

A Current and Practical Guide to Yacht Arrest

Maritime Law Association of the United States

May 6, 2021

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New yacht construction bookings have continued to increase this past year both domestically and internationally resulting in the construction of even larger and more innovative yachts. Some of these yachts are reaching market values well into the hundreds of millions of dollars. As these floating behemoths are launched and encounter legal disputes, maritime practitioners must confront the novel legal and practical issues that they pose. For example, issues might arise regarding a yacht's unique operations, crewing, insurance, charter disputes or force majeure (COVID) operational issues. Additional considerations arise due to the increased complexity of yacht operations and judicial enforcement of possessory (In Rem) claims.

Despite the increased size and complexity of yachts, the fundamental legal process for the judicial arrest of a yacht remains intact. As a direct result of the global pandemic additional innovations in the legal process have emerged with Zoom hearings now being favored. Arguably this has created a new measure of efficiency in the prosecution of a yacht arrest.

This article focuses on the practical steps needed to protect a client's best interests in these valuable assets during an arrest. Preparing for these often nonjudicial issues and how to care for the particulars of a yacht in the course of an arrest can

present challenges for the legal practitioner distinguished from prosecuting an arrest for ships or smaller, less complex vessels.

A few years ago, a yacht arrest was typically for a small “necessaries” claim or dispute and seemingly more streamlined than what we confront today. The pleadings would be filed, the warrant executed, security or a bond posted following negotiation, and the yacht released. More recently we have seen circumstances involving claims of higher dollar amounts against yachts for extensive repairs, refit work, mortgage related claims, salvage, allisions and even attachment/Rule B claims. Each of these presents more complexity at inception of the arrest. As yacht sizes increase, the manning numbers increase, and crew wage and injury claims continue to rise. The increased dollar value of arrest disputes for yachts has made it only more expensive for litigants in this process.

Understanding the challenges to the practical side of arrest is essential in effectively managing these cases and producing a cost-effective result for clients in the process.

Prior to commencing a judicial arrest, a claimant should secure a current condition survey and market value appraisal of the yacht weighing its value against the totality of liens or possible intervening claims. If you are representing a “necessaries” provider who has not been paid, determine if the crew payroll is current and if the mortgage payments are being remitted. Ascertain if there could be any technical default that would affect the status of the mortgage, such as a priority claim ranking ahead of your client’s lien. A conflict for any of these issues could prevent a quick resolution and cause a longer-term custody issue and/or possibly force a sale of the yacht to the detriment of the claimant. It is important to carefully consider at the initial stage

whether it would be a good outcome if the case were to go to sale? It should be determined whether there enough value in the yacht to support long term *custodial legis* and still pay all claims?

Economic Climate:

The current economic climate presents multiple issues that can affect the outcome of a case. Due to current COVID restrictions on travel and recreation, yacht values are at an all-time high, but these could plateau or even drop should the market change. Insurance premiums for yacht coverage are expected to rise. Tax law changes and fuel price increases may also affect the market. These changes could occur quickly and should be considered by anyone commencing a yacht arrest.

The current regulatory impositions on Banks have demonstrated that yacht lenders react more quickly and aggressively with a greater proclivity to assert technical defaults or breach of loan covenants by yacht borrowers. Examples include a borrower allowing a yacht to suffer a lien for “necessaries”, failure to pay insurance or threat of civil forfeiture claim.

For a loan payment default, current bank policy may allow an individual yacht owner to defer payments under the COVID relief act. This typically only applies to a “consumer” transaction and would not be applicable to a corporate owned yacht.

Jurisdictions and Districts:

It is normal in today’s market for any yacht over 30 meters to move around the globe, either on her own bottom or via readily available yacht shipping companies. A majority of these yachts choose to fly “flags of convenience” and / or are flagged outside

of the United States. As a result they may encounter lien issues domestically and in other international jurisdictions.

Arrest and foreclosure rules, procedures and ranking of maritime claims vary between US and international jurisdictions, affecting such factors as the speed at which arrest actions are resolved, priority of lien claims, countersecurity requirements and the predictability of outcome. In less sophisticated parts of the world, vessel custody periods can linger several years, and otherwise-routine decisions become prolonged. Partiality may favor local yacht owners while inexperienced jurists can cause costly delays and/or unpredictable decisions. Forum shopping for the best suited jurisdiction for an arrest thus becomes an important decision for any lawyer providing advice on the foreclosure/arrest of an internationally moving yacht.

There are inconsistencies in the ship arrest process amongst federal court districts even in the United States. Variances in local rules, service of process, marshals, deposit requirements, substitute custodian requirements, time challenges and the overall familiarity with vessel arrest process can further complicate the procedure. Given a lack of arrest frequency in some judicial districts, judges, their clerks and US marshal personnel may be less familiar with ship arrest practice. If the arrest involves complicated legal issues, multiple claimants or the likelihood of significant custody costs, a claimant might best be guided to relocate the yacht to a more seasoned maritime judicial district for arrest proceedings.

Another challenge for practitioners commencing an arrest, especially in the COVID climate, is the potential lack of availability of U.S. Marshal personnel to execute the arrest. One should check if such judicial districts permit private service in lieu of federal marshal service of process by Court appointment.

Yachts that travel between major ports sometimes change location quickly. Good rapport and communication with the judge and clerk assigned to the arrest warrant, and the local Marshal's staff to ensure their availability during the short window of opportunity for the arrest is paramount to effect and timely serve process for an arrest warrant. One should be cautious not to earn a reputation of "crying wolf" or telling the Marshal or the courts that an arrest is an emergency when it is not. Favors should be saved for when they are really needed. If you miss the execution on the yacht while in her current location, research the target vessel's future routes in case you must file quickly in another district. As COVID policies were put in place, most judicial districts curbed marshals from executing vessel arrest warrants. As a substitute, some court districts allow private parties, state marshals and even claimant's attorney or the custodian to execute in their place. Utilizing this private execution and the fact that it has become more commonplace could be advantageous post pandemic.

With AIS technology available today and the ability to track vessels and even anticipate their next port, preparing in a friendly or preferable jurisdiction is easier to predict and plan to achieve arrest forum shopping.

Total Arrest Cost vs. Arrest Return:

Yacht values can fluctuate dramatically based on many factors other than just year and size. Heavy charter use (wear and tear) and high engine hours can cause what appears at first blush to be an attractively appointed yacht to in fact be less valuable. A yacht built by a non-pedigree yard could be worth less than one from a well-known reputable builder. This can also be the case if the yacht builder is or has experienced financial problems. Therefore, a professional assessment of yacht value is an important consideration in prelude of any arrest. It is very important to budget as tight of a time

frame from arrest to sale as possible. Contested arrests add to the custodial costs, legal fees and increase the likelihood of deterioration of condition and diminution of value for the yacht.

Environmental Issues:

Government authorities throughout the world are increasingly conscious of environmental matters on their waterfronts. Whether pier side or at anchorage, there is an underlying risk of a yacht causing pollution or other environmental damage. The liability associated with fuel spills or reef damage may prove to offset any possible gain for the arrest of a mega yacht and should be carefully considered. A current insurance Certificate Of Financial Responsibility (“COFR”) as applicable for any yacht domestically in the US over 300 gross tons should be verified in advance of arrest.

Countersecurity/wrongful arrest

Domestically, Supplemental Admiralty Rule E (7) provides for security for a counterclaim that arises out of the same transaction or occurrence as the original action. While the language of the Rule is mandatory, courts are reluctant to require countersecurity where the counter claim would unfairly burden a maritime lien claimant or unreasonably inhibit a claimant’s prosecution of its case. Expert Diesel, Inc., v. Yacht Fishin Fool, 1986 AMC 2110 (S.D.Fla. 1986). Certain foreign jurisdictions have onerous requirements for countersecurity, which must be posted in advance and may be difficult or time-consuming to have released. Countersecurity is an effective sword however if the claimant’s case is weak or bordering wrongful arrest.

The Substitute Custodian:

The substitute custodian should provide professional communication and transparency to all parties conveying a good understanding of the strategic and legal aspects of yacht

arrest. This ensures commonality of custody assignment goals and will help achieve an efficient outcome. There are several critical custodial goals that are common to all yacht arrest assignments: ensure the safety of yacht and crew, control costs (locally fair and reasonable) and preserve value of the yacht.

Crew assessment, pay, immigration, reduction and medical concerns

Upon taking custody of a crewed yacht, several vital assessments must be made by the substitute custodian. It is essential to immediately meet with the yacht's master, describe the procedural protocol and implication of the arrest, the purpose and responsibilities of the substitute custodian, and assess whether the captain will be a positive on-board influence relative to the arrest. Disposition of essential and non-essential crew becomes a requirement for the period of arrest.

Typically, the captain and senior officers are qualified and committed servants of the sea, possessing both good communication skills and a commitment to the yacht and crew. While there may eventually be potential conflicts with the yacht owner, operator or charterer of the yacht, it is important to get the point across that the Court is ultimately in control of the yacht during arrest and captain and crew will be paid in highest priority. Communicating with and taking instructions from an experienced watchman, as the court/custodian representative, also helps solidify the relationship with the captain and move any arrest in a positive direction.

Compile a crew list with payroll records and crew contracts, when available, as they are vital tools in determining repatriation strategies during the custody period. Since crew compensation scales are frequently broken down into several categories, proper documentation ensures that unnecessary compensation (Severance) is not paid. During most long-term arrest assignments, it is best to retain the existing crew. Obtain

court permission for payment of crew services provided during the arrest period. These wages are considered a cost of administration.

When foreign crewmen are on-board, immediately confirm the immigration status of each crewmember. If the arrest is executed upon arrival in port, the crew may not have been cleared by immigration authorities. If the crew has been cleared, the physical location of their passports/visas is confirmed with the boarding agent. If the crew wants to leave the ship during a long-term arrest, ascertain that the documentation is appropriate based on the immigration requirements. COVID has introduced yet another layer of complexity here.

One effective way to save costs in arrest is to eliminate unnecessary, underutilized crew, as crew pay generally represents a significant portion of the custodial expenses. Retaining unnecessary crew also increases exposure to both injury and illness. Review safe manning documents to determine the appropriate level of crew personnel necessary to safely keep the yacht. The minimum headcount must also be observed to comply insurance coverages in place. If it is determined that unnecessary crew can be eliminated and create savings, plan for repatriation on a timely basis.

Immigration department protocol typically dictates that foreign crew must be escorted to the airport gate of an international flight. When the yacht location is not proximate to an international airport and connecting flights are required, security escorts must accompany foreign crew onboard each domestic leg of the trip.

Clearing crew medical issues is of the utmost significance and becomes an issue in more instances than one might expect. At time of arrest, an immediate verification of any pending medical conditions can avoid major cost and P&I coverage issues at a later date. Document if any crew is ill, being treated or is currently injured. Crew medical

issues, including expensive maintenance and cure requirements which last throughout the term of the illness and which arise during the arrest period could become administrative costs of the arrest.

Insurance Issues & Coverage

In order to minimize claimant risk and to preserve the value of the collateral, hull & machinery, port risk, P&I, crew and pollution coverages should be in effect during the pendency of the arrest. Immediately after taking possession of an arrested yacht, it is important to evaluate which coverages are in place and the effect the arrest has on coverage. The yacht arrest might have an adverse impact on insurance coverage as some underwriters suspend coverage if the owner no longer controls the yacht during an arrest. It is recommended that the vessel custodian and the Marshals Service be named as an additional insured under all insurance coverages. This will ultimately serve to confirm underwriter's knowledge of the arrest and verify that coverage is not affected. In general, if there is a substitute custodian, he must have sufficient coverage to indemnify the U.S. Marshal against claims.

In some instances, the U.S. Marshal may charge for insurance coverage which may not provide coverage for hull and machinery, port risk, P&I, crew or pollution claims. Identify the specific Marshals' coverage to avoid uninsured risks or duplicate coverage.

Lapses in coverage often forces claimants to scramble to place insurance coverage at less-favorable terms. Fixed premium, limited term policies are better alternatives for a custodial scenario, compared with annual policies or a P&I Club environment. Due to

the shorter term and the fact that normal vessel operations are not underway, (Port Risk) rates are substantially discounted.

Yacht Valuation & Survey

Best practices dictate obtaining an independent valuation and survey in advance of arrest and/or early in the process and updating the same prior to filing motions for sale, particularly when there are multiple claimants. The valuation should be based upon orderly liquidation or quick sale value in an as is, where is condition. The valuation is the basis to resolve pre-sale minimum acceptable bid arguments raised by lower-priority claimants and assists with the court's ultimate confirmation of sale (in instances where other claimants or the owner express doubt about the sales price in relation to value).

The survey also becomes a valuable sales tool, as it contains a substantial amount of technical information such as vessel specifications, onboard equipment, identified deficiencies, maintenance requirements and class-related issues. Ensure that the survey is prepared in a format suitable for widespread distribution, eliminating potential claimant liability.

Court Ordered Sale

Domestically, court-ordered, judicial sales are generally administered by live auction format overseen by the U.S. Marshal Service. The judicial sale has the benefit of cleansing title, eliminating ("foreclosing") all prior-existing maritime liens which may have attached to the vessel. The timing for judicial sales for yachts, depending on the facts can be ordered by the court either pre-judgement and/or post-judgement.

A pre-judgment, interlocutory sale may be ordered by the court when it finds: (1) the yacht is exposed to deterioration, decay or injury; or (2) the expense of keeping the

vessel is excessive or disproportionate to its value; or (3) there is an unreasonable delay in securing the release of the property. Because interlocutory sales transpire in advance of the known outcome of a case, vessel proceeds are held by the court until each claim's status is decided, which could take several years. In general, the claimants cannot credit bid their claim amount.

On the other hand, in a post-judgement sale, the proceeds of the sale are quickly disbursed to the judgement creditors to settle the outstanding charges. In this instance, judgement creditors are permitted the right to credit bid up to their relative lien position. This eliminates the need for creditors to double-down their investment when making protective bids.

It is the claimant's responsibility to file motions for sale, which should consider (as appropriate) hiring a competent broker to promote the sale, pre-sale marketing expenditures and advertising, written vessel valuation and survey, minimum bid and credit bid conditions and requirements, and the opportunity to perform physical inspections by potential bidders. In general, the costs of sale are considered an administrative cost.

Promotion of the court ordered sale is an essential tool that improves the likelihood of a successful sale. Although the U.S. Marshal is required to publish a legal advertised "notice of sale", it is generally inadequate to aggressively promote the sale without assistance. A competent broker will place electronic and print trade advertising, target potential buyers, distribute survey reports and technical materials, explain the sales process and buyer qualifications. These services are generally performed for a fee that is a percentage of selling price, which is generally court- approved as an administrative expense.

Minimum Bid

A court-ordered minimum bid is established to protect the interests of non-priority lienholders and vessel owners from the vessel being sold substantially below value. It is generally recommended that the court direct minimum bids to be on the lower end of the value range, so as to encourage auction attendance and spirited bidding. If the vessel does not ultimately sell at auction, it can take a minimum of 15 additional days to arrange a new sale date. Meanwhile, carrying costs continue. Repeat sales generally attach the “didn’t sell last time” stigma to a vessel, further reducing bidder interest.

Bidding

The Marshal’s office handles the administrative aspects of the sale; the marshal’s deputy serves as auctioneer. Their involvement is vital to the success of the auction.

Before the bidding begins, confirm that the Marshal is aware of any conditions of the auction (citizenship, minimum bids and the right of party[ies] to credit bid) and ascertain that each bidder is properly qualified. Generally, there will be a minimum deposit requirement for bidders.

With the current COVID travel restrictions, the US Marshal has utilized outside parties to conduct online or Zoom video auctions.

Protective Bidding

Depending on the actual bidding, it may be in the claimant’s best interest to acquire the vessel at auction. The court auction process is typically bidder unfriendly; vessels are sold on short notice, “as is, where is”, and financing contingencies aren’t allowed. This may yield lower, under-market bids. Creditors who establish a realistic understanding of the vessel’s value, in relation to the priority of their claim (in the case

of interlocutory sales), may opt to purchase the vessel at auction, so as to protect their claim equity against successful under-market bids. Because of the value of the underlying claim, in practice, protective bidding is generally limited to the mortgage lenders. Although these buyers generally remarket the yacht immediately after the auction (in a more buyer-friendly environment) in some instances they continue to trade the yacht until such time that they can realize an increase in value.

We hope the above provides a current and practical guide to legal practitioners to consider in advance to commencing a yacht arrest.