

YACHT FISCAL

MONACO MANAGEMENT MEETING

Monday 6 October 2008 — Tuesday 7 October 2008

Day 1

LEGAL PERSPECTIVES

John Leonida	Clyde & Co
Gianfranco Puopolo	Puopolo Geffers Rosin & Bosin (PGRB)
Jay Tooker	Holman Fenwick & Willan
Panos Pourgourides	Hill Dickinson

Martin Redmayne — Chairman

Sorry about that. I'm a technophobe and I pressed the wrong button. And we'll get the air conditioning back on in a minute—I'm sorry. The final session for today is when you have 4 lawyers who will give a perspective on where the market is today, where it's been, and where they see it heading with a legal perspective. We've heard a few things about the price of legal advice, the price of contracts for the finance guys, various things on shipyard refund guarantees, so it's a fairly sort of suitable conclusion to the day for these 4 gentlemen to give their views. I'll start off with Jay, who's now taken his tie off and is looking more relaxed. Jay, thank you.

Jay Tooker Holman Fenwick & Willan

Sorry, you're probably sick of the sound of my voice after today, and I think I am. But I think what I see for the yacht market at the moment is similar activity to what we're seeing in the commercial sector, and that is after a long period where people were throwing money at the industry like there's no tomorrow and while everybody's making money, they're not really counting the euros. As the market takes pause, I think people will start counting the smaller amounts much more carefully and start scrapping over smaller amounts, and I think what I see is owners and shipyards and certainly banks who will genuinely be suffering difficulty in the market. I think there will be players trying to get out of contracts and they could be owners, buyers or sellers or shipyards, depending on how they see the deal. And I think there will be litigation over some of that because people won't be able to break their deals as graciously as they would like to. And that's been happening already in the commercial sector—as freight rates go down, everybody starts counting every dollar and fighting over it, and I expect a similar sort of thing to happen here. I think the industry will come through it—I think a lot of that scrapping will happen on the fringes of the industry; people who came into it in good times because it was fashionable and sexy, and people perceived that they could make a lot of money out of it. Some of those people will fall off the edge. The core of the business that took the opportunity of the last 10 years to consolidate their business and run it on a sensible framework will survive and will go on. There'll be a falling off at the edges, is the way that I see it.

Panos Pourgourides Hill Dickinson

Yes, I would echo Jay's comments. I think that if we are going to see some sort of pause or dip in the market then inevitably, we will be in a position of revisiting contracts that were drafted perhaps in a different environment three years ago. But I think as an industry, the industry had already matured to the point that things were

being done and done correctly. Three or five years ago, or however long ago it was, such that the impact I would hope, even in those situations where one party is in difficulty, I would hope that the impact will be limited, and that it will be possible for people to negotiate new terms or get their arrangements onto a better footing. I think the other thing one would have to say is in truth probably nobody knows exactly where we're going to be in 6 months, or a year's time. To the extent that events are still unfolding quite rapidly in the financial sector. But I think there is still this consensus that, at the very top end of the market, things seem to be quite robust and holding up quite well. I don't think it's going to lead to any sort of fundamental changes, I just think there's probably going to be, as I say, some existing contracts which will end up being revisited, and I think contracts that are still being done today are probably going to be looked at that little bit more closely. But I don't think there's anything fundamentally wrong or flawed in the way that deals are being done at the moment such that it needs a correction. A pause for breath might be no bad thing in some ways. We shall see.

Gianfranco Puopolo Puopolo Geffers Rosin & Bosin (PGRB)

The way I see it also is that, until recently, it was quite common to see owners entering into contracts for more than one, or two, yachts at the same time, putting options to build several new builds. Right now, with the change obviously in the financial markets, this actually doesn't happen any more or so often. And obviously, people are much more cautious than they were before. We're assisting already in a situation where owners cannot actually comply with the obligations of the contract or with the obligations in the letter of intent and so on, and obviously they try to step out from these contracts by assigning this contract or letters of intent to other potential owners. This is something that again, we have already seen in the last, I would say weeks or months, it's something which is absolutely real and should also make us think in terms of how to amend the yacht building contracts by providing for clauses which will assist the shipyard. Specifically, in the case the owner will not perform. Obviously, likewise it is very difficult for the shipyards to obtain the financing which is necessary in order to guarantee the owners, where it is difficult for the owners to obtain financing, in the case of this individual needs bank finance –on the other side it is obviously very difficult to provide the owners with refund guarantees and the amount they expect because, once again, the recourse to financing is becoming more and more difficult, and therefore these negotiations of contracts become extremely tough right now. But again, I also think that in reality, nothing really major will change in consideration of the fact that the people normally involved with this type of industry, namely the owners, are obviously wealthy individuals, so generally speaking do not really need the type of financial assistance than other people in a smaller type of yacht industry would require.

John Leonida Clyde & Co

The observations the panellists made, that things don't really have to change that much from a contractual point of view, is a fairly accurate reflection that the contracts we have in place, be they build contracts, be they sell-and-purchase contracts, are pretty much OK. What we are beginning to see a change of is, rather than the contract being stuck in the desk drawer and ignored for 3 or 4 years while the ship is built, it's now on the desk of the shipyard, and every possible permissible delay the shipyards are sending notices out in a way that they didn't do before. It's requiring on the owner's side a lot more diligent management of ship building than we've ever seen before, and in a sense this, what Jay was saying about people watching the pennies, is accurate. And the shipyards are realising that they can only make money if they build ships more efficiently, and as a consequence we're now seeing the

contracts that we all draft being scrutinised and analysed in ways that perhaps they weren't intended to be. But the professionals now working in the industry can't deal with the contracts in the rather cavalier way they dealt with them in the past.

Martin

OK. Any questions to the panel, before I start throwing things at them? Steve, please? Sorry, I need to wake up Sophie first.

Steve [From the floor]

I've obviously just come in, so I've missed the other bits and pieces, but being honest with all of us here, how do you really honestly feel that the industry is going to look in 6 months to 2 years' time in respect of volume and throughput and so on. Are we really going to be affected by what's going on, almost hourly, in various places throughout Europe and the world?

Jay

Oh, I think in 6 months' time, a lot of yards will still be building the yachts that they've contracted to build, right through to 2012 and 2013. So, from the shipyards' point of view, I think there's quite a big cushion against the downturn. Assuming that all those buyers can perform. And I do think that at the core of the industry, the major shipyards are pretty big industrial concerns now, and they could all improve their efficiency and their quality control, they could improve in all areas, but compared with where they were ten years ago, it's moved on apace and I think the fall off will be on the fringes. The shipyards that have started as green field—it's exactly what we're seeing in the commercial sector, the solid shipyards that have been there in Korea and Japan, and those that have been there for some time in China, are still quite sound. It's the green field sites, the shipyard that started from a paddyfield 6 months ago and is now supposedly building huge tankers, they're the ones that will suffer, because they just don't have the expertise to manage their business through a crisis like this, or the financial resources to do it. And that's who will suffer. And I think for owners who have orders placed at shipyards like that, they will find it difficult because there really is no protection against that sort of disaster. There's certainly nothing that we, lawyers, can put into a contract that will protect an owner in that scenario.

John

Well, Steve, from my perspective, I would expect at least one household name to go under in the sub 40metre size. Not because they're not good boat builders, and not because the product is not good. But because the current financial crisis is probably hitting their client base more than the much larger boats. Certainly, in the last 5 years, a lot of the owners that I'm aware of that have bought that sort of boat have come from the financial market— hedge fund managers for example— it's been a great source for those boat builders, and at that size where you're spending sort of between €5million and €20million on a yacht, people are going to think twice. They're seeing the resale value of those kind of boats drop quite dramatically, and people who have yachts already are going to hold them a lot longer than they would have done in the past, and as a consequence, this will have a knock-on effect in, I think, that sub 40-metre market. Much bigger boats, as Jay quite correctly says, those contracts are there. The only thing that I think may happen is a lot of those contracts were signed 2 or 3 years ago, where everyone was signing contracts like there was no tomorrow, and a lot of those yards are hurting because they can't deliver on time. And what I think we will see is a number of renegotiations to push out

delivery dates so people become more realistic about delivery dates, so they can actually get the boat they want, and in fact, on a number of yachts I've been involved with, we've had 2 or 3 addenda pushing out delivery dates to a year after the original delivery. And I think we'll see more of that.

Gianfranco

If I may add, John, I think it's absolutely right what you're saying. On the other hand, there is also to be considered again that before, especially like 2 years ago, maybe even like last year, many of these owners were actually buying the yachts in the expectation to resell them to other people, to other friends of theirs. To other business affiliates of theirs. Right now, obviously, the situation has deeply changed, and therefore lots of their expectations to turn their yacht to someone else is obviously changed. And therefore, that's right. They become more down to earth in accepting also the delays in the delivery dates, and renegotiate the contract to this extent. From a shipyard or general contractor perspective, I think, as you also said before John, there will be much more due diligence on the owners themselves, because, even if before everybody was very happy to sign a €50million contract with Mr X or Mr Y, now there will be much more attention in really getting also a security if possible. That obviously this individual actually has the financial means to perform his obligations to buy the yacht.

Martin

Ayuk, please?

Ayuk Ntuiabane

Can I just follow up on that question to the panel. Given the scenario that you've just painted, where basically some of the shipyards that have taken some fairly considerable contracts—I know of one or two, or three, fairly new shipyards that are building yachts over 60 metres, and given the worry that they may not be able to deliver on these yachts, and given also that you, lawyers, will have (not you personally, but the profession) drawn up these contracts without—I know you will have been cautious to have put in all sorts of caveats and so on—but nobody really predicted this economic crisis. And given, finally, that you don't just draw up the contract and walk away, quite often you keep a watching brief over the build process, can I ask you what you are doing, or what you think should be done, on a practical basis if you are aware that a shipyard may be in some difficulty? What do you actually do to the contract? Because, in many respects, the owners tend to rely on you for ongoing advice in situations like this. What, in your experience so far, are you having to do to avoid or limit the damage, should any of the shipyards go under?

Panos

Well, you seemed to have asked one question which is the difficulty of yards delivering and the delivery slots being pushed back, and then the other question, which I think is a slightly different point—yards getting into financial difficulties. I mean, in terms of yards that are struggling to deliver, I don't think that situation is any different to what it was one year, or 3 years ago. It's sort of about managing expectations on each side and trying to have realistic targets. You would see contracts where builders would have an incentive if they delivered early, and then people realised that was just in fact a way of getting the builder to sweep things under the carpet at the end of the build process and that it wasn't working. So people stopped that idea. But I don't think there is much you can do in those cases, unless

you take it early before it's finished, you agree it'll go back in for warranty work, and there, I suppose, is where you would start now to be talking about a guarantee from the yard, and all those things for that kind of work to be done. The wider question, about yards that get into financial difficulties, I think in truth it's a point that Jay made earlier, which is that I think it's quite difficult to go back and revisit a contract. If the buyer didn't get security in some form or another at the beginning of a project, it's very difficult to then come in and inject that security. Probably twice as difficult now as it was a year ago, before the markets went the way that they did. But I think most of the larger builders are either going to have some form of progressive transfer of title, depending on what jurisdiction you're in, or conceivably refund guarantees, or a mixture of the two. And I guess in a worst case scenario, that's what you would be looking at, and that's what you'd be advising the owner on. But, as I say, there's probably not much you can do after the event. It doesn't mean that you sit there and wait for the problem to come and hit you—if you can see the problem coming, there are obviously things you would be doing. But the fact remains it's difficult to then go in and put that security into a deal that was done three years ago. And indeed, if the yard is now really in trouble, well, they're going to have even more of a job if the security just isn't there to be had. So there's not much that one can do after the event.

Jay

I don't think there's anything you can do, even before the event really. I think that shipyards defaulting in yacht construction is a real problem, and I think an even bigger one than in the commercial sector, because in the commercial sector you'll get a refund guarantee that at least gets you your money back plus some interest, so it's as good as if you had your money in the bank the whole time. It won't get you the ship, but then, the ship being something that you can buy from any number of shipyards to the same specification, there's not so much anxiety as there is in the yacht sector about getting the very yacht you've contracted for, one brand being very different from another. But even in the commercial sector, in a rising market, you had the problem of shipyards that were more than happy to give you your money back. They were begging you to terminate the contract because they'd give you your money back and sell the ship to someone else for much more. And that's the problem in the yacht sector as well. There are very few yards that give refund guarantees, from a buyer's point of view there is that risk. I don't think it's a great risk—the couple of shipyards that I know that do, as a rule, give refund guarantees do not and have never taken that approach of persuading buyers to terminate so that they can sell the boat elsewhere. But there's a different aspect to that in yachts, in that buyers actually do want their boat. And if you think that, when most problems arise, they arise in the latter stages—the hull gets built, the superstructure gets joined, the machinery is in there, the basic shipside of the yacht is built, and then it's the interior fit out that causes the real problems, where the money is lost and the project gets out of control. And in that scenario, the buyer can see the boat he's contracted for, it's there, it might even be in the water. The last thing he wants is his money back. He wants to get his hands on the boat. But then, is that a practical solution either? Certainly, before the boat is in the water, the practical difficulties of getting the boat out of the shipyard, taking it somewhere else, and getting it completed at anywhere near the original cost that he's bargained for, particularly if it was a low cost, which may be a factor in why the shipyard has gone bust—it's impossible. And if the boat is not in the water, what's he going to do, particularly with a large construction, that may just be in hull sections? How does he transport them somewhere else, and get the job finished? And those are purely practical problems that a lawyer can't do much about. You can do everything possible to give the buyer

title under the local law over the vessel if she's built, but you cannot solve those practical problems of getting the boat out and getting it completed.

Tork

Do you think we're going to see, in view of contracts coming under more scrutiny from either side for whatever reason, of nervousness, do you think we can see a little bit more realism as to completion dates and build times? Because if the contention that every yacht is always late, which isn't quite true but very, very close, then simply we're just telling ourselves stories as to how quickly they can be built, for whatever reason. Do you think we're going to see more realistic completion dates?

John

I've seen it already with four of my projects, where the owners and shipyards have sat down together and said 'guys, when is it really going to be ready?' And the shipyards have been honest, and the owners appreciated the honesty, they rebalanced their expectations, we negotiated addenda to the contracts, and we pushed out the delivery date to something that was more realistic, and in all cases it was between 6 and 9 months later than the original delivery.

Tork

But do you think we can start to see that not as a renegotiation but actually as a realistic expectation at the first contract signing?

John

When boats are sold, and this goes back to the initial period of signing letters of intent, when the salesman at the shipyard, when the broker get together, what often drives the boat being delivered on a particular date is often not the production schedule, it's the owner's birthday, or a girlfriend's birthday or some event.

Tork

Or just to make the deal?

John

Or just to make the deal. And we saw that 2 or 3 years ago, with some builders offering delivery dates within weeks of each other—they would be contracted to deliver 5 or 6 yachts within a month. Which was never going to happen. Now, in the headiness of signing contracts, people said "we'll get all the people in that we need to build them". What they didn't factor in was that every other yard was doing the same thing, and they were all relying on the same sub-contractors to build the same boats. So when they all went and said 'can you work for me and do this job'—they said 'no, I'm already contracted to this person'. And part of the reason we've seen the cost of interiors go through the roof in the last couple of years is because everyone put into their contracts they wanted a certain interior finish, and there's only so many hands that can build those interiors. The costs went through the roof, the delivery dates got pushed out. If people want their yachts in the condition that they really want them, owners properly managed, shipyards properly managed, can sit down together and try and renegotiate those delivery dates.

Gianfranco

I agree. The other day, when the owners sign a letter of intent to sign a contract, they know, I think, that the day they see on the contract is not going to be the actual date when their boat is going to be delivered. 36 months— actually, it's too short a period of time. It depends—there may be some shipyards that really meet this type of deadline, but let's say the majority of shipyards, and especially the shipyards where I come from, obviously they will be even more difficult to be punctual on delivery date. At the end of the day, when the owners actually see the difficulties in completing the construction on time, they can either terminate the contract, in which case then a big mess will start and it's not actually what they want, or just unfortunately cave in and accept the reality. And obviously, negotiate an extension of the delivery date. There is really not much to do after that, because otherwise they will put the shipyard under even more pressure and that will not be helpful in obtaining what is actually the dream yacht that they wanted.

Panos

I think that's very true—and the other thing that I certainly agree is that the owners are aware of it. I can remember, 2 or 3 years ago, sitting in on meetings where the owner's project management team was there, they know the yards, because they're actually on the ground supervising other builds, and everyone in the room—the elephant in the room is that they are not going to deliver on time. And yet, the owner will sit there diligently and be told 'what sort of liquidated damages you want for the delay' and the owner will say 'well, if she were chartering, she'd be worth €250k a week', and then everyone has to gradually talk down to a level the yards can realistically deliver against, and terms that they are prepared to agree. Even the owners—it's experienced owners, not necessarily the guy who's ordering his first yacht—but experienced owners even then would say 'well, fine, I know it's difficult but I want to incentivise these people, or dis-incentivise as the case may be—I want to push them, I want that early delivery' and that's how a lot of deals were done. They were done on the basis that people knew it would be a difficult date to meet but that's how the yards got the job, and that's why the owners decided to build there. So I don't know if that's going to prove helpful in the long term, but I think it's certainly not a case that you have owners coming to a build that's 3 months late completely flabbergasted that it's 3 months late. They know exactly where they are, most of them, as I say, would have had a project manager telling them just how behind they are.

Martin

Is there a likelihood that the current order book is going to have a big fallout on that issue, I mean in the next 12 months? There are huge delivery delays already.

Jay

Do you mean a fall out in terms of owners terminating or—

Martin

Yes, just penalising hugely.

Jay

Yes, I think there will be that problem, but why should it be any worse than it's been in the past?

Tork

Greater incentive to do it at the moment?

John

Most contracts will have a cap on liquidated damages. The shipyards know how much they're in for, and so they know it won't cost them more than this. What they won't have factored into it is the additional management time, labour time, yard time, for keeping that boat in the yard, and the longer that boat is in the yard, it means it's holding back other projects as well. So, the pure economics of it, yes, we, as lawyers, can try and protect if we're representing the yards, or protecting the owners as much as possible. But, as Jay has often said to me, across the negotiating table, this is a partnership. Building a yacht isn't like buying a packet of cigarettes. This is almost a joint venture, and it's our job as lawyers not to beat each other up too much, but enough to have a balance. Otherwise, the worst thing you can do is penalise a yard so much that they physically can't build the boat, it becomes completely uneconomic. But also, the shipyard has to recognise that the reason why the owner has come to you is because he wants a boat to sail in. And once they recognise that, they are in it together, then you will see some sanity.

Tork

But, I mean, years ago you always used to say about keeping the contract in the drawer, and today you were saying it's coming out of the drawer. Is that going to make that situation worse?

John

No, it's coming out of the drawer, it's on the desk and it's been looked at. We're getting owners saying 'oh, I didn't know I'd agreed to that. But they'd read it, they didn't appreciate it'. And it's now sometimes our job as lawyers to talk the owners through what their obligations are, talk the project managers through what their obligations are, and for the yards to realise what their rights are as well. Because it's not a one-way traffic. Sometimes, owners do bad things too.

Tork

Paul, did you want to interject something?

[From the floor] Paul Miller

I mean, you sort of touched upon it a bit, but is the real risk in all this the sub-contractors? In that most of the yards, I think, at the moment, it's probably 65% of the boat is probably built by sub-contractors, probably more for all I know. And Jay talked about the commercial vessels. But most of the big yards are able to build a commercial vessel in-house pretty much 95%, if not 100%. Whereas, on the yacht side of it, what we're really exposed to is the sub-contractors, and if the financial squeeze comes to the yards, let's just say cash flow is a bit of an issue, they start delaying payment to the sub-contractors by 30, 60, 90 days, the sub-contractor then has the problem, and either walks off the job or goes bust. That's when the problems

are really going to occur in the yacht side of it, because we're so reliant on the sub-contractors, because none of the yards can build a boat from A to Z.

Tork

Sorry to interrupt, but that is actually a localised phenomenon in that it's true in Europe, but actually in the United States the sub-contractor culture is much, much less.

Paul

But, ultimately, Tork, where are the build orders sitting? They're sitting in Europe, aren't they? And I think that's the issue. From the financial side of things going wrong, it's in the sub-contractors potentially triggered by the yards having a bit of a cash flow problem if they can't borrow the money to keep going, or whatever it is they need to do.

John

But on the deals we've renegotiated, we've also renegotiated the terms of payment in order to release some of that capital to go into the yard.

Paul

But you've got no guarantees that the yard is actually going to pay the sub-contractors with it, rather than go and pay someone else with it.

Gianfranco

Actually, what happens very often is the owner may also have a right of assignment of sub-contractors contract first of all, and also to enter into some type of arrangement by which it is actually the owner who pays the sub-contractors rather than the shipyards. That obviously would protect the owner from any type of delays that the shipyard might have in paying the sub-contractor. It's already happened to me a couple of times, that owners actually request that certain key sub-contractors, such as joiners, painters, for instance, or main ones, are entering into contracts directly with them. Or they control the payments, for instance.

Panos

Sorry Paul—there is also the other instances—just a quick aside—where, before you pay the next instalment, as the buyer, you want the key sub-contractors, as Gianfranco says, to actually sign off and say 'OK, we're paid up to date and we're not owed anything'. Because what you don't want is, as you say, the money going on something else.

Paul

But I think the risk is, I personally believe, much more in the sub-contractors than the yards themselves. And I think, Gianfranco, what you're saying is right but I think, if you like, the other side of that, where the owner pays the sub-contractor direct, then the yard blames everything on the sub-contractor because, when you come to argue about liquidated damages, and we didn't deliver on time, your sub-contractor didn't turn up. Or they were too slow.

Gianfranco

You're right. That's obviously the way the shipyard is organised, as far as I know in the yachting industry, there is none which actually can perform all types of work within a construction. Being super luxury items, if you want to talk about interiors, the shipyard does not have capability, the means, the skills, in order to build the interiors at the quality that the owners would expect by again contracting to some big name companies. But I think the way, well, actually, it is happening right now, with the financial problems, and again that dovetails with what we were saying before, is that the owner probably wants more control of the way the money is spent, and the owner probably wants to have a second control in the way the money is actually paid to sub-contractors and other people around. And that's why project managers have to have a certain skill also in terms of managing the cash flow from the owner to the shipyard and to the sub-contractors.

Martin

So does that make the shipyard a sub-contractor?

Gianfranco

No. It's not a sub-contractor because it is the main contracting party of the owner. But the shipyard is the one controlling the quality of the sub-contractors but the payments are made by the owner.

Tork

But isn't there a contradiction there, if the owner is actually paying the sub-contractor it's quite difficult to make the shipyard responsible for their quality, isn't it?

Gianfranco

No, because the contract can be with the shipyard and the payment obligation actually stays with the owner.

Jay

I was going to say it's a problem I've seen on many occasions, and not just in bad markets. Because there have been lots of shipyards over the years that have got into the yacht sector, their attraction is low prices, prices that are too low to justify profitability in the first place. The problems inevitably emerge and the owner, because he has no guarantee or a very limited guarantee, at most 10% or 15% of what he is paid, has no alternative but to go down the slippery slope of managing the project himself. And what I think it means is that, for a lot of shipyards, maybe a lot of yacht builders, the turnkey model that works for commercial ship building isn't always the most appropriate. Maybe this problem with delivery dates is that we're trying to make a simple turnkey project of something that is, in many ways, a partnership or at least something that needs to have a lot more give and take in it than the ordinary commercial project. Delivery dates are not very much negotiated at least at the stage when I tend to come into new build contracts, they've been agreed. There may be a couple of weeks' movement—but the pressure generally comes from the buyer in my experience—it's the buyer who's saying 'come on, you can deliver a month early or two months earlier than that'. And the shipyard gives in, and how much thought goes into that concession, I don't really know. I don't get involved in it, there's not much I can contribute on that question. But maybe what we need to accept is less rigidity in delivery dates, a delivery range with a bit of tolerance, a bit more tolerance in it,

because you get the standard 30 days' grace in a yacht contract that you do in a commercial one—maybe you need a bit more tolerance, maybe a better understanding. If only because, when things go wrong, you are forced to step outside the turnkey model with the kinds of solutions that we've been talking about, of buyers stepping in and taking control of payments to sub-contractors, then the next step is to take control over the supervision of sub-contractors, making sure that people are actually on the job and doing what they're supposed to do, and a worst case scenario is you ditch the main contractor altogether because he's not performing and you take control of the whole thing, if necessary moving the boat out to another facility.

Panos

I mean, it's inherent in what's being done where, particularly on a fully custom yacht, that it's a very sophisticated product and, even with the best intentions, the parties go into it at the beginning and it can actually be difficult to see where they are going to be in 2 or 3 years' time. And I think the thing I've noted is that it's quite interesting to see that the market has responded to it in a couple of places. I'm aware of it with two builders who now are doing it on the basis of actually building you—even for a custom build—they'll build you the white boat, the hull, the superstructure, the main engines, most of the kit installed such that you can hit the water and you can sail, in theory, and what they're doing is to let the buyer go out and find his own interior contractors to actually try and take that risk out of the market. I imagine that's also why the likes of, I suppose, the Feadship semi-custom model has met with some positive reaction in the market, because you're delivering what is still conceived as a good quality product with some degree of customisation, but you're taking a lot of the uncertainty out. But I think it's what all of us are saying—which is that there's actually only so much that you can do. Everyone in the room on a custom build knows that the dates might not be realistic. The owner's side is pushing to have incentives to have the yard to deliver, and the yard at the same time is trying to seal the contract whilst at the same time not putting themselves in a position where they know they're going to be in default. I think the point you made earlier, Martin, which is that whereas now the periods—often you see sort of staggered damages payable for delay. I think if yards really do fall very far behind, if you've got an unhappy buyer, I dare say that may be a reason for him to cancel in circumstances, where in a rising market and everything else he would have stuck with it and waited. But that really depends on the individual buyer—as Jay says, if you've got a buyer that it's his dream project and he's waited 5 years, he'll continue to wait. But it very much depends on the individual buyer.

Jay

I would question, what does he get out of cancelling?

Panos

Well, if he wants out and he's got good security and everything else—

Jay

That's my point. What does he get out of cancelling—if he cancels the contract, his only option in many cases is to step into the shoes of the builder with all the genuine problems the builder has in getting the project finished. If the problem is really with sub-contractors, or if the problem is financial, the buyer's position is no better than

the shipyard's when he steps in and cancels, and tries to take control. Well, unless he's made a valid termination and he's got a refund guarantee.

Jay

OK, if he's got a refund guarantee then he, at most, gets his money back. But at least he gets his money back.

Gianfranco

First of all, you have to say how much is the refund guarantee for. Because as you know very well, these times, it's very difficult to find a shipyard which is willing to provide a refund guarantee for 50% even of the price of the yacht. So, at the end of the day, you're much better off in terms of the owner to step into the project and be assisted by real, valid project managers, and say 'OK, it's my money, I will eventually take it to completion'. Otherwise, really I don't see any way for the client to be really satisfied in a situation like this.

John

The other alternative of course, if the owner has had enough, is to try and sell the project on to someone who is more committed to seeing it all the way through. And that's also a possibility.

[From the floor] Chris

I've heard this exact conversation for the best part of 24 years. About builders and buyers. Exactly the same conversation, and most of the industry has moved on somewhere. I'm not saying everyone is where they should be, but the industry has moved on. The builders seem to be exactly where they were 20 odd years ago. Underestimating how long it will take to build the yacht, underestimating the costs. And then, it's up to the buyer and the industry to bail them out every single time. Surely, the building industry has got to start taking some responsibility. They should, by now, have some idea of how long it will take to build a yacht. Even allowing for the changes of wives and so forth. There must be somewhere where they've got to start saying 'no, this yacht will take you 5 years to build. We might get it out quicker if you don't make any changes, but it's going to take that'. And if the whole industry says 'it's going to take you 5 years' nobody is going to say '*well, they say it's going to take 3 years*'.

Panos

But that's probably the difficulty, though, isn't it. Because I daresay they probably do all know now how long it's going to take them. The issue is, and certainly in the market we've come out of, they've known they may well not get the contract because there is the owner out there who, as we've said, birthday or whatever it may be, wants a particular date. And if the guy down the road is offering him that date whether or not they can deliver, the owner might go for it.

[From the floor] Chris

But if they're going to go bankrupt because they don't deliver, then they're going to say 'sorry, I'm not going to do your deal. It's not worth my while'.

Panos

Well, we, as lawyers, I think, in the early negotiations, if we are involved in those, somebody will invariably stick their hand up and say 'well, actually, we think they might not be able to deliver and we can really impose some hard terms here' but at the end of the day, if they can't deliver they can't deliver. Whatever is on the page is not going to change that. So I agree with you, it's just a case of the market has been not driven only by delivery dates but it's been a big factor, and it would take all of the builders to be honest effectively and say 'well, this is when we can deliver, for that to change.

[From the floor]

The builder always delivers what the engineers can produce. The salesman always promises to get the deal. And that's life. Unless it changes —

Gianfranco

Yes. You can raise up your hand all the time, and say 'well, I don't think you're going to make it on time' and then the broker will say 'no, it's not true, you don't know anything about building boats, we will make it in 3 years'. And that's it. The entire conversation stops there.

Jay

Haven't we got the solution with Sensation Singapore?

Martin

What, closing down every yard they build?

Jay

No, yachts in 6 weeks or something on the production line, this grand idea they've got?

Martin

9 months. It's dream world.

Tork

But it's true. Certainly, I mean, even at Monaco, you'd go around talking to shipyards and say 'what's your delivery?' —*well, you know, we're really aiming for 16 or 18 months. I mean, it's 36 on the first one but the next one will be out in 18 months*'. It's like— 'oh, stop'.

[From the floor]

I blame the lawyers. They should negotiate the terms better.

Gianfranco

I told you, try to talk to the commercial guys within a shipyard or a broker, and they'll tell you we don't know anything about building boats, so they will tell you 'no, it's 16 months'. And the owner believes them.

Jay

They're not cars or planes, and I don't think they ever will be.

Martin

Well, stately homes used to take about 30 years to build, didn't they?

Tork

A cathedral in Palma took 550 years, and it's not quite finished.

Martin

Can we talk about brokerage and their involvement to the new build sector?

John

Sure. What do you want to know?

Martin

OK. I'll throw out one thing. With the refund guarantee, does the broker give his commission back?

John

Interesting. Well, he should, yes.

Martin

Has it ever been enforced?

Jay

I've never had to enforce it. I've been involved in some pretty heavy discussions but never had to enforce it legally. But the problem is in this sector that there really are very few principles and— *[laughter]*
I mean principles, but not principles in the ethical sense, I see how I may have been misinterpreted!

And one of the principles seems to be that, if brokers introduce a buyer who then fails to perform, he hasn't earned his commission and ought to account back for it. And the solution there is that the broker only earns his commission as and when the buyer pays. If the buyer stops paying, the brokerage stops getting paid as well. But it's always more complicated than that because, what happens when a buyer introduced by a broker terminates or flips on one contract, and then signs another contract, maybe for a different model at a different price, how do you adjust the position then? It does get terribly complicated. Then what happens, if you get more than one broker involved in introducing a buyer, how do the shipyards sort that problem out, how do you work out whether a broker has justified the full 5%

brokerage for introducing a buyer when he may have given a name, turned up for the first meeting and then made himself scarce and simply sent an invoice. And there is very little guidance. The law is very old, it goes back to the 1920s, and hasn't really changed or developed at all since then, and it simply turns on the question of who has been the effective cause of the business. What does that mean? There's no scientific answer to it. So I think it's a very unregulated part of the business, and quite how to regulate it, I don't think anyone really knows.

Tork

One suggestion might be the actual —we talked about this at lunch— the transparency of pricing. So that what yachts sell for is known. I mean, we were talking about aircraft, and you can get a pretty good idea of what an aircraft sells for, but we don't really know.

John

Apart from a few types of yachts, the yachts that we deal in are not commodities. I mean there is no—there will be a base price, but once you start adding all the add-ons, the reality is—

Tork

No, I'm thinking of resale, I'm not thinking of new build. I'm thinking of as yachts sell. If we actually knew what they sold for, it would be a much more transparent and easier way to deal with industry.

John

I mean, there is confidentiality, and tax reasons of owners and buyers that wouldn't want that to be public. That's the reality.

Jay

If you're talking about brokerage, then brokerage is not such a problem in second-hand sales. There are fairly sound conventions for all of that. The problem is in the new build sector.

Martin

Does it create a lot of litigation?

Jay

It doesn't create litigation. I haven't seen much litigation. As I say, the cases go back to the 1920s, and most of the case law that you see involves real estate where the principles are the same. Principles in the non-ethical sense. And there are very few ship broking cases and very little law on the subject because it all turns on the fact of who has been the effective cause of the deal that the shipyard has done. And if a broker has introduced, or mentioned a name of somebody that a shipyard didn't know previously and a contract is later signed, is he the effective cause of that business, does he earn a commission, and if so, how much? Is it the full 5% that shipyards eventually will pay for an introduction, or is it something less than that because all he's done is mention the name, perhaps introduced somebody at a boat

show, and then that's the last you see of the broker. Is a broker that sits right through the commercial negotiations and then participates right through the build process somehow worth more, in the way of commission than someone who's merely mentioned the name? All of those questions are very unclear. There is just no legal answer to it. Which is why there is very little litigation. It all turns on the facts.

Martin

How do your clients react to it?

Jay

Well, client shipyards are concerned about it. And there is an organisation meeting at the moment to try and develop this concept—they haven't got terribly far into it—but their aim is to try and, by agreeing among themselves, develop a convention of how brokers should be paid on new builds. Of course, it requires getting all the brokers to agree! And a number of them are involved in the process. The brokers that are involved tend to be the ones who are the hardest working in the industry, they are the ones that earn their commission every time and, in a sense, they're defending themselves against the others who simply keep a list of names and send off registration forms to shipyards and expect that gives them a stipend for the rest of their life, every time on the off-chance that one of those people on the list of names that they've sent in will sign a contract. On the other hand, can you really begrudge those brokers if a name that was previously unknown to the shipyard comes along and signs a contract as a result of his introduction?

John

The only issue my owners have is not knowing that "their broker" has taken a commission from the shipyard. And on the few occasions where the owner has become aware of that, they've got quite upset about it. Odd, because that's where the broker earns his money. I mean, he gets commission from a shipyard and one knows that. Where some owners feel strongly is that 'how can the broker negotiate for me, did he get the best price, knowing that his percentage is linked to the price that he's negotiated with the yard'. And that's a whole different issue. But we, as lawyers, hardly ever get involved at that level.

Tork

It's a good question though.

Gianfranco

I think also there is a legal contradiction, because sometimes in the contract, there is always a clause in which we state that no commissions be paid to agents, brokers and so on, but even then the client actually knows that his name has been made known by a broker, and actually introduced himself to a specific shipyard and so on. And the contradiction, and also the conflict, there is also because, obviously, the client, as you were saying John, I mean, is not sure whether the price he is getting from the yard is the best price he could get himself. Because obviously, he has to factor in the commission as well. So that is some grey area which sometimes really creates problems with owners.

John

There's a couple of brokers that I work with who take a different approach. They won't take a commission from the shipyard, but what they will do is project manage the project and they will effectively get what would have been their commission, but they earn it and they feel slightly better about themselves for doing it that way, as opposed to taking a straight commission from the yard. An honest broker. It is an unusual concept but it does happen.

Jay

But I think there, you do come up against a legal issue, because that may work for the broker and the buyer, they may find that a more satisfactory way of doing business, but if a broker introduces a buyer to a shipyard and is the effective cause of some business that would not otherwise have been done, then the broker is entitled to a commission from the shipyard. So you will get unscrupulous brokers who will come to that arrangement very comfortably with their buyers and still take the commission from the shipyard. So from the shipyards' point of view, that is not a solution. At least unless it becomes a convention by which everybody abides.

[From the floor]

I've got the impression that the world is more imperfect than I thought. I want to make that clear, just in case of ordering at one of our shipyards in Holland, that delays tend not to be the case, and even for the semi-custom, interiors are included. And my question is, in case of a perfect world, who would be the principal of a broker? Because we mentioned all examples where it wouldn't work, but is that the party who pays the commission? Is that the party who the broker claims to represent? What would be, let's say, your view on that in a different world from today's world?

Panos

Well, that's a difficult question actually. I think the simple answer, which isn't the answer to the question, is in a perfect world there'd be transparency. And then, that would be the answer. But the more hypothetical, academic question of who is the broker there for—I think that's quite a difficult one. And that's actually why the issue, from a legal perspective, I think is as unclear or problematic as it tends to be, because, you know, you get all extremes. As John said, you've got somebody that takes the whole build through to the very end, and at the other extreme, you've got someone that sends a list of names. So I think transparency would benefit the industry. I think certainly, from an owner's perspective, that would be best and I guess the unscrupulous brokers would say 'well, no', and they'd give you reasons why that shouldn't be the case. But I think there can be little argument that, as long as everybody knows where they stand, then that's a fair position. Whether or not you want to do the deal on that basis, is then a separate question. Whether you think it's fair or justified. But as long as you know. I think the difficulty comes about when a buyer doesn't realise what's going on. And that is understandably awkward.

Jay

I think my own view is that, in a perfect world, everybody would pay for what they perceived as value for money. So shipyards will gladly pay a commission to someone who genuinely brings a deal to them. Buyers will pay a broker or project manager for services genuinely rendered. Ironically, I think if you introduce total transparency, you would kill the need for brokers altogether. Because everybody would know everybody. Shipyards would advertise directly, and buyers would go directly to them. So you'd probably put brokers out of business with total transparency. Certainly,

brokers are the last people who want it. Because, as soon as buyers realise—they are naïve if they pretend they don't know brokers are being paid commissions by the shipyards. Everybody knows that.

Martin

In essence, more and more owners are going direct to yards anyway.

Jay

Well, they do. And that raises separate issues of brokers who may also introduce that buyer and claiming ownership of the client. But there are rules against secret commissions, so if a broker's commission were totally secret then the broker could be made to account for it, to pay it back. To account to the buyer for it. So he's got a commission from the shipyard; on placing a deal, he has to account to the buyer for the profit he's made without telling his clients. Peculiar position where the broker is paid by the shipyard but is the agent for the buyer. But I don't think those commissions really are secret, because it's well enough known by everybody in the industry that that's how brokers are remunerated. So it's not secret even if you don't tell the client directly.

Tork

But I have heard another suggestion, which is that a broker should be part of a new build team along with the naval architect, the representative, project manager etc. And as part of the team, they get paid as part of the team.

Gianfranco

Yes, but what is he going to be there for? What is he going to do?

Tork

Often to do with the negotiations.

Gianfranco

That is the problem. Because most of the time, the owners I mean, are introduced by the broker after which they even dislike him. In many cases, I've seen where owners are introduced to shipyards and the moment after they just don't want to see the broker anymore. Really, they prefer to talk to the commercial people at the shipyard.

[From the floor] Barbara Tambani

It came just once that we followed the construction of a boat, and we introduced a client to the shipyard, we were part of the contract so it was written clearly in the contract how much we would have got for that introduction. We followed all the construction and we have been paid as project managers for the whole construction that lasted for 3 years. But it was clearly stated in the contract—all parties knew how much was the percentage, it was not 5% but it was part of the deal and negotiated between the shipyard, the client and ourselves. I think it was transparent, clear to everyone. We didn't have to hide anything, we have introduced the client, it was quite easy even to manage the situation afterwards if there were problems with one of the parties.

Martin

John—you mentioned transparency being driven by owners not wanting to disclose figures etc. Is that a rule of thumb?

John

I don't think any owner wants the world to know how much he's paid for a boat. Or how much he's sold a boat for. I mean, all the bills of sale that I've ever done, aside from the very small transactions, have always had on their face of it *\$10 and other good and valuable consideration*. And we have a separate invoice. Protecting how much you've paid is quite important.

Martin

And does that create a problem with the transparency issue from brokers and making everyone not wanting to disclose stuff?

John

There is a culture, not of secrecy, but a culture of confidentiality that's grown up which in part can be and has been abused. The origins for not disclosing the price were real. The way that it's abused perhaps should be called into check but it still has a function.

Jay

I have a certain amount of sympathy with brokers, you know. I envy them enormously when deals go through. But I certainly don't envy them when they've chased a client around for a year and a half at their own expense and then the deal falls over.

Tork

Or it's stolen by someone else?

Jay

Or it's done by someone else. I've seen it happen, that a client the broker had chased around for 18 months has gone on board the boat next door, bumped into the broker there and bought it like that.

Tork

There's not much loyalty, is there?

Jay

There's no loyalty in it, and what happens when the parties are 3 or 4% apart on price and in negotiation, whether it's second hand or a new build, who gets squeezed to make up the difference? It's often the broker who funds the final step in the negotiation.

Martin

Never the lawyer!!

Jay

Well, no, I'm the first to admit it. And I hesitate to get back into another debate like we had this morning, but if we must we can, but we lawyers get paid whether the deal works out or not. And so brokers are envious of us when the deal falls over.

[From the floor] Simon Ballard

It's kind of changed into two parts now. You were saying about disclosure of valuations— just ask for a copy of the insurance policy—that hopefully should tell you something. Because they're flying around all over the place—we've got a problem at the moment with a Capitano—he's passing on documentation. So they're never kept secret. But my original point is, and maybe this comes from a naïveté side when you're looking at brokers. Do we realistically believe an owner, who has made millions and millions of pounds, will go into a contract with a broker not realising that he gets paid possibly on both sides, and what is the owner's remuneration to the broker directly, as well? I mean, is that on a fee basis, so therefore what's the broker's worth within the negotiation, within the actual point of sale? Is he going to get €1million from the owner directly as an invoice, or does he get £10 from the owner as an invoice? In which case, if he gets £10, surely the owner knows he's getting paid somewhere else?

John

If the broker is getting a fee for his services to the owner, if the broker is offered a commission, the broker really should hold his hands up and say 'I've been offered this commission' and the owner should say either 'knock it off the price' or 'you can keep it' or 'I don't want to know'. The difficulty arises when there is...

[Phone ringing—that's not me!! Tork—no, I'm trying to find it for the person who dropped it. John—next time it goes off, you dance!!]

— If the broker is being paid a fee then it's fine, but if the broker is not being paid a fee and he's acting purely as a broker, you're right. The owner would be naïve to wonder where he gets his food from. It's got to be from the shipyard.

Simon

Yes. So basically, what we're talking about is double bubble and the guy earning two lots of commission. Rather than the broker who's actually assisted and helped the owner along and then actually, as far as the owner is concerned, has never got paid. No owner is going to be that stupid.

John

No, but as you so colourfully said, double bubble.

Jay

Yes, but he's doing two different things—he's introducing a buyer to the shipyard, and that justifies the commission which is conventionally 5% —and separately, he's doing project management for the owner and he's perfectly able to justify that. There is a convention of shipyards paying a commission for introducing a buyer, no problem

with paying a fee for services rendered in terms of project management for the owner. The problem is that shipyards resent brokers who do no more than send them a name, which may itself come out of the fact that brokers have abused that by simply sending names and expecting that that shipyard should pay them.

Simon

But does that really happen?

Jay

It does.

Simon

Good business going forward! Why don't we all do it, if it's that easy?

John

But I've seen it with one of my clients who are builders. They receive regularly letters or emails from brokers saying 'I've mentioned your shipyard to another client' and bang—they'll claim their commission.

Simon

Do they actually physically get the money?

John

Well, if that owner turns up there, they'll pursue it because it's worth millions of dollars.

Jay

I don't think it is as simple as that. The question, as I say, is, has he effectively introduced the business?

Martin

What quantifies introduction, though?

Jay

Introduction is—

Martin

Is that being debated now by SYBAss? What qualifies and quantifies introduction?

Jay

Yes. What has happened is that there is this perception that brokers are making a turn twice. Doing the same thing and making it twice. And that is, I think, because shipyards, in response to this attitude that brokers are simply sending them names, and doing nothing to earn their commission, are starting to insist that broker do

something to earn the commission. Which happens to coincide with what brokers are sometimes doing anyway for their owners and being paid by their owners. So the problem goes in a circle.

Tork

To some extent, we all know what we are, we're just arguing about the price. If you simply give a name, which results in a €40million build, it's worth something. Maybe not 5%, but it is clearly worth something if the shipyard did not know the person.

Jay

But it's worth a commission or not. And if it's worth a commission, then the convention is 5%.

[From the floor] Chris

One of the things I have noticed over the years is that the European brokers tend to look more to the management of the clients and try to keep the clients on the side for more and more yachts as they go on through their careers. Whilst the American brokers, and I'm generalising here, tend to look for just the immediate sale and sometimes, once they've got that sale, they really have no further dealings with the clients. I don't know whether you've seen that as well.

Jay

Well, try telling Merle Wood that, that he doesn't earn a commission—

Chris

No, I wasn't saying they don't earn a commission, it's that they do the sale, get their commission, whereas European brokers will tend to want to deal more with the day-to-day management of the boat afterwards, for the next transactions, whilst the Americans, and I think it's changing, tended to be more— do the immediate sale and then to hell with the management side, go on to the next sale.

Jay

I think it's down to individuals, I don't know whether it's a difference between the U.S. and Europe. I mean, you look at the brokers like Bill Sanderson, Stuart Larsen—I mean, they're pretty hard workers on a project. Some of them will stay right through a project. I think it's a case of individuals. And there are brokers who will just expect a commission for nothing both in Europe and the U.S. I don't think there's any ready answer to this problem.

Martin

What about fixed fees for introductions?

Jay

Well, in a way, you have that already. You have the convention of 5% for an introduction.

Martin

Where did that 5% come from?

Jay

Convention. Where did the figures on second-hand sale and purchase come from? It's purely convention.

Simon

Sorry, just going back to the original point of it. Is that not your job as the owners' lawyers to point that out right at day one that this could be going on? It's going to be quite rude sounding, but are you just silent on it or—is that something you do and they just don't want to listen? Because ethically, it's wrong, and OK brokers have got to get paid. And as Tork said, it's kind of how much, and everybody finally agrees it if it's transparent from the start. But would you, John, turn around and say to an owner 'well, you do know he's just earned 5% from the yard'? Does it work that easily?

John

I have, especially when an owner is new to the industry, and he's not comfortable with his broker because he sees the broker as someone who earns commission, yes, I will tell him the facts of life as far as yachting is concerned. And what he does with that is for him.

Martin

Can we publish those facts of life?

[From the floor] Ayuk

I just wanted to add—Martin, you asked whether fees would not be a good substitute and Jay's response was that commissions are part of the convention—I just thought I should point out that the accountancy profession, for example, forbids commissions. That's part of the ethics. And I think part of the problem we have in this industry at the moment is understandable because we're very much in the early stages, the industry is still evolving, but I can see a time when—and I hope it is the case, actually, I hope it moves in that direction—a broker's fees will be, or a broker's income will be a fee for doing what they do, rather than a simple commission. I think it's possible to introduce, but I might be naïve, a fee culture as opposed to a commission culture. I have personally experienced a situation where a very important client discovered, in an advanced stage of negotiating with a well-known shipyard, that the owner's representative that had been appointed to oversee the project had earned a commission from the shipyard as well as earning fees from the client and that fact was kept secret from the client. The consequence of that, and given that this was a client that was new to the industry but of considerable potential, it just left a bad taste in the mouth.

Tork

Can I ask—how did he find out?

Ayuk

Well, he found out! He happened to have some connections in the industry—the short story of that is that representative was dismissed instantly. And not only that, but the contract was moved to a different shipyard.

Tork

What happened in that deal? Did the owner walk away and never build a yacht?

Ayuk

No, they moved the contract to a different shipyard. So what I'm saying basically, is that part of a solution might be a fee culture rather than a commission culture. I'm pretty sure not many brokers will agree with me in that respect.

Jay

As I said before, the brokers envy us when the deal goes south, and we envy the brokers when the deal goes north because on a fee-based arrangement for work, assuming you mean that the fee is going to be smaller than the current commissions, that only works if the broker is being paid come what may. So are you suggesting that a broker should become just a fellow professional like an accountant or a lawyer or an architect?

Tork

It's not a bad idea.

[From the floor] Alastair Hazell

For what it may be worth, when we have lending transactions introduced to us, we are content to pay a commission to the introducer, because, let us assume, by definition we wouldn't otherwise get it. But it is a banking convention, if not law now, that we declare that that commission has been paid. And I think that would put an end to any questions over it.

[From the floor]

From finance brokerage, I can add to that that we declare that we get either paid by the bank or we sign that we actually only get paid by the client, never both sides.

Panos

Again, that's the argument in favour of transparency, as I see it. But I mean, the question from Ayuk about the fee basis, you can see the difficulty with that that the guy that shows 100 yachts to get one sale and the other guy that happens to be there at the right moment and in an hour has sealed the deal—I guess it becomes very difficult. But there isn't necessarily a right or wrong way of doing it. I think transparency is the only thing that you can aim for.

[From the floor] Barbara

I was saying exactly this. Up to when it's many times now that we discussed this same issue. Commissions and commissions or fees or whatever we call them. It's just because we are always discussing ethical issues, just because they are not

transparent. Up to when it's inside a contract it's clear, all parties know about it and I'm quite sure the client is happy to pay a fee or a commission to someone that helps him to find the best solution for the best final building he's going to do. But it's clear the broker is there, and he got it to here where he wanted the client to go, and of course, if this commission is secret and it's an agreement between 2 parties, the client obviously is going to think 'who's going to pay them? Surely, that will increase my final price?' It's sure. So this is where the problem happens—who is going to pay for it. Up to then it's clear and it is in the contract, I don't think there are any issues from any party's point of view.

[From the floor] Adrian

I just thought that if you have an agent acting for a principal, and that agent doesn't disclose the principal that they're taking, isn't there some anti-money laundering legislation now, which means that it's some heinous crime?

Jay

As I was saying before, if it's a secret commission then yes, it can be a problem, but I think it's such a convention that it's not a secret, nobody can treat it as being a secret that the shipyard is paying a commission to the broker.

Martin

What does the shipyard say?

[From the floor] Bas

First of all, I would like to say that the 5%, let's say, is not a rule, we talk about introductions, we don't talk about 5%. That's our rule. We talk about a lot less than that.

Tork

What is it, Bas?

[From the floor] Bas

Let's say it's more about 1% rather than 5%. And the other thing I wanted to say is that I think the solution lies in the word mandate. If a broker acts on behalf of a buyer and he doesn't have a mandate of the buyer, then it goes wrong. So when the day starts that the broker gets a mandate the problems are solved. Because then, it's clear who pays who and who is representing whom. Etc. So that should be a solution sooner or later.

Martin

Any comment?

Gianfranco

This is true, obviously. The mandate acts as the basis of the relationship between the broker and the other party—it could be with the owner, in which case the owner knows, clearly, or it could be hidden as it is actually in most cases that it is the shipyards actually paying the brokers. And as we said, it's absolutely obvious that the

owner, as a well-informed businessman who is building a custom-made yacht, obviously expects someone is going to pay the broker if he's not paying, it's pretty obvious that someone else is. But I mean, again, the mandate, if it were signed, and the brokers are so organised in a way that they would get all their contracts signed and so on, maybe it would be the right solution.

[From the floor] Andy Williams

I think a broker has two functions, traditionally. One is as search agent for the principal, whether he's looking for a shipyard or another boat. And then, having found either the shipyard or the boat, his second function is to negotiate the best deal for his client. I would argue that the first function, i.e. the search agency, is now really obsolete with the advent of instant communications and the internet, and therefore the broker's only value to the transaction or the relationship is his negotiation of the price. Secondly, I also think that the level of commission, 10% typically for second-hand yachts and 5% for new builds, is an artefact of a small industry where it was difficult to put buyers and sellers in touch with each other, but Paul made the point earlier on that this is now quite a well developed, mature industry where I don't think those levels of commissions and what the brokers do, I think it's become obsolete and I'd be interested in asking the lawyers who do the commercial shipping work how they—because I know that in commercial shipping sales commissions are about 2% or 1%—so I suspect that's the way the yachting industry is going. I'd just be interested in your thoughts on that.

Tork

Just a quick question—don't you think, Andy, that it's not just the fact that we know Lürssen because we can see it on the internet, or Feadship, or Amels, or Benetti. But a broker should be able to bring his knowledge of the specific characteristics and offer to that yard so they can make a positive recommendation as to which yard suits that particular owner. Because it might not be Feadship, it might be Benetti. I think that hasn't become obsolete, has it?

[From the floor] Andy

No, no, but I would say that a yacht manager could equally well fulfil that role!

Martin

For 1%?

Tork

And that was the end of the commercial break!

Martin

So, what are your comments on commercial broking—because obviously BRS have bought YPI so that's going to be an interesting marriage?

Jay

I mean commercial ship broking works very, very differently from yacht broking.

Martin

It's transparent?

John

No, not transparent. But I mean, the thing that Jay alluded to earlier is that you're dealing with commodity products there. There's much greater turnover, you know principally who are buying ships, who are selling ships. Very rarely do you deal with single owners, someone who owns a single ship. You're dealing with people who own fleets. You have accounts, it works very, very differently.

Martin

Do you find though, that the synergy is that it's such a small industry that people do normally know who's buying what? Within the inner sanctum of the market?

John

We often, between us and the brokers, know all the deals that are going on, and who's the potential buyer for deals. What's interesting is the new entrants—I mean, in the last 2 or 3 years, money from the former Soviet Union has come in and gone straight in at the top. Those often don't even have brokers, they've come in and gone straight to the yards. And in a great respect, they've broken the mould because they didn't own the Sunseeker, they didn't trade up to the Benetti and go to an Amels and then onwards and upwards. They've come in straight at the 80metre without brokers and have negotiated deals themselves.

Martin

Have they negotiated good deals though?

John

Well, that's the thing. Often they haven't, from a price perspective, and not necessarily got the right boat—

Martin

Do they get a 5% broker discount?

John

I doubt it! But it's different, commercial ship broking and yacht broking are very different. A good yacht broker is an asset to any transaction and I have the privilege of knowing some very good yacht brokers who add a lot to the deal, and the boats that they are involved in are often much better boats than those that have no brokers involved at all.

Tork

And presumably have happier and more satisfied owners?

John

Yes.

[From the floor] Chris

There is one broker, I think they are still trying to do it, in Antibes and they are actually charging a fixed fee for putting the boat out in the market and a monthly fee. People aren't using them. They still prefer to pay the 5%, because if they don't sell they don't get it. Whereas these guys, they have to pay them all the time and the clients are still feeling they're getting a better deal by paying commission.

Tork

I think in that case they're also one of the smaller brokerage firms, which also in the current climate doesn't help them.

Martin

Let's move on to tomorrow's subject of tax. And what is the situation with the legal attack of current tax regimes? Any comment on that?

Jay

I can only report on what I've heard. Which is where Ayuk will jump in any moment now and tell me how badly I've got it wrong—but my understanding is that the EU commission has decided to attack the commercial regimes that we have in the Mediterranean, France and Italy, Malta. I think the first attack is initially on Greece, and the basis of the attack, as I understand it, is the notion that these schemes work by deeming a boat to be operating in international waters for a certain percentage of the time and irrespective of how long it's actually spending in international waters and notwithstanding the fact that most of them are just going back and forth between Antibes and San Remo. But it's something that's always been on the cards when you're supposed to have a uniform regime throughout, and plainly it's not, it's different in France and Italy, Malta and Greece from what it is in Spain and parts North. So, sooner or later, I think the Commission was going to have to put its foot down and say 'you're right, and you're wrong'. Or vice versa. And they seem to be attacking the commercial approach. Whether they are attacking the commercial approach entirely, or simply picking this facet of it and saying 'we're OK with the idea of yachts being commercial like cargo ships can be or are, and we just want you to tidy up this aspect of it', or whether they're attacking the whole concept, I'm just not sure as yet. But I'm sure Ayuk will tell us.

[From the floor] Ayuk

Thank you for trying to steal the thunder from my presentation tomorrow! But I think I'll just comment on a general basis now, to say that the VAT regime allows a VAT rate of between 15% and 25%. OK. There are exceptional cases where 5% is allowed, but that's usually for economic reasons. I can say generally that yachting is not a service that falls within that economic regime. And so it's not surprising that the EU commission is taking action against certain countries that introduced all these schemes. But I think that's only a taster to what we have tomorrow.

[From the floor]

Hello to everyone. Just to put the records right, really, from what I'm aware, the leasing regimes are actually based on a treaty convention, on a treaty provision,

which is included in the 6th VAT directive. Which does actually allow any member State to interpret how much of that goods is being used within the EU and how much it is being used outside. And does give a right to each member State to interpret that, so that principle itself is embedded within the 6th VAT directive. And as far as I'm aware, there has been talk with the Commission, and if I'm not mistaken, in March, there has been an amendment to the directive, which did not affect that provision. So I can't think that that will be changed shortly. Now the leasing schemes are actually based on that provision and it's an interpretation driven by each member State that has introduced these regulations upon which this is based. Now, whether the interpretation is one way or another, that's up to the member State to decide. And I would latch on to what Remco said earlier this morning. And say that it is those who are bending the rules within the regulations of each member State that have to fear any legislative intervention. Or any enforcement by any official. Rather than the concept itself. Because the concept is embedded within the VAT directive and it can't really be attacked. And just one small thing that I'm aware of, that in June there has been a conference between VAT commissioners of the different member States to which the EC Commission representatives were present. There have been questions from the northern countries—I will not mention who they were, not that there's any secret but anyway—and they have questioned this situation about leasing countries including Malta where I come from, France and Italy. But based on this provision in the EEC treaty as I am aware of it, they have found no fault, because it is based on a treaty provision which has not been changed. Which is a law applicable in all the member States and that's what it is until the next amendment.

[From the floor] Chris

I have heard rumours that there is another directive due to come out in the near future, on VAT specifically in the yachting industry. The main things were tidying up cross border leasing, I don't think it was really linked too much to the bank lease purchase structures or the commercial structures for true yacht charter business. The French themselves, this year, tightened up their interpretation of 262 by specifying specifically that yachts being used by the principals for most of the summer, with the rest of the year open to 3rd party charters, are not accepted under 262 for obvious reasons. The use as a pleasure boat takes priority over the use as a charter boat. I haven't yet managed to get my hands on a copy of what's being proposed as the new directive, no doubt that will be published shortly. But I suspect, as the gentleman in the front said, this is all being run by the northern European countries, UK, Germany, who don't understand our industry one little bit. And that's the big problem. We've got tax people who go to the London Boat Show, Düsseldorf Boat Show, see sailing dinghies, and as far as they are concerned that's the yachting industry. They don't really see the big stuff. And if they do, they're just jealous.

[From the floor]

Well, from my experience, what I can say is that we have to make a big distinction between cross border leasing and the Italian, Maltese and French leasing. Which have nothing to do with the cross border leasing, which, I think now no one is doing it anymore, has been declared to be illegal. That's how to avoid paying VAT by using a loophole in the system. Which is completely different from the leasing arrangements under the Maltese, Italian and French systems. As regards chartering the yacht, I think, even there, one has to make a distinction between a leasing and chartering. It has nothing to do with it. Sure, if a boat is chartered, in that scenario there is no VAT upon the purchase of the vessel. When we're speaking about leasing it's a completely different concept, because we're saying with leasing that the vessel is being used in EU waters for a percentage of time depending on the length of the

vessel. In chartering, it's a commercial legislation, and there's no VAT whatsoever on the purchase of the yacht. So one has to distinguish between the concept of commercial use of a yacht, where that means the yacht has been chartered, and a finance lease or a lease.

[From the floor] Ayuk

Just again two comments. First one for Chris—I can confirm that the directive that you're referring to came out in August and is called the A206 directive. Which basically revises the place of supply rules. OK. So it's not to come, it's actually there. But it will be introduced in phases in terms of implementation in different member States. The second point is, just to clarify to the first gentleman from Malta? I don't think—well, factually the attack is not against the so-called use and enjoyment rules. The directive basically allows items such as yachts depending on whether they're being used outside the EU or within the EU for member States to deem that use one way or the other the concept is fixed. And what Jay was referring to and what I said earlier is not that there is an attack on that particular concept. What's being attacked specifically is, if you like, the sort of artificial leasing schemes where a very small percentage, usually between 1% and 5% is what the owner ends up paying and there are particular issues with that and it's to do with the interpretation of those rules. So what I'm saying specifically, what Malta has done, for example, in calculating, in saying that well in advance an owner is determined to have used the yacht for a particular percentage of the time depending on the size, within the EU say 30%, that's playing on the use and enjoyment rules and finding a way to determine what tax should be paid. That specifically is not being attacked. There are several things that have happened in the industry in the last few years where so many schemes have been merged from different countries where basically the rate of VAT has moved away from the ambit of the between 15%-20%, that the Commission is basically quite concerned. And part of the tidying of the rules of the directive as we'll explore tomorrow is basically meant to clean that up somewhat. There are other things happening in the industry, other additional measures that are being taken by different countries, different authorities. Again, we'll look at that tomorrow. Tax is very much an issue at the moment.

[From the floor] Adrian Jones

I'll be speaking again tomorrow, so I'll make this very short, I think we all want to get to the bar.

Tax is complicated, no question about it. And VAT particularly so in the area of yachts. I agree with Ayuk, there needs to be more clarity, a certain cleaning up, because I think some of the structures that have been put out there work very well if they're adhered to properly but some have been abused, it's quite clear. And yet, hopefully, tomorrow we'll discover more and you'll all be much wiser.

Jay

I agree with all of that. I agree with everybody. I feel a personal challenge when a client comes into the room to see how long you can keep the conversation going without mentioning VAT. It's never very long, sadly. It seems to be cart before the horse. What people really want to buy and enjoy is a yacht and you end up having long and turgid discussions about VAT.

Martin

But is it true that owners are still being sold stuff they don't need, ownership structures and VAT schemes etc? And what's that down to?

Jay

Yes, very much so. I think it's down to everybody passing on the last bit of knowledge that he or she heard. Without necessarily researching it. And people come to me with bits of advice that they've picked up from all sorts of people who had no business giving that advice and the client had no business listening to it. But there are a lot of false assumptions—it's a complicated area, which means that you can mishear something slightly, misunderstand it slightly and get the wrong picture. And if you then act upon that misapprehension, you're in for trouble.

John

I mean, I was recently involved in a transaction which ultimately collapsed because the owner of the yacht that we were trying to buy had his yacht put into such a complicated structure it was nigh impossible to extricate the yacht from that structure without causing huge financial harm to the previous owner, or the still existing owner. And we couldn't close the deal because the structure that was set up was specifically for him, we couldn't buy the asset out of that structure and we couldn't buy into that structure because it didn't suit the circumstances of my client. And in the end the deal collapsed.

Tork

So, does that mean the only person who could buy that yacht effectively was one who wants to have that same complicated structure?

Jay

I had a better one than John's! An owner who was using a privately owned yacht, so he went into an Italian lease and he went through the whole 5 years of an Italian lease and ended up with a fully VAT paid boat and then decided he wanted to borrow some money against the boat and was persuaded or not dissuaded, I'm not sure which it was, to go back into exactly the same lease structure again so he got to pay his VAT all over again. And then we were buyers of this boat and we came in 2 years down the track and he wanted to get out of this lease and the only way he could do it was by paying big back end fees and all the VAT. It was a disaster. I have no idea how that happens. How can the bank that financed him the first time around take his money the second time around?

Tork

By saying thank you very much.

Jay

Sadly, yes.

[From the floor]

He should have gone to SpecSavers!!

[From the floor] Chris

The reason that probably happened was that some of the banks, they only know how to lend one way. And that is through their leasing structure. And they just can't think beyond that— 'so you want to borrow money, oh, you've got to go through our leasing structure'. And they don't ask—is it VAT paid? A basic question you would have thought they would have asked.

Martin

Any more comments from the panel? It's about time we went to the bar, isn't it. Right. Dinner is served at the Brasserie again at 7 o'clock tonight, and we'll all be in the bar now for a couple of drinks, and I'll see you tomorrow morning at 9.30, a civilised hour. Thank you very much.
