BOHONNON LAW FIRM

THE RIGHTING MOMENT

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INSOLVENCY OF A YACHT BUILDER-BUYER'S BEWARE

By Dean W. Baker

The insolvency of a builder of custom yachts in the United States raises significant risk to the "financing buyer's" interest in the vessel under construction. A "financing buyer" provides financing to the shipyard to build the vessel by making payments in installments, typically at agreed-upon milestones of completion. It is generally the case that buyers, entering into construction contracts that have a duration of more than a few months, have no way of predicting the financial health of their builders. Moreover, within the last year, we have seen cases of reputable builders who could no longer pay their bills and perform existing construction contracts for previously agreed-upon fixed prices. Well known builders that have recently experienced financial distress include Christensen Shipyards, Ltd. (filed receivership in early 2015), Gunboat (filed Chapter 11 bankruptcy in late 2015) and one other builder of large custom yachts that was unable to complete its contracts.

State law grants suppliers of materials and labor (to a yacht under construction) vendor liens to secure nonpayment of their bills. State law will typically dictate the procedure for obtaining and publically filing vendor liens. Certain states, however, like Washington sanction "secret liens". The liens are "secret" because they do not need to be recorded at either the county or state level. Vendor liens (including secret liens) for materials, labor, and services rendered prior to completion of new construction of a vessel are characterized as nonmaritime "dry land" liens, that, depending upon the applicable state law, have preference over all other liens and claims to the vessel. So is there anything that the financing buyer can do to protect himself? The buyer could theoretically require lien waivers from every vendor suppling goods or services and exact strict cash and spending controls on the builder who is acting as a general contractor. That level of micromanagement of a yacht build is typically not

required by American buyers and it is certainly not an industry standard at this time. Moreover, it may be difficult to procure lien waivers from sophisticated vendors who may be reluctant to issue waivers in advance of being paid. Accordingly, at some level there exists the likelihood that unpaid vendors will enjoy a lien on the vessel under construction in an insolvency situation.

At minimum, however, the financing buyer must take steps to secure the advances that it makes to the builder. Most American-build contracts provide that title to the vessel under construction resides in the builder until delivery. A fairly balanced contract will additionally grant the "financing buyer" a security interest (under the Uniform Commercial Code) in the vessel under construction to secure the builder's obligations to the buyer under the contract. The security interest is then perfected by the filing of a financing statement with the Secretary of State in the state where the builder is incorporated. We have seen form new build contracts that do not provide for the grant of a security interest in favor of the buyer. A buyer that is lulled into signing such a contract is playing Russian roulette and any lawyer who blesses such an arrangement is risking a malpractice claim.

Notwithstanding the fact that vendor liens may prime the buyer's security interest, it is critical that buyers obtain liens in order to preserve their interests in the face of any ensuing bankruptcy or receivership proceedings. Without a lien, the buyer's contractual interest (as well as all advances made by the buyer to the builder) in delivery of a completed vessel is at risk of being lost. A trustee or receiver has the power to reject the construction contract as burdensome, retain the vessel under construction and relegate the buyer to the status of an unsecured creditor in the bankruptcy or receivership proceeding -- a disastrous outcome for the buyer who might receive pennies or no dollars on account of his unsecured claim. While a security interest (to protect the financing buyer's advances) does not insulate the vessel from the reach of the vendor liens, it will protect the advances (up to the value of the uncompleted vessel) and ultimately buyer's right to foreclose its lien on the uncompleted vessel. This will allow the buyer to secure title to the vessel (in all cases where there is no equity in the vessel beyond the buyer's lien – which will be virtually all cases) if the bankruptcy trustee or receiver rejects the contract.

The other immediate consequence of a builder's insolvency is the certainty that each buyer's bargained for fixed-price contract is typically no longer possible. Buyers are faced with the choice of moving their vessels to another yard or renegotiating their contracts with the builder, in some cases for millions of dollars more than what they originally budgeted for a completed vessel. In either case, buyers understand that the original fixed price may be exceeded substantially.

The lesson learned is that at minimum any buyer entering into a construction contract must insist on securing its advances to the builder through the proper creation and perfection of a security interest granted under the construction contract. Any burden on the builder is minimal and any prudent buyer will simply walk away from a builder that balks at this requirement.

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UNDERSTANDING THE VESSEL WARRANTY

By: David M. Bohonnon

The contents and detail of the Vessel Warranty which issues in the new yacht purchase process are critically important. Often it is the case that the terms and conditions of such document are overlooked or not fully scrutinized by the Buyer in advance of closing. Part of the problem is simply the Warranty language or documentation is a mere reference in a Purchase Agreement, but does not find its way as a full exhibit in such agreement. Sometimes the Warranty is not fully conspicuous and appears on the "opposite side" of the contract labeled "Terms and Conditions" and such transparency does not appear. Frequently the language of a Warranty document can be cumbersome and/or troublesome to read which inhibits buyer comprehension.

Warranty Overview:
A Manufacturer's Warranty is contractual in nature and its explicit language and meaning needs to be well understood. The written Warranty that typically issues with the sale of a new Vessel is commonly referred to as an "Express Warranty." The written or express Warranty is issued by the manufacturer and/or supplier of the consumer product attesting that the material and workmanship of such product is free of defects and will meet certain standards of performance for a prescribed time period.

Layered over the terms and conditions of the Express or Written Warranty State and Federal laws have been enacted over time offering statutory protection to consumers in the sale of consumer products. The good news is that most Vessels can be characterized as "consumer products" under State and Federal law as to attain this extra level of Warranty protection. The statutory warranty protections mandated by State laws are known as "Implied Warranties." Implied Warranties have developed over time and interpretation through case law and legal decisions as to create minimum standards for performance of consumer products on a uniform basis. In part Implied Warranties limit commercially unreasonable disclaimers by manufacturers in the performance of their products.

The Magnuson—Moss Warranty Act:
The Magnuson—Moss Act is a United States Federal law (15 U.S.C. Section 2301 et seq.) which governs warranties on consumer products sold in the United States. The general purpose of the Act is to provide Consumers with access to reasonable and effective remedies in the case of a breach of warranty for the sale of a consumer product. Under Magnuson—Moss Federal minimum standards have been established and refined by case law for warranties. A prerequisite is that Written Warranties must be conspicuously designated.

Generally Magnuson—Moss further provides the following guidance for a "Full Warranty":

a. Manufacturers cannot disclaim the duration of Implied Warranties;
b. Warranties shall not be limited to just the first purchaser/consumer;
c. Warranty service is free of charge;

d. Replacement or refund of purchase after multiple failures to fulfill warranty repair to the consumer;
e. Consumers will have no unreasonable preconditions for receiving warranty service.

Manufacturers and Written Warranties along with Implied warranties and claims under Magnuson—Moss are hotly contested. Best advice to the consumer or Vessel Buyer is to carefully read and understand the nature and terms of the Manufacturer's Warranty in advance of your purchase. If the language is riddled by disclaimers or abbreviated you should take note.

Warranty claims can be researched against manufacturers with relative ease today, do some research. Additional terms and conditions on big ticket warranty items can be negotiated in advance of purchase, therefore you should consider this an important part of your transaction. Don't be persuaded at a sales level that there exists a "standard warranty" or that the written warranty is not open to negotiation.
We of course hope your Vessel selection and purchase is the right choice and rises to the highest level of quality and performance, be proactive in understanding the Warranty as to avoid the post-closing blues.

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STATE AND FEDERAL REGULATION OF UNMANNED AIRCRAFT SYSTEMS ("DRONES")

By David M. Bohonnon

The popularity and accessibility of drones has significantly grown in the last several years based on improved technology, affordability, and out of the box operation. For the hobbyist, backyard and field use of drones has skyrocketed. The potential commercial application of drones is extensive. Understanding the current laws and regulations for the operation of drones is critical in an ever changing regulatory landscape. Further, the operation of drones by any individual or owner outside state and federal requirements carries serious consequences.

Unmanned aircraft systems ("UAS" or "Drones") are now subject to regulation by the Federal Aviation Administration ("FAA"). Effective December 21, 2015, anyone who owns a Drone which weighs more than .55 pounds (250 g) and less than 55 pounds (25kg) is required to register the UAS. *See Public Law 112-95, Title III, Subtitle B.-Unmanned Aircraft Systems*. The UAS or Drone operated under this registration must be used exclusively as a model aircraft by the registered owner (as defined in Section 336(c) of Public Law 112-95 and 14 C.F.R. Sec. 1.1). To register your Drone, please visit: www.faa.gov/uas/registration/

Having fun and flying your UAS safely for hobby or recreation doesn't require FAA approval beyond the requirements of registration and compliance with

We are a fourth-generation law firm with over a 100-year family tradition of legal service with the maritime community. We represent clients in a wide variety of maritime and admiralty practice areas, including:

- Domestic & International Yacht Transactions & Ownership
- Yacht Documentation, Classification & Flagging Matters
- State, Federal & International Yacht Taxation
- Customs & Duty Concerns
- New Vessel Construction
- Vessel Warranty & Defect Claims
- Yacht Charter & Management Contracts
- Yacht Captain & Crew Agreement
- Maritime Liens, Arbitration, & Litigation
- Maritime Injuries and Claims

The clients we serve include:

- Yacht Owners
- Marine Lenders
- Yacht Managers
- Charter Brokers
- Dealers and Yacht Brokers
- Marinas & Boat Yards
- Yacht Manufacturers
- Ship Captains & Crew
- Family Offices

State and Federal laws. The operational limits of UAS are ever evolving with the explosion of their use, so it is critical to understand the requirements of their operation at any specific location.

Guidance for UAS "Hobby" operation may be found at: http://www.faa.gov/uas/publications/model_aircraft_operators/

A UAS is an Aircraft that Must Comply with Safety Requirements

A UAS is an "aircraft" as defined in the FAA authorizing statutes and is therefore subject to Regulation by the FAA. 49 U.S.C. § 40102(a)(6) defines an "aircraft" as "any contrivance invented, used, or designed to navigate or fly in the air." FAA regulations (14 C.F.R. § 1.1) similarly define an "aircraft" as "a device that is used or intended to be used for flight in the air." Because an unmanned aircraft is a contrivance/device that is invented, used, and designed to fly in the air, it meets the definition of "aircraft." In addition, on December 16, 2015, the FAA promulgated an Interim Final Rule (80 Fed. Reg. 78594) that defined Unmanned Aircraft, Model Aircraft, Small Unmanned Aircraft and Small Unmanned Aircraft System in 14 C.F.R. § 1.1. The FAA has promulgated regulations that apply to the operation of all aircraft, whether manned or unmanned, and irrespective of the altitude at which the aircraft is operating. For example, 14 C.F.R. § 91.13 prohibits any person from operating an aircraft in a careless or reckless manner so as to endanger the life or property of another.

Model Aircraft Operations

An important distinction to be aware of is whether the UAS is being operated for hobby or recreational purposes or for some other purpose. This distinction is important because there are specific requirements in the FAA Modernization and Reform Act of 2012, Public Law 112-95, (the "Act") that pertain to "Model Aircraft" operations, which are conducted solely for hobby or recreational purposes. While flying model aircraft for hobby or recreational purposes does not require FAA approval, all model aircraft operators must operate safely and in accordance with the law. The FAA provides guidance and information to individual UAS operators about how they can operate safely under current regulations and laws. Guidance may be found at: http://www.faa.gov/uas/publications/model_aircraft_operators/

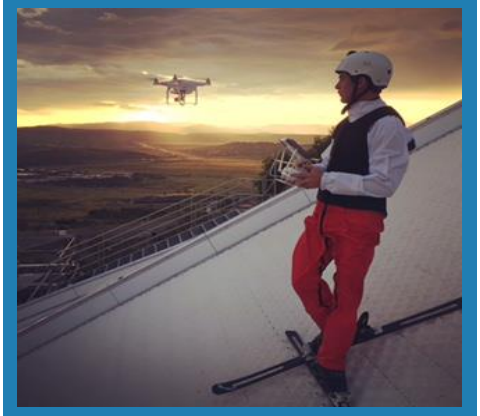
Section 336(c) of the Act and 14 C.F.R. § 1.1 define "Model Aircraft" as an unmanned aircraft that is –

(1) Capable of sustained flight in the atmosphere;
(2) Flown within visual line of sight of the person operating the aircraft; and
(3) Flown for hobby or recreational purposes.

Each element of this definition must be met for a UAS to be considered a Model Aircraft under the Act and the regulation. Under Section 336(a) of the Act, the FAA is restricted from conducting further rulemaking specific to Model Aircraft as defined in section 336(c) so long as the Model Aircraft operations are conducted in accordance with the requirements of section 336(a). Section 336(a) requires that—

(1) The aircraft is flown strictly for hobby or recreational use;

(2) The aircraft is operated in accordance with a community-based set of safety guidelines and within the programming of a nationwide community-based organization;
(3) The aircraft is limited to not more than 55 pounds unless otherwise certified through a design, construction, inspection, flight test, and operational safety program administered by a community-based organization;
(4) The aircraft is operated in a manner that does not interfere with and gives way to any manned aircraft; and
(5) When flown within 5 miles of an airport, the operator of the aircraft provides the airport operator and the airport air traffic control tower (when an air traffic facility is located at the airport) with prior notice of the operation (model aircraft operators flying from a permanent location within 5 miles of an airport should establish a mutually-agreed upon operating procedure with the airport operator and the airport air traffic control tower (when an air traffic facility is located at the airport)).



(US Ski Team Olympian and FIS Aerial World Champion Mac Bohonnon utilizing a Drone for training in Park City, Utah July 2015)

Model Aircraft that Operate in a Careless or Reckless Manner

Section 336(b) of the Act, however, makes clear that the FAA has the authority under its existing regulations to pursue legal enforcement action against persons operating Model Aircraft when the operations endanger the safety of the national airspace system ("NAS"), even if they are operating in accordance with section 336(a) and 336(c). For example, a Model Aircraft operation conducted in accordance with section 336(a) and (c) may be subject to an enforcement action for violation of 14 C.F.R. § 91.13 if the operation is conducted in a careless or reckless manner so as to endanger the life or property of another.

UAS Operations that are not Model Aircraft Operations

Operations of UAS that are not Model Aircraft operations as defined in section 336(c) of the Act and conducted in accordance with section 336(a) of the Act may only be operated with specific authorization from the FAA. The FAA currently authorizes non-hobby or recreational UAS operations through one of three avenues:

(1) The issuance of a Certificate of Waiver or Authorization, generally to a governmental entity operating a public aircraft;
(2) The issuance of an airworthiness certificate in conjunction with the issuance of a Certificate of Waiver or Authorization; or
(3) The issuance of an exemption under part 11 of title 14, Code of Federal Regulations that relies on section 333 (Special Rules for Certain Unmanned Aircraft Systems) of the Act for relief from the airworthiness certificate requirement, also in conjunction with the issuance of a Certificate of Waiver or Authorization.

It is important to understand that all UAS operations that are not operated as Model Aircraft under section 336 of the Act are subject to current and future FAA regulation. At a minimum, any such flights are currently required under

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the FAA's regulations to be operated with an authorized aircraft (certificated or exempted), with a valid registration number ("N-number"), with a certificated pilot, and with specific FAA authorization (Certificate of Waiver or Authorization).

Regardless of the type of UAS operation, FAA statutes and regulations prohibit any conduct that endangers individuals and property on the surface, other aircraft, or otherwise endangers the safe operation of other aircraft in the NAS. In addition, States and local governments are enacting their own laws regarding the operation of UAS, which may mean that UAS operations may also violate state and local laws specific to UAS operations, as well as broadly applicable laws such as assault, criminal trespass, or injury to persons or property.

If you own a UAS or Drone, register it immediately. If you are utilizing the UAS or Drone beyond the definition of "Hobby" or "Recreation", for example in a trade or business for which you derive income, understand the laws and regulations that are applicable for such use and be sure you are compliant with the same.

References:

1. U.S. Department of Transportation, Federal Aviation Administration "Law Enforcement Guidance For Suspected Unauthorized UAS Operation
   See:
   https://www.faa.gov/uas/regulations_policies/media/FAA_UAS-PO_LEA_Guidance.pdf
2. State and Local Regulation of Unmanned Aircraft Systems (UAS) Fact Sheet, Federal Aviation Administration, Office of Chief Counsel, December 17, 2015

MARINA DOCKAGE & YARD REPAIR AGREEMENTS – ENSURE YOUR VESSEL IS INSURED

By Steven A. Clark

As the vessel owner excitedly pulls into that slip at a new marina or commences an extensive refit or restoration at a trusted yard, it is essential that the vessel owner (and his/her trusted counsel) fully read and understand the terms and conditions of the dockage/repair agreement. Many times the front page of a dockage/repair agreement contains basic information including the name of the vessel owner, the vessel information, and a summary of the dockage to be secured and/or repairs/refit to be done. More importantly, typically there is a statement that the vessel owner agrees to the terms and conditions on the reverse side of the page, which oftentimes can go unread by the vessel owner and/or the captain. The terms and conditions are essential as they universally contain language which affects the rights of the vessel owner, and can ultimately impact the insurance coverage on the vessel.

The operative words of these clauses are as follows: "hold harmless", "indemnify", "defend", "waive", and "release", they directly affect liability. By way of example, such clauses would take some form of the following:

> "The Marina shall not be liable for any claim, loss, damage, or cost arising, in whole or in part, out of any injury, loss, or damage to any person or property while the Vessel is in or at the Marina. The parties acknowledge that Marina is not liable for any loss, damage, or theft of the Vessel, its equipment or any other property of the Vessel owner on or about the Vessel.
>
> Vessel Owner shall hold harmless, defend, and indemnify the Marina from and against any claim, loss, damage or cost including without limitation, attorney's fees, at trial and on appeal arising in whole or in part, out of any injury, loss or damage to any person or property occasioned by any act or omission of the Vessel Owner, any act or omission of any other person operating the Vessel, onboard the Vessel, or about or visiting the Vessel, or for any act or omission related to the Vessel. Vessel Owner agrees to release and waives any right to assert a claim against the Marina from any and all manner, losses, damages, or injuries sustained by Vessel Owner or his property arising from fire, theft, vandalism, water damage, collision, improper mooring, hurricane, severe weather (or its effects), or any other cause of action arising from the use of Marina facilities, whether occurring by reason of any act or omissions on the part of the Vessel Owner, or whether the same be caused by the negligence of the Marina, its officers, agents, or employees. Vessel Owner shall indemnify, defend and save the Marina harmless from and against any and all claims and costs, expenses, and liabilities incurred in connection with any such claim or action or proceeding brought by and behalf of any person, invitees, or entity arising from any condition of the Marina, including, but not limited to, any and all violations of federal, state, and local laws, statutes, rules and regulations (including environmental laws, statutes, rules and regulations)."

Contracts of insurance expressly do not allow a vessel owner to waive its rights as the insurer wants to retain its right of subrogation for any claims. In many instances, such "release and waiver" language violates the terms and conditions of the policy and can potentially void coverage for a loss that may otherwise be covered. It is also important to note that some insurers will exclude contractual liability (i.e. any liability assumed under the terms of an executed contract).

In order to counteract some these issues, many times an insurer will agree to some level of limitation to the language. For instance, many times we will suggest language whereby the vessel owner waives any rights to assert claims in situations where the vessel owner, captain, or any owner representatives are negligent. Conversely, we can suggest language whereby the Marina will be liable for any claims caused by the negligence of the Marina and/or its employees or subcontractors. Such limitations of the language have generally been acceptable to insurers, and the vessel

owner can then be confident that he/she and the vessel are sufficiently covered during its time at the marina/yard.

It is important to remember that every situation is different and can present unique facts; for example a vessel refit which requires "hotwork" (welding or other open flame work) presents unique risks which need to be discussed and handled by the vessel owner and insurer to ensure proper coverage. Regardless of the situation, anytime a vessel owner is contemplating dockage or a yard repair/refit, it is advisable to have such agreements reviewed by your insurance agent/insurer and legal counsel.

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Thank you for reading our firm's Spring 2016 Newsletter. If you have any questions or concerns, please contact our office, and we would be happy to speak with you.

Enjoy your 2016 Cruising Season!

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