Rule on December 9, 2008, NOAA began to issue notices of violations to commercial vessels for allegedly violating the seasonal speed limits. A violation of the Rule is a violation of the Marine Mammal Protection Act and the Endangered Species Act. Penalty assessments in some of those cases have ranged from \$11,500 to \$92,500, depending on several factors. It is uncertain how aggressive NOAA will be pursuing civil penalties from recreational yachts. We are aware of one instance in which NOAA alleged violations of the speed restriction using AIS navigation charts between 2010 and 2011 to determine a vessels speed in protected areas. If you receive a letter from NOAA or a notice of violation, you should seek advice on responding to same to discuss mitigating your potential penalty exposure (as NOAA has enforcement discretion depending on various circumstances).

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