BUYER BEWARE – SECTOR-SPECIFIC RISKS FOR BUYERS IN MARITIME M&A TRANSACTIONS

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OVERVIEW

In the maritime sector it is much more common to undertake the sale of a vessel on an asset sale basis than as part of a more traditional M&A transaction effected by the sale and purchase of the vessel owner's shares. This is the case even though ships tend to be owned by special purpose vehicles, which own only one ship and have no assets or liabilities unrelated to that vessel.

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There is often a good reason for this. As the buyer is usually interested only in acquiring ownership and control of the ship and nothing else, it is seen as less risky and more straightforward to buy the vessel rather than acquire the owning company which as well as owning the ship is also potentially exposed to historical liabilities of which the buyer is not (and, in many cases, cannot be) aware of at the completion date of the sale.

Nonetheless, there are sometimes good reasons to acquire a vessel (or more often, a fleet of vessels) using a more traditional M&A share acquisition transaction structure, either acquiring individual vessel-owning SPVs or an ultimate holding company. Reasons for this include:

- a fleet is to be sold *en bloc* and/or vessel management companies or other associated businesses and operations are also to be acquired by the buyer;
- the vessels that are to be sold enjoy advantageous contractual arrangements that may be problematic to novate to a new owner, e.g. financing, management or pool arrangements or charters (although note that many such arrangements will be subject in any event to requirements to notify or get consent from the contractual counterparties); and
- coordination of the sale and purchase of a fleet within a single day can be legally and practically complex if the vessels are transferred as individual assets, particularly if some of them are mid-voyage.

However, one thing is clear: if you are not buying a vessel directly but are acquiring a company that owns the vessel, this gives rise to a transaction with unique maritime sector specific characteristics in addition to the customary considerations and risks which are common to all M&A transactions undertaken by sale and purchase of shares. Approaching a vessel-focussed M&A transaction in the same way as any other share sale is short-sighted and fraught with risk for a prospective buyer.

The WFW Corporate maritime team has extensive experience in acting for both buyers and sellers in connection with vessel-focussed M&A transactions structured as sales of ship owning companies rather than asset sales. This article highlights some of the main additional risks we encounter and address during such transactions.

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Sanctions

Given the multi-jurisdictional nature of shipping transactions and ownership structures, there is an elevated sanctions risk compared to other sectors. In particular, there is the risk that a major customer or service provider is, or is at risk of becoming, subject to sanctions, therefore exposing the vessel owner to liability or compromising part of a vessel's supply chain and affecting the value of any charters or customer contracts. Vessels and vessel owners themselves can be subject to ongoing blacklisting or other restrictions if they have previously been operated in contravention of applicable sanctions. Continuing provision of services by third party service providers can also be complicated by sanctions concerns; for example, the commercial bankers for a fleet may decline to continue providing such services following completion of the sale of a vessel SPV or a fleet if the new owner is unknown to them or has a different sanctions risk profile. For more information, please see our in-depth guide on sanctions and shipping here: Sanctions & Shipping: Update & Overview".

HS&E Liability and scrapping

The risks posed by environmental liability in a shipping business are obvious. Less so is the importance of understanding how such risk varies according to the jurisdiction in which the relevant vessels are operating. Certain jurisdictions, such as the USA, have highly punitive regimes and have a track record of actively prosecuting breaches. Environmental risk can rest with the owner/operator rather than the vessel itself, and therefore there is an increased risk profile if it is the owner that is acquired. In common with certain other jurisdictions, the EU has an increasing focus on the treatment of "end-of-life" vessels and compliance with the Hong Kong Convention (the Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships, 2009), and liability for historical transgressions, and future compliance with the convention in connection with vessels that are acquired but are approaching the end of their lives, may become a problem for the new owner of a ship-owning group.

Calculation of Bunkers

In an individual vessel sale, it is usual for the buyer to buy all fuels on board the vessel at the time of completion, at the price the seller paid for them. In order to determine the amount payable, a joint sounding/stocktake of the bunkers, lubricants and greases by the parties occurs the day before completion to determine the volume of fuels that remain. In a multi-ship M&A transaction with a simultaneous closing on all vessels, where some vessels are mid-voyage, this can pose a number of practical issues including the fact that bunkers cannot be properly sounded unless a vessel is stationary. The share purchase agreement will need to include a mechanism to address this practical issue and ensure that the buyer does not overpay or underpay for bunkers.

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Type of Bunkers

There is a risk that the seller might have ignored the recent application of MARPOL Annex VI regulations which requires the use of certain types of low emission fuels or, alternatively, emission scrubbing equipment to ensure emissions from fuel burned remains within specified parameters. A buyer will wish to confirm that vessels are in a position to comply fully with these regulations immediately post completion.

Maritime liens and "in rem" claims

Certain types of claims may attach to a vessel (as opposed to the company owning that vessel) therefore, after purchase, the vessels may still be subject to such claims even if the claim arose prior to the sale and was nothing to do with, or was not in the knowledge of, the buyer or possibly even the seller. Such claims could allow a claimant to arrest the vessel (and some maritime jurisdictions provide claimants with the ability to arrest sister ships as well). Adequate protections should be included in the sale and purchase document in respect of these risks, some of which might be considered unusual in M&A transactions in other sectors but should mirror the protections a direct buyer of the vessel would otherwise receive if the transaction was structured as an asset sale.

Customer contracts and charters

Charters for vessels are often agreed by recap or through multiple documents making up one binding agreement. When buying a vessel directly, it will be very clear what chartering obligations are being assumed by the new owner of the vessel as any continuing contracts will need to be specifically novated but if the vessel-owner is being acquired the position may not be as clear. During due diligence it is imperative that the buyer retains specialist shipping lawyers to ensure such charters (which usually represent the main income for the business) are binding and contain the terms as expected and that the vessel-owning companies are not subject to any unexpected, disadvantageous contractual arrangements. It is also common within shipping groups for the ownership and operation of vessels to be undertaken by separate entities or for customer contracts to be entered into by one group entity and then sub-contracted within the group. It is important for the buyer of a vessel-owning company or group to have a clear understanding of the contractual basis on which the vessels are operated and commercialised and ensure that the benefit of key contracts for the operation of the vessels are acquired by the buyer and not mistakenly left outside the transaction perimeter.

Counterparty Risk (especially with Charterers)

The main income of the target group will usually be through charter hire, contracts of affreightment, or pool arrangements. If the transaction is structured as a share sale, or an asset sale where the underlying contracts for the employment of the vessels are also novated, understanding the risk profile of the charterers or other counterparties and their ability to continue to pay charter hire or equivalent will be key to evaluating the purchase price for the vessels/group.

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Shipbuilders' warranties

Shipbuilders usually give warranties/guarantees against defects for the period of one year following delivery, or in the case of certain key equipment of up to two years. If a vessel-owning company has purchased newly built vessels, it would be usual to ensure that the buyer can continue to enjoy the benefit of these warranties/guarantees. In particular, there is a risk that the counterparty under the original shipbuilding contract may not be the party that owns the vessel at the time of completion or be a party within the transaction perimeter (for example, if the shipbuilding guarantee(s) were given to the ultimate owner of the group and that company is not being sold to the buyer).

Crew/employees

The direct level of risk relating to crew and employees is dependent on how many, if any, of the crew of the vessels need to be transferred at completion and whether the technical management of the vessels will change. Often in a share sale no crew change will be required because the same crew managers will remain in place, although this will give rise to a need for heightened specialist due diligence on the crew arrangements which would be different from those where the vessel was being purchased directly. There is also a heightened focus on seafarer welfare and human rights at sea, and a comprehensive vessel-focussed SPA will contain warranties and undertakings relating to such matters.

Watson Farley & Williams LLP is an international law firm with expertise in all areas of maritime law including M&A, Joint Ventures and Commercial Contracts. Please do not hesitate to contact one of our key contacts or any member of the Corporate team if you have any further questions.

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