

INSIGHT

Expert knowledge and opinion from superyacht industry professionals

	page
Buyer's interest – or conflict of interest? by Barry Gilmour	108
Moving towards cruise companies by Wim Koersvelt	118
Getting serious about after-sales by Ian Hornsby	122
The 'special one' by John Leonida	127
Keeping engines running in a new fuel environment by Adam Pearce	131

Buyer's interest – or conflict of interest?

The purchase processes for pre-owned luxury yachts are often relatively straightforward. However, in the case of new construction yachts, fundamental differences exist that must be considered when buying standard production, semi-custom or bespoke vessels, and in all cases, it is the buyer's wishes that should ultimately be honoured, as Chairman and CEO of Royale Oceanic **Barry Gilmour** explains.

Differences in buying processes are first established after the buyer decides whether he wants a standard production or semi-custom yacht (both types referred to here as 'production' yachts). The buyer may require a semi-bespoke yacht, featuring a standard machinery platform and equipment fit, but which offers flexibility in layout, superstructure and accommodation outfit, or a yacht of wholly bespoke design. Both of the latter types are referred to as 'bespoke' yachts here.

At first glance, the purchasing process for these yachts could be expected to be similar, but there are significant disparities that render the procurement approaches quite different.

PRODUCTION YACHTS

If a buyer knows exactly the make and model of yacht he requires, the purchasing process is relatively straightforward as contact can be made directly with the yacht builder and his approved dealer or sales broker to obtain the latest marketing literature, specifications, prices, terms, conditions and delivery details, together with available change options/extras.

If the purchase progresses, the builder's

standard sales contract will usually be offered and utilised, as opposed to using the types (forms) adopted in pre-owned and bespoke yacht purchase transactions, and whilst the builder is usually unwilling to negotiate standard terms, it is well worth taking legal advice so a buyer is aware of just how unbalanced the standard terms can be.

If the buyer's best interests are to be served, the involvement and advice of an experienced professional new construction broker or expert is essential.

The yacht may be delivered from stock or scheduled as part of a production run, the buyer being able to make minor changes to the layout, fabrics, materials, colours, extras, etc, and dependent on its size, the reputation and experience of the builder, may or may not use (although it is highly recommended) a project manager to monitor progress, quality and conformity to specification during construction.

In the case of a production yacht, the

normal process is for the yacht builder to pay his dealer or sales broker a fixed or pre-agreed commission of around five to 10 per cent, in accordance with a formal distribution or representation agreement. This commission is normally included in the purchase price quoted to the buyer.

This should not present too many problems, as being a production yacht which features a tariff of standard prices, terms and conditions, it is relatively clear to the buyer that the dealer or sales broker is acting as an agent for the yacht builder and is merely an extension of the yacht builder's sales function. In this connection the dealer or sales broker has little discretion or ability to influence the design, specification or price of the yacht and does not provide the buyer with guidance or advice.

BESPOKE YACHTS

Bespoke yachts do not feature standard prices, terms or conditions and as their technical complexity increases, so do the purchasing issues, these typically culminating when dealing with a wholly bespoke yacht in excess of 50m, featuring unique exterior styling, interior design and specifications, that may involve complex technical arrangements, for example underwater doors, side shell openings, regulatory compliant helipads, hangars, diesel electric machinery, Azipod propulsion and dynamic positioning systems, etc.

With new large bespoke yachts, the construction process is quite different and more complicated, hence, if the buyer's best interests are to be served, the involvement and advice of an experienced professional new construction broker or expert is essential.



Throughout the rest of this article and for simplicity we refer to the new construction brokers and experts simply as the 'expert', who is also often appointed as the owner's representative.

It is advisable never to fall into the trap of thinking that all builders from a particular country share the same DNA; each yacht builder must be judged on their own merits.

As the first step in any bespoke purchase process, the buyer should employ the services of an expert who is familiar with all procurement, design, construction, operational, contractual and financial aspects of new yachts and who only serves the interests of the buyer, guiding him throughout the entire process; thereby ensuring the buyer receives the yacht he wants, at the right price, specification and delivery time.

Thereafter, the buyer will consult with his expert and decide on the broad features and requirements for his new yacht, which include exterior styling, interior design, layout, specialist features, performance criteria and

indicative budget and so on. The expert will provide guidance and may prepare a statement of requirements (SOR).

Once the SOR is prepared and agreed and where appropriate, the expert will recommend exterior and interior designers, who are considered experienced and suitable for the type of yacht required, he will then include their inputs together with the buyer's SOR to create a 'concept specification'.

On occasions, as a first step, the buyer may contact an exterior or interior designer directly,

in which case this part of process will be reversed. Thereafter, the expert will typically recommend one of the following generic options:

a) To convert the concept specification into a fully detailed tendering/ technical-performance specification, which once agreed with the buyer, will be distributed to selected yacht builders, so that they can respond with their comments, indicative prices and delivery quotations;

or

b) Based on the concept specification, the expert will prepare a 'short' tendering specification and distribute this to selected builders, so they can respond with their proposals for a yacht that essentially complies with the short spec. This approach allows for the inclusion and inputs arising from the builder's previous yachts, design platforms, specifications and experience and provides some flexibility, which could result in time and cost savings over a totally bespoke yacht;

or

c) The expert may simply distribute the concept specification to selected builders inviting them to submit designs and specifications for a yacht, which broadly conforms to the outline requirements of the concept specification. >>

It is worth noting that with regard to options b) and c) the builder's responses will probably fall short of the buyer's requirements and their submissions will require substantial review and amendment by the expert, hence a second or third round of tender reviews would not be unusual. Therefore, for a large bespoke yacht, the only way the buyer really gets what he wants is by preparing the full tendering/technical-performance specification outlined in the first option above.

On receiving the builders' responses, a full analysis of the proposals and specs is executed by the expert. This constitutes a detailed and transparent competitive tendering exercise to identify the most suitable and competitive bids.

The tendering exercise not only evaluates compliance with the specification, but also identifies the builder's alterations, omissions, exclusions and other implications relative to establishing the basic price,

delivery times and terms of payment, etc. Following analysis of the tenders, a shortlist of builders is drawn up and negotiations entered into with the preferred bidders, where all elements of design specification, price, delivery and terms of payment and contract are clarified and discussed.

It is not unknown for a sales broker to register their buyer's identity with several yacht builders in order to put their 'marker' down and ensure that a commission can be secured, irrespective of which yard is the most suitable for the contract.

If, for whatever reason, negotiations with the preferred bidder are unsuccessful, the process is repeated with the second bidder on the short list, or in some cases these processes

are conducted in parallel, the contract being awarded on a 'first past the post' basis.

A bespoke yacht is usually constructed by builders who specialise in bespoke construction and possesses all the necessary experience and established track record. Caution is necessary, as some builders may claim expertise in the construction of large bespoke yachts and quote an extremely competitive price, when in fact, they may not possess the capability or experience and, in some cases, even the facilities to build the proposed yacht. It is advisable never to fall into the trap of thinking that all builders from a particular country share the same DNA; each yacht builder must be judged on their own merits.

During the latter stages of the process, the draft build contract is also prepared by either the buyer's or the builder's lawyers. The buyer would be wise to use the services of legal advisers who possess significant yacht contract

experience on whether it is the buyer's or the builder's contractual template which is used. It will be subject to perusal and heavy amendment by the buyer's and builder's legal team and this, together with the specification, will ultimately form a bespoke legal document.

The form of purchase contract is more comprehensive, complex and substantially different from that used by production builders and, as a consequence, can only be prepared and understood by experienced expert and specialist superyacht legal advisers. Buyers should not be swayed by builders who advise them against using particular advisers, as whilst specific opinions of the builder may be worthy of consideration, it is clear the builder may be looking for an easy ride and is therefore trying to push the buyers away from the advisers that they really need.

The process can be relatively complex, with the building specification being incorporated into and congruent with the legal contractual documentation, as it is not unknown for a build contract to conflict with the requirements of the specification, and vice versa. Moreover, there will probably be several meetings between the buyer's and builder's teams, to negotiate changes to the design elements, specification and contract, which also addresses pricing, PC sums, exclusions, performance criteria, liquidated damages, delivery, build programme/schedules and other aspects, before the contract is finally agreed.

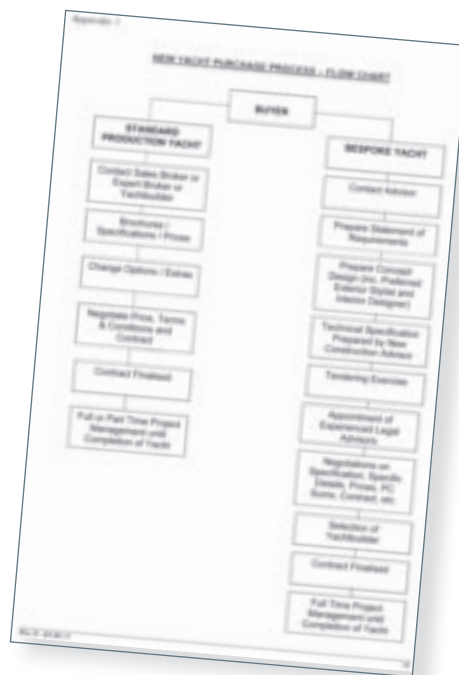
The expert will be significantly involved in commercial negotiations with the builder and must adopt a pragmatic balance to achieve an outcome, which ultimately suits both buyer and builder. An honest, transparent and non-confrontational approach is needed, as this will form the basis of a buyer/seller relationship that will continue for at least the next four years.

Once the contract and all elements are agreed, the transaction is finalised in a formal legal completion meeting and

There are people who are only too happy to take the buyer's money and when it all goes wrong, leave the buyer with problems and costs.

the construction phase commences in accordance with the contract.

Buyers should appreciate that whilst this seems to be a time-consuming process, it is best to complete all the necessary phases in detail, as every dollar spent pre-contract can save thousands post-contract, in avoiding variations to contract, delivery delays, general problems and even litigation during the construction period. Expert pre-contract advice and professional project management should be regarded as an investment.



PROJECT MANAGEMENT

From day one, a bespoke yacht needs to be project managed by the expert (and their team) in order to ensure that its construction complies with the specification and contract, which will assist in guaranteeing that the required quality standards are met and cost/time overruns are avoided. This involves the expert, who is also often appointed as the owner's representative and the official point

of contact with the builder, providing full technical and commercial management throughout the construction period.

The generic differences between the standard production and bespoke yacht purchase processes are illustrated in Appendix 1 below.

SALES BROKERS & EXPERTS

Significant differences exist between unqualified and inexperienced sales brokers and new construction experts, the principal differences being as follows:

NEW CONSTRUCTION EXPERTS

Experts normally only work for the buyer, are professionally qualified, have extensive experience in luxury yacht procurement and construction and do not take a commission from the builder. They are retained on a transparent fee agreement by the buyer right from the start of the process and, therefore, only serve the buyer's best interests and do not possess any conflicts.

SALES BROKERS

It is surprising to note the number of unqualified and inexperienced sales brokers, who, despite their lack of capability, seriously attempt to convince buyers that they are able to guide them through the purchase process of a bespoke luxury yacht.

Some sales brokers 'pass themselves off' as possessing the necessary skills, qualifications and experience as experts. However, undertaking a large new construction project without the necessary capability is a risky process and buyers may not realise that, despite the self-confidence exuded by some sales brokers (and captains) regarding their capability to undertake such projects, it is the buyer who takes the ultimate risk and is financially responsible when things go wrong.

A significant amount of experience is required in the purchase of large bespoke yachts which is far in excess of that required in standard production yachts, and a sales broker cannot just hope to make an introduction and

walk away with a commission, he has to be accountable for his actions, advice and accept responsibility.

Buyers need to be cautious, even with well-established brokerage houses that offer both brokerage and new construction services, with regard to the quality of their 'Chinese walls', confidentiality and impartiality. It is not unknown for tensions to exist between their sales brokerage and new construction divisions, where the latter may recommend a wholly impartial competitive tendering process with an entirely open mind as to the outcome, but find the sales brokerage division trying to influence the outcome of the tendering exercise to favour yards where commission arrangements exist.

Sometimes the statement of requirements, concept specification, detailed specification and tendering exercise may not always be undertaken by sales brokers, who may short-cut the process by taking buyers directly to builders where an established commission arrangement exists. In such situations, the builder may also provide the sales broker with technical advice, which is not impartial or in the buyer's interest.

It is not unknown for a sales broker to register their buyer's identity with several yacht builders in order to put their 'marker' down and ensure that a commission can be secured, irrespective of which yard is the most suitable for the contract.

The buyer – sales broker relationship may be established without the buyer being aware that the sales broker may receive a commission from the builder. This is important – if the sales broker receives

a commission from the builder, then technically the sales broker is the employee of the builder, which represents a conflict of interest. If this is undisclosed and the influence on the buyer is adverse, as of April 2011, if the sales broker is British or works for a British-based sales brokerage house this becomes a potential criminal offence under the Bribery Act. This also presents an interesting paradox, if not legal contradiction, for

sales brokers who approach builders advising that they have 'a client' who is interested in buying a new yacht, when the sales broker subsequently receives a commission from the builder, then it is the builder who is their legal client.

There is seldom more than one sales broker involved in the new construction purchase process, although there may be intermediaries associated with the transaction whose

identities the sales broker wishes to remain secret. This sometimes includes people who may be close to the buyer.

A sales broker who receives a commission from a yacht builder and has the buyer's captain (a significant decision influencer) on-side may not negotiate very hard regarding the specification, price, terms and conditions, etc. The 'trade-off' being that the builder does not create any problems during the construction period and absorbs any problems or minor cost increases into the high price on which the sales broker's commission is based.

Cosy arrangements between builders, sales brokers and captains are interesting, as all parties are handsomely rewarded, but few audits are undertaken to ensure that the buyer is not over-paying and is receiving value for money (that is, his overpayment may conceal inefficiency, ineffectiveness and questionable conduct). Moreover, a sales broker can become overly dependent on the builder, as with the exception of superficial issues, nobody wants to 'rock the boat', and the sales broker does not possess the experience, knowledge and motivation to challenge the builder on important issues.

It is also not unknown for construction milestones to be signed off prematurely by sales brokers to ensure their next commission instalments or give a builder some much needed cash flow in circumstances where the relevant stage should not be signed off.

It therefore becomes a 'club culture' where everybody is comfortable, that is the yacht builder gets the price he wants, the sales broker receives his commission (as may some unnamed intermediaries) and the captain can also put 'construction supervision of a large yacht' on his CV for use at some future time.

If a sales broker involves an independent new construction expert, it is important to establish their credentials as this may also present difficulties as an expert should not be controlled by the sales broker.

Hence, when any form of technical independence is required, the sales broker may seek some from 'friendly' project managers or individual captains and chief engineers, who may have been appointed to their positions by the sales broker or who, in the future, may rely on them for work.

It is recommended that the buyer should pay the sales broker or expert, especially as he ultimately pays all the costs in any case, whether it be builder's commissions or the expert's fees.

We are at pains to re-emphasise the earlier differentiation between 'sales broker' and 'new construction expert', and that there are many professional captains and other people in the yacht industry who act with decorum and honesty. However, this professional conduct is not universal in the yacht industry and there are people who are only too happy to take the buyer's money and when it all goes wrong, leave the buyer with problems and costs.

It therefore follows that the following pertinent questions are relevant:

- *Who is the sales broker's true/legal client?*
- *Is the buyer aware the sales broker may be receiving a commission from the builder?*
- *Who are the other parties involved in the chain?*
- *Who is the broker really serving?*

REWARD MECHANISMS

We have already mentioned reward mechanisms and it can be seen that the differences between the production and bespoke yacht sales processes have a major effect on the method of reward to expect. Hence, it is useful to note that, irrespective of the differences between the construction of production and bespoke new yachts, there are only two basic reward options for experts: sales commissions are paid by the builder (seller), or commission or fees are paid by the buyer. In both cases, however, it is the buyer who ultimately pays.

Option 1 – the sales commissions being paid by the builder (seller)

In the purest sense, as with pre-owned and new production yacht sales, the dealer or sales broker represents the seller (builder), which is the contractual/ legal position. A commission that is in accordance with a formal distribution agreement with the builder should be payable to the dealer or sales broker hence, for production yachts with standard specs, prices, terms and conditions and where the dealer or sales broker represents the seller, or acts as his agent, this reward mechanism is regarded as normal practice.

However, for a large bespoke new construction, this is inappropriate due to the following reasons:

The buyer may be represented as being either an established or new client of the sales broker. When representing the buyer, there is a conflict of interest if the sales broker is receiving a commission from the builder, it being impossible to act in the best interests of both parties. Therein lies an inherent conflict;

If a competitive bidding scenario exists, say, between three builders, where the sales broker has an agreed commission arrangements with each of them, the builder will be paying the sales broker to work on their behalf, it follows that true competition cannot be achieved with any degree of professionalism;

Some builders (not many) refuse to pay commissions especially where information is received; in these cases the only alternative is for the sales broker to divert the enquiry to a yacht builder who does, irrespective of the client's best interest as to which builder is the most suitable for the project.

The UK Law Financial Service Act 2010 is generally tightening on commission-based advice, where information received is neither impartial or accurate and is relayed to the client on the basis of commission driven products, of which the client is not aware, they are not being in receipt of the best advice on the product available but simply being

BUYER'S INTEREST – OR CONFLICT OF INTEREST?

recommended the products which feature the highest commission for the sales person. This system is now being changed to reflect the required level of independence and impartial advice. Therefore clients will pay a fixed fee and the information provided will be wholly transparent and free of pecuniary interest.

Whilst this legislation does not yet apply to other industries it is a demonstrable act as to how the legislators are now thinking. It follows that sales commissions paid by yacht builders for large new constructions are fraught with conflicts. This mechanism is not recommended to buyers of new large bespoke yachts, unless they are fully aware of the conflicts and are confident that such conflicts can be adequately managed.

Option 2 – sales commission/fees being paid for by the buyer

The most appropriate reward mechanism for large bespoke new constructions is that the builder does not pay any commissions at all and that the sales broker or new construction expert is to be retained and paid directly by the buyer. This ensures that the buyer's best interests are served at all times and all conflicts of interest are avoided. In this scenario, sales brokers may be severely exposed as they may not possess the necessary technical qualifications or new construction

experience and therefore bring little to the party. Moreover, the sales broker's personal reward expectations may not be achieved by a transparent fee.

With commissions or fees being paid by the buyer, there are no conflicts of interest and the process is wholly transparent. It is recommended that the buyer should pay the sales broker or expert, especially as he ultimately pays all the costs in any case, whether it be builder's commissions or the expert's fees. At least with the latter, it is beyond doubt that the sales broker or expert is working directly for the buyer.

The purchase process for bespoke yachts varies from that of production yachts and requires a different approach, especially as there are no standard prices or terms and conditions. Buyers of bespoke yachts therefore need to bear the following in mind:

The involvement of an experienced new construction expert from 'day one' is essential. If conflicts of interest are to be avoided and the buyer's best interest served, the buyer should directly retain and pay the sales broker/expert. The builder should not pay commissions unless they are wholly transparent and the buyer is made fully aware of the arrangement and its implications.

Not unreasonably, many sales brokers concentrate on getting very close to

their clients and in some cases to such an extent that they may become an intimate and trusted friend. However, this should not justify the payment of an undisclosed commission; additionally, the payment of such undisclosed commissions may be interpreted as bribes and could become illegal under the UK Bribery Act 2010.¹ Buyers should ask sales brokers whether they are receiving a commission from a yacht builder and consider inserting clauses in the purchase contract that prohibit payment of undisclosed commissions.

New construction experts work hard for their money and risk working with the chance of not being paid. However, all the time that commissions are disclosed it is not an issue; it is when they are not that potential problems can arise.

Whilst saleforms for brokerage vessels clearly state the procedure for remuneration, this is not the case in new construction. Therefore, without such it is not fair compared to the relative risks that new construction experts take and considering the benefits they provide to the buyer.

Opening image: istock.com

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1. Reference: 'Dirty Cash' by Clyde & Co/J Leonida The Yacht Report issue 117