

So, You Want to Buy a Ship? Sale & Purchase Essentials

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A memorandum of agreement (“MoA”) is customarily the governing sales contract. Various standard form MoAs exist, the most widely used being a joint product of the Norwegian Shipbrokers’ Association and BIMCO. The latest version of this periodically updated MoA, and the subject of this article, is the “SALEFORM 2012”, better known as the Norwegian Sale Form 2012 (“NSF 2012”). The NSF 2012 and its preceding versions (notably the NSF 1993) have become industry standards within the UAE and most other popular shipping jurisdictions.

Before Concluding the Memorandum of Agreement

Brokers & Preliminary Negotiations

Before signing the MoA, there are several important stages. Generally a prospective buyer, or eager seller, will approach a ship broker as a first port of call. Brokers are ordinarily remunerated on a commission basis, conditional upon closing, calculated against the value of the vessel. Traditionally it is the seller who is legally responsible for the brokers’ commissions. The total brokerage fee is often split between the seller’s and buyer’s brokers, with an effective commission of one percent each. In practice there are many variations of this arrangement. Parties should be mindful that, contractually, brokers are invariably not party to the principal sale and purchase agreement.

Once a prospective sale is identified, the main terms are considered, with negotiations often led by the brokers. The extent of preliminary negotiations may vary, but will usually focus on larger items, such as; price, required deposit, lay dates for delivery, and inspections. Lawyers are often only engaged once these preliminary negotiations are complete.

Parties are cautioned to ensure these negotiations are not capable of unintentionally creating legally binding agreements. This could (and has) occur through inadvertently extending an offer capable of acceptance through a broker (as ostensible agent), or accepting such an offer. Such risks may be easily avoided by, for example, ensuring correspondences, or recaps, clearly assert that all terms are subject to execution of the MoA. The inclusion of phrases such as “subject to contract” in relevant exchanges have become good practice in this regard.

Inspections & Due Diligences

Before signing the MoA, buyers may seek a basic inspection of the vessel and copies of the main certificates. Whilst recourse is available for failed inspections after signing the MoA, a prospective buyer with no contractual obligations (or paid deposits) may more easily walk away from a sale should the vessel be patently unacceptable. Detailed inspections and surveys are usually performed after signing the MoA, as considered below.

Before signing, each party is also encouraged to perform a preliminary due diligence on the other. Modern vessel ownership is typically structured using single ship-owning entities registered in regulatorily friendly offshore jurisdictions. Opaque structures may obscure the identity and arrangement of one’s true contractual adversary. Similar to inspections, safeguards should also be employed in the MoA, for example; evidence of good standing, proof of vessel ownership, etc. And similarly, it is recommended to perform basic checks before committing to the MoA, after which it may be more difficult to avoid the sale if an unsatisfactory position is discovered.

Parties should also be aware of any financing relevant to the sale, before concluding the MoA. If the vessel is mortgaged, or otherwise encumbered, a prospective buyer will be eager to ascertain how clean title will be attained. A seller should also establish from the outset if the buyer intends obtaining financing. From a practical perspective there are various elements that require attention if debt, or equity, financing is applicable. For example; required deletions of registered mortgages, registration of new mortgages, permissible corporate structures, particular requirements of the lender, etc. Whilst it is beyond the scope of this article to consider ship finance in any detail, parties should be mindful that applicable financing will invariably affect some elements of the sale and purchase transaction.

Sale in terms of the Memorandum of Agreement

The NSF 2012, in its unamended form, extends just eight pages covering eighteen clauses. The short document is, however, remarkably versatile. It provides a roadmap of what is required by the parties before transfer of the vessel, what may be done if such requirements are not met, and how transfer of the vessel should take place. Here we consider the main terms.

The Parties

The identities of the buyer and seller are not always immediately apparent. In practice, the named buyer will often be a special purpose vehicle ("SPV"). Alternatively, a mechanism permitting novation of the MoA is frequently sought by buyers who have not yet established a SPV to own the vessel at the time of signing the MoA. The buyer should also confirm the identity of the named seller, which should be the same entity listed as the officially registered owner of the vessel.

Vessel Description, Purchase Price and Deposit

Two essential terms of any contract of sale are the property being sold (ie; the vessel) and its price. Both should be clearly stated.

Payment of a deposit by the buyer, to the value of 10% of the purchase price, is standard practice. The NSF 2012 affords the buyer three banking days to make such payment to a third party holder, after signing, and confirmation from the deposit holder that the relevant account has been opened. All things being equal, the deposit will ultimately be transferred to the seller on delivery of the vessel.

Inspection

Inspection of the subject vessel, her records, and acceptance thereof is a requirement particularly susceptible to disputes. The various NSF versions have long taken the default position, and still do, of affording the buyer unfettered discretion to effectively either accept or reject the vessel on the basis of inspection.

To accept the vessel, the buyer is required to perform a positive action – the issuance of a written notice of acceptance to the seller. This should be provided within 72 hours of the inspection, unless stated otherwise. If accepted, the NSF 2012 deems the sale "*outright and definite.*" Should such notice not be forthcoming, the sale is automatically considered null and void, and the buyer is entitled to have its full deposit returned along with any interest it may have earned.

In practice the inspection clause is often keenly negotiated. Sellers may seek to amend the default position so that the inspection will only nullify the sale if defects are discovered, which cannot be rectified within a reasonable period of time. Buyers will likely seek to maintain total freedom to entirely avoid the sale if desired. Reliance on a purportedly failed inspection is a popular route for buyers seeking to avoid the sale for any number of reasons. Parties should also be mindful of the underwater or drydocking inspections the buyer is entitled to, although non-acceptance in this instance does not by default vitiate the sale, even if defects are found. In all cases, parties would be well advised to clearly stipulate their respective rights and obligations concerning inspections.

Closing the Sale

A ship sale and purchase transaction culminates with its “closing.” Here the buyer and seller (usually on the same day) exchange documents, make payment, and physically deliver and transfer the vessel. It requires careful coordination between various parties who operate in unison to ensure the sale successfully closes. Each party has its role to play. As an indication, some key participants on the day may include; seller and buyer (or authorised representatives), lawyers, bankers (both as financiers and for payments), flag state representatives, crew (old and new if replaced), brokers, class representative, insurers, with others potentially also required, normally not all in the same location, or even the same time zone.

There are essentially three main elements to a conventional sale and purchase closing; (i) delivery of documents, (ii) delivery of the vessel, and (iii) payment. Closing often occurs through two simultaneous meetings – one onshore in a meeting room and the other onboard the vessel. Parties will establish communications between the two meetings, and with any required third parties. A “pre-closing” meeting may also occur as a dry run before final closing.

(i) Delivery of Documents

Documentary exchange usually extends to two types of documents. Firstly, the delivery of vessel documents by the seller to the buyer. Secondly, delivery of all other documents stipulated in the MoA.

Vessel documents are those directly associated with the continued operation of the vessel, often kept onboard. They may include; safety certificates, class certificates, technical documents, logbooks, manuals, plans, blueprints, etc. These documents are often exchanged at the ship meeting. Buyer’s representative onboard the vessel, commonly an appointed technical manager, will confirm the vessel documents are in apparent order to the onshore meeting.

The second portion of documents is all others required by the MoA. These are generally exchanged at the onshore meeting. The core documents provided by the seller to the buyer are:

- *Bill of Sale*

This is an important document, legally recording the sale between the parties, normally in a statutory or official form dictated by the flag state. As per the NSF 2012, it should be in a form recordable in the buyer’s nominated flag state, transferring title of the vessel and stating that the vessel is free from all mortgages, encumbrances and maritime liens. It should also be notarised, legalised or apostilled (as may be required). Parties should afford sufficient time to have this process completed, and also factor in costs.

- *Evidence the transaction is authorised*

Corporate entities should provide board and/or shareholders’ resolutions.

- *Power of attorney appointing representatives*

The actual execution of the necessary documents, and transfer of the vessel, should be completed by parties duly authorised to do so (buyer and seller).

- *Certificate from registry evidencing current ownership*
- *Evidence of class*

Here evidence is presented of the vessel’s good standing with a particular classification society.

- *Certificate of deletion from previous registry*
- *Commercial invoice*
- *Commercial invoice for bunkers & lubes*

Ordinarily a buyer will pay for the vessel's bunkers remaining on board, as well as any unused lubricating and hydraulic oils. Practically, this is often directly deducted from the purchase price.

(ii) Delivery of the Vessel

Physical delivery of the vessel is facilitated through several stages. Firstly, the parties elect a place for delivery. In accordance with the NSF 2012 the seller is obliged to deliver the vessel at this location "*safely afloat at a safe and accessible berth or anchorage.*"

The parties will also record the lay dates for delivery, being the acceptable period within which delivery may take place. This is done through recording a particular date after which the seller may issue a notice of readiness ("NOR"). The NOR stipulates that the vessel is ready for delivery. Following its issuance, the buyer is obliged to accept such delivery, or risk being considered in default. The seller is obliged to keep the buyer abreast of when it intends tendering the NOR, with intermittent notices of twenty, ten, five and three days being required.

The parties will also record a "cancelling date." The seller is obliged to tender the NOR before such date, failing which, the buyer is afforded the option to cancel the contract.

At closing, delivery of the vessel is achieved through two actions, which take place simultaneously. The first action is the *physical* delivery of the vessel by the buyer to the seller. There are various possibilities in this regard, depending on the circumstances of the sale. Sometimes representatives are placed onboard to communicate with the shore meeting that the vessel is handed over, as noted in the vessel's log book. It may be accompanied with a crew change.

The other action is the *documentary* delivery of the vessel through the signing of a protocol of delivery and acceptance ("PoDA"). The PoDA records the exact time and place of delivery. It is generally regarded as evidencing the exact time title and risk pass from the seller to the buyer. It is ordinarily signed by the authorised representatives at the shore meeting once payment of the purchase price is confirmed.

(iii) Payment

In accordance with the NSF 2012, the buyer is obliged to pay the balance of the purchase price, and release the deposit, "*on the delivery of the Vessel, but not later than three (3) Banking Days after the Notice of Readiness has been given.*" Aligning payment and delivery presents practical challenges, with international bank transfers often taking up to several working days. Various mechanisms have been developed to address this predicament.

One option is a suspense account. Here the buyer prepositions the funds with the seller's bank for quick release upon its instructions. The release may be made in accordance with an irrevocable payment instruction from the buyer/its bank. This is often achieved through issuance of a SWIFT message, usually a MT 103, from the buyer's bank to the seller's bank instructing the payment. Often an accompanying SWIFT MT 199 message details when such payment may be made, and any applicable conditions (eg; receipt of the PoDA).

Confirmation and payment letters are another option. The buyer's bank may confirm it will initiate payment to the seller's nominated account immediately following any specific action (eg; signing of the PoDA). A payment letter will accordingly be released at closing, neutralising any timing challenges.

An escrow agent is a further option. Here a third party is mandated to release funds received from the buyer (in advance), against agreed conditions.

Conclusion

The sale and purchase of a ship presents a variety of challenges, both legal and practical. Many of these

may be overcome through careful planning and execution. The NSF 2012 remains a stalwart contract aimed at clearly guiding both buyer and seller through the process. As with sailing a ship, performed well, a sale and purchase will mostly be smooth sailing. Performed poorly, and she may quickly run aground.

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