

# New York Law Journal

## Corporate Update

WWW.NYLJ.COM

VOLUME 248—NO. 23

An ALM Publication

THURSDAY, AUGUST 2, 2012

### SECURED TRANSACTIONS

## Resolving Vessel Ownership And Lien Issues Through New Act



By  
**Alan M.  
Christenfeld**



And  
**Barbara M.  
Goodstein**

**R**ecordation of ownership of and liens on motor vehicles is a fairly straightforward affair. Each of the 50 states has a certificate of title statute and these vary only nominally from state to state.

By contrast, the situation is entirely different when it comes to boats and other vessels. Only 33 states currently have certificate of title laws for vessels, and there is significant variation among those title statutes, including as to items such as size and types of vessels covered and basis for registration. In addition, existing title laws pre-date revised Article 9 of the Uniform Commercial Code (UCC), and the lack of harmonization between the current provisions of the UCC and these title statutes hampers vessel financings. Finally, federal regulations overlay vessel ownership, operation and financing, and do so without effective coordination with state statutes. For example, federal law accords preferred ship mortgage status (see below) to security interests perfected under state title statutes approved by the Coast Guard.<sup>1</sup> However, none of the existing title statutes has been approved.

With these considerations in mind, the Uniform Law Commission (ULC, formerly NCCUSL) resolved in 2008 to formulate a uniform certificate of title statute for vessels. A number of interested parties with diverse expertise participated in the drafting process. These included representatives of the Department of Homeland Security (U.S. Coast Guard), the U.S. Coast Guard's National Vessel Documentation Center, the National Association of State Boating Law Administrators, the National Marine Bankers Association, and the Maritime Law Association of the United States.

The ULC Drafting Committee held its first meeting in late 2009. The proposed Uniform Certificate of Title for Vessels Act (UCOTVA or the act)<sup>2</sup> was finalized by the ULC Committee in July 2011 and approved by the American Bar Association in February 2012 for adoption by the various state legislatures. Today, we briefly examine the existing regulatory scheme for owning and placing liens on vessels, and summarize the changes to be effected pursuant to the proposed uniform statute.

### Federal and State Regulations

The vessel trade has been under U.S. federal regulation and scrutiny since the late 18th century.<sup>3</sup> It is not surprising, then, that the recording of ownership and lien interests in vessels is subject to a hodgepodge of federal and state laws.

Three sets of federal legal requirements apply to identification of vessels for ownership and lien purposes: the Coast Guard documentation requirements, the federal law requiring "identification by numbering" by state authorities for undocumented vessels and the federal law establishing a "vessel identification system."<sup>4</sup>

The Coast Guard requires any vessel that weighs at least five net tons, is owned by a U.S. citizen (meaning either an individual who is a U.S. citizen, or an association, trust, joint venture, partnership

The Uniform Certificate of Title for Vessels Act seeks to create a statutory regime that fits more seamlessly with both the current UCC, including revised Article 9, as well as federal law.

or corporation that qualifies as a U.S. citizen under federal requirements) and is used in coastwise trade<sup>5</sup> or fisheries<sup>6</sup> to be "documented" with the Coast Guard National Vessel Documentation Center (meaning it must be issued a certificate of documentation by the Coast Guard with an endorsement that allows it to engage in that trade).<sup>7</sup> Certain barges, and vessels that meet such size and citizenship requirements but are used solely for recreational purposes, *may*, but need not, be documented with the Coast Guard. According to the ULC,<sup>8</sup> fewer than one percent of all vessels in the United States are documented, and most of those undocumented vessels are pleasure boats. Recordation with the Coast Guard is the exclusive method of perfecting a mortgage or similar lender's lien on a Coast Guard-documented vessel.<sup>9</sup>

Vessels that are documented with the Coast Guard cannot be documented under the laws of any foreign country. Federal law prohibits a documented vessel from being titled by a state, and any certificate of title issued by a state for a documented vessel must be surrendered.<sup>10</sup>

Federal rules require most vessels<sup>11</sup> not documented with the Coast Guard but which are equipped with "propulsion machinery" of any kind, or, in the case of barges, weighing in excess

of 100 gross tons and operating on U.S. waters, to be assigned a number issued by the state in which the vessel is principally operated.<sup>12</sup> All 50 states, the District of Columbia and the U.S. territories currently use vessel numbering to identify vessels.

In addition to this federal requirement for a state-run vessel numbering system, the Secretary of Transportation is required to maintain a vessel identification system (VIS) database of information about vessels and their owners for the public's use mainly for law enforcement and other purposes relating to the ownership of vessels.<sup>13</sup> States are not required to provide the vessel numbering identification information and titling information in their system to the VIS. Thirty-one states and territories are currently participating in the VIS.

As noted above, 33 states have a certificate of title statute, 16 states have no certificate of title law for vessels and Mississippi allows owners of undocumented vessels the option to obtain a certificate of title. For states with title laws (including, in the case of Mississippi, when a title certificate is elected to be issued), ownership is noted, and, in general, perfection of a security interest is achieved by notation, on the certificate of title.<sup>14</sup> For non-title states (or, in the case of Mississippi, when no election is made to issue a title certificate), in general, perfection is accomplished by filing a UCC financing statement.<sup>15</sup>

A mortgage or similar lender's lien on a Coast Guard-documented vessel, which can be perfected only by recordation with the Coast Guard, can be accorded the status of a "preferred mortgage."<sup>16</sup> A preferred mortgage is a perfected security interest with priority over certain non-preferred maritime liens and all non-maritime liens in an admiralty in rem foreclosure.<sup>17</sup> A lien on a vessel perfected under state law can also be accorded preferred mortgage status, but only if such lien is perfected under a state titling statute that has been approved by the Coast Guard and if such state participates in the VIS.<sup>18</sup> However, since no titling statutes have been approved by the Coast Guard, preferred mortgage status is currently not available to secured parties that perfect under the vessel titling laws of any states.<sup>19</sup>

### The Act

UCOTVA seeks to create a statutory regime that fits more seamlessly with both the current UCC, including revised Article 9, as well as federal law. It is intended to qualify as a state titling law that the Coast Guard will approve, allowing liens under the act to be accorded preferred mortgage status. As further discussed below, it also implements a novel

ALAN M. CHRISTENFELD is senior counsel at Clifford Chance. BARBARA M. GOODSTEIN is a partner at Mayer Brown. HASHEM SABBAGH, an associate at Mayer Brown, assisted in the preparation of this article.

branding requirement intended to protect vessel purchasers by obligating owners and insurers to disclose hidden hull damage.

Summarized below are some of the more salient provisions of the proposed act.

**Definition of Vessel; Jurisdiction of Registration:** Under UCOTVA, a “vessel” is defined as any watercraft used or capable of being used as a means of transportation on water. The exceptions are seaplanes, amphibious vehicles for which a motor vehicle certificate of title is issued, lifeboats, stationary floating structures, mechanically restricted vessels that operate on a fixed course, government-owned vessels, and watercraft less than 16 feet in length and propelled solely by sail, paddle, oar or an engine of less than 10 horsepower.<sup>20</sup>

The act requires the owner of a vessel to apply for a certificate of title in the state of principal use. That application must be submitted within 20 days of the owner acquiring the vessel or the state becoming the location of principal use. Each certificate of title must include all security interests in the vessel known to the applicant (including names and addresses of each secured party). An application for a certificate of title is *not* required for a vessel documented with the Coast Guard or under foreign law, or a barge, a vessel under construction or a vessel held by a dealer for sale or lease.<sup>21</sup> If an application for a certificate of title is not required, perfection of the security interest in such vessel will be governed by Article 9. However, if an owner elects to obtain a title certificate, perfection must be accomplished in accordance with the act.<sup>22</sup>

### Title Brand

Perhaps the most unusual aspect of UCOTVA is its title branding rules. Each certificate of title under the act must note any “title brand” known to the applicant and, if the applicant knows that the vessel is “hull damaged,” must contain an indication to that effect.<sup>23</sup> “Title brand” is defined by the act as a “designation of previous damage, use, or condition that must be indicated on a certificate of title.” “Hull damaged” is defined as “compromised with respect to the integrity of a vessel’s hull by a collision, allision, lightning strike, fire, explosion, running aground or similar occurrence, or the sinking of a vessel in a manner that creates a significant risk to the integrity of the vessel’s hull.”<sup>24</sup>

Only a few state laws provide for the branding of a vessel’s title in the event the vessel is damaged. As a result, hull-damaged vessels are often sold in secondary markets without disclosure of the condition of the vessel, potentially increasing the number of unseaworthy vessels in use and the likelihood of dangerous accidents. As the introduction to UCOTVA notes, this problem can be significant after a major hurricane or other widespread casualty.

UCOTVA imposes a branding obligation on both owners and insurers, the latter when they are transferring ownership interest in a hull-damaged vessel (acting in their capacity as insurers). Prior to the transfer of a vessel by an owner, if the damage to the vessel occurred while that person was an owner and the owner has notice of the damage at the time of transfer, the owner must either deliver a new certificate of title application that contains the title brand designation “hull damaged” or indicate “hull damaged” on the existing certificate. An insurer who is transferring an ownership interest must submit a

new application to the state office that includes the title brand designation “hull damaged.” An owner or insurer who does not comply with these provisions is subject to an administrative or civil penalty of up to \$1,000.

Secured parties who acquire title to a vessel, either by foreclosure or otherwise in the exercise of rights and remedies, will be subject to this title branding requirement. Although the obligation to disclose hull damage is limited by knowledge, the exact degree of scienter required to satisfy the knowledge test will ultimately be a matter of case law.

### Security Interests

UCOTVA includes a number of provisions that address security interests in vessels, including choice of law, manner of perfection and termination of perfection and priority, all of which are consistent with revised Article 9.<sup>25</sup> Under the act, creation and enforcement, as well as the effect of perfection and non-perfection, and the priority, of a security interest are generally governed by the UCC.<sup>26</sup>

A secured party may perfect a security interest in a vessel *only* by delivery to the state’s office of a compliant application for a certificate of title that identifies the secured party on the certificate, together with payment of the applicable fee. This

The Uniform Certificate of Title for Vessels Act imposes a branding obligation on both owners and insurers, the latter when they are transferring ownership interest in a hull-damaged vessel (acting in their capacity as insurers).

requirement aligns with UCC §9-311(b), which states that compliance with the requirements of a certificate-of-title statute is equivalent to the filing of a financing statement under Article 9. Generally, perfection occurs on the later of the application’s delivery and payment of applicable fees to the state office or attachment of the security interest under the UCC (i.e., there is no “relation back” to an earlier date of attachment).

Assuming the title statute would otherwise govern perfection of such security interest, the act provides a temporary period of automatic perfection of up to four months for a security interest in a vessel where such vessel was, but is no longer, subject to Coast Guard documentation requirements.<sup>27</sup> The act imposes certain requirements on the state office to preserve documents, and maintain an index and permit searches and disclosure of records relating to vessel titles and applications.<sup>28</sup>

### State Adoption of UCOTVA

Thus far, Connecticut is the only state that has formally introduced UCOTVA for adoption.<sup>29</sup> It is important to note that Connecticut does not currently have a certificate of title law for vessels.

The act, as proposed in Connecticut, differs from UCOTVA in several respects, including coverage by minimum vessel size and type. Most interestingly, and possibly as a foreshadow of things to come, the report of the Connecticut legislative advisory committee noted that its committee members were divided about whether to mandate owners

and insurers to “title brand” a vessel when they had notice that it was “hull damaged.” Opponents were concerned that no other state had adopted this requirement or definition of “hull damaged,” that it may be difficult to identify hull-damaged vessels, and that owners would be compelled to brand the title of the vessel following an accident, even if there is no evidence that the hull’s integrity was compromised. The bill ultimately introduced in the Connecticut Senate contains an optional amendment which would allow the legislature to remove the title branding requirement (although it would preserve brands noted on titles from other states and any requirement imposed by the Connecticut state titling office).

### Conclusion

UCOTVA would bring needed change to the legal framework surrounding vessels in numerous ways. The act has not yet gathered traction among state legislatures, although it is still relatively early in the legislative process. It remains to be seen whether the much-heralded benefits of title branding will, as occurred in Connecticut, also draw some unwanted controversy.

.....●●●.....

1. See 46 U.S.C. §31322(d)(1).
2. Uniform Certificate of Title Act for Vessels (UCOTVA) (2011), available at [http://www.uniformlaws.org/shared/docs/certificate\\_of\\_title\\_for\\_vessels/ucotav\\_prestylefinal\\_jul11.pdf](http://www.uniformlaws.org/shared/docs/certificate_of_title_for_vessels/ucotav_prestylefinal_jul11.pdf).
3. See act of Sept. 1, 1789, ch. xi, §1, 1 Stat. 55.
4. See 46 U.S.C. §§12102, 12103, 12301, 12501.
5. Coastwise trade is defined as “the transportation of merchandise by water, or by land and water, between points in the United States to which the coastwise laws apply, either directly or via a foreign port.” See 46 U.S.C. §55102(b).
6. “Fisheries” includes processing, storing, transporting, planting, cultivating, catching, taking, or harvesting fish, shellfish, marine animals, pearls, shells, or marine vegetation in the navigable waters of the United States or in the exclusive economic zone.
7. See 46 U.S.C. §108.
8. See Prefatory Note to UCOTVA (Nov. 7, 2011), [http://apps.americanbar.org/buslaw/committees/CL190020pub/materials/2012/UCOTVA\\_FinalAct\\_2011.pdf](http://apps.americanbar.org/buslaw/committees/CL190020pub/materials/2012/UCOTVA_FinalAct_2011.pdf).
9. See 46 U.S.C. §§31321, 31322; UCC §9-311(a). Note that liens such as those arising in connection with the provision of “necessaries,” including repairs, fuel, wharfage, insurance premiums and other goods or services, tort liens, seafarers’ liens for wages, maintenance and cure, and salvage liens, arise as a matter of law and do not need to be recorded.
10. See id. at §12106.
11. Barges are not required to be documented for coastwise trade. See id. at §12102.
12. See id. at §12301.
13. See id. at §12501.
14. See UCC §§9-311(a)(2), (3).
15. See id. at §9-310(a).
16. See 46 U.S.C. §§31301(5), 31325, 31326.
17. See id. at §§31301(5), 31321, 31322.
18. See id. at §31322(d)(1)(B).
19. Connecticut Law Revision Commission, Connecticut Law Revision Commission, Report of Advisory Committee on Adoption of Uniform Certificate of Title for Vessels Act (Feb. 22, 2012), available at <http://www.cga.ct.gov/lrc/UniformVessels/Report-Committee%20Draft%20Bill.pdf>.
20. See UCOTVA §2.
21. See id. at §6(v)(5).
22. See id. at Comment to §6.
23. See id. at §2, 7.
24. See id. at §2(a)(13).
25. See, e.g., id. at §§15-16, 19.
26. See id. at §24.
27. See id. at §15(h).
28. See id. at §11, 25.
29. See S. 418, 2012 Gen. Assemb., Substitute Sess. (Conn. 2012).