

MEMORANDUM

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UCOTA – Certificate of Title Act for Watercraft

There are a few court decisions in federal maritime law that could put a gloss on scope provisions of the certificate of title act. I suggest giving those a bit of thought early in the drafting process. You may decide that these points do not have a meaningful impact on the draft. My only recommendation is that this be thoughtful choice. I raise them below in no particular order.

Four years ago I published a law review article that discusses the theoretical background of these issues in greater detail. It is *Ships as Property; Maritime Transactions and State and Federal Law*, 79 TUL. L. REV. 1259 (2005). This article discusses the relative application of state and federal law to all of the common transactions that occur with respect to vessels and associated property, including consensual security interests perfected under the federal ship mortgage statutes, the Surface Transportation Board statute (49 U.S.C. §11301(a), 49 C.F.R. part 1177), and the UCC (section II.C of the article).

What is a Vessel?

The state watercraft statutes that I have seen define what a watercraft is using the same language that federal law uses to define a “vessel,” which is something that is “used, or capable of being used, as a means of transportation on water.” 1 U.S.C. § 3. There is a fair amount of jurisprudence on what is a “vessel” in relation to a variety of unusual watercraft, much of it in the context of determining whether a personal injury plaintiff was a seaman on a “vessel.” Until 2005, I was fairly confident that if the object someone was dealing with was, as an existential matter, a vessel, then it was a vessel for federal documentation purposes or state certificate of title purposes. Once so documented or certificated, then one knew that the means of perfecting the security interest in it was by either recording a preferred mortgage with the Coast Guard or, depending on what state one was in, noting the existence of the security interest on the certificate of title, or filing a UCC financing statement. The second level issue was, if this object was a vessel “in navigation,” it could attract maritime liens for such things as crew wages, collision, repairs, fuel, dockage, and the like.

This relatively orderly state of affairs was called into question by the U.S. Supreme Court in its decision in *Stewart v. Dutra Construction Co.*, 543 U.S. 481 (2005). This was a personal injury case in which the question at issue was whether the injured worker on a dredge was a seaman on a vessel or was a worker covered by the U.S. Longshore and Harbor Workers' Compensation Act because he did not work on a "vessel." In deciding that the worker involved was in fact a seaman on a vessel, the court used language that tended to conflate the existential status of being a vessel ("capable of being used as a means of transportation") with that of being a vessel "in navigation," *id.* at 496. For this purpose a vessel can be deemed to remain in navigation if it is not being used for navigation for a temporary period of time. Justice Thomas wrote that "structures may lose their character *as vessels* if they have been withdrawn from the water for extended periods of time," *id.* at 496 (emphasis added), suggesting that the potential future use of the vessel in navigation must be more than "theoretical," *id.* at 496.

The *Dutra Construction* decision is understandable when the question is whether a worker on the vessel is a seaman or not, but, in stating that its treatment of the navigation concept was part of the definition of "vessel" at 1 U.S.C. § 3, *id.* at 490, its *dicta* is problematical if the question whether a vessel-shaped object is a vessel for purposes of the ship mortgage and certificate of title laws turns on an owner's subjective intention for its use when the security is granted, or worse, if its status as a "vessel" can change after a secured transaction based on its use in the future. Recently, a federal district court used *Dutra Construction* to reinforce its decision that a shipyard did not have a maritime lien for the complete reconstruction of a large yacht because the vessel did not satisfy the "in navigation" requirement for a vessel repair or reconstruction lien. The holding was not all that unusual, but the court cited *Dutra Construction* for part of its rationale, stating that the case "makes clear that the 'in navigation' requirement 'is an element of vessel status.'" *Crimson Yachts v. M/Y Betty Lyn II*, 2009 U.S. Dist. LEXIS 15682 (S.D. Ala. Feb. 26, 2009). I haven't seen this happen yet but, based on *Dutra Construction* and *Crimson Yachts*, it may be just a matter of time before a court rules that the subsequent utilization of a vessel could impair what was previously a duly perfected ship mortgage or state title statute perfection of a security interest in the vessel. In this regard, we should bear in mind how often small boats are pulled out of the water for long and sometimes uncertain periods of time. The drafting question for a certificate of title statute is whether to use a different definition of vessel than the one in 1 U.S.C. § 3, and make clear that the enormous and continually evolving jurisprudence on seaman status under the Jones Act and the Longshore and Harbor Workers' Compensation Act do not blow back into the state certificate of title acts. These issues are discussed in section III.A of my article.

Appurtenances

Personal property that is associated with real estate for purposes of perfecting a security interest are fixtures. The analogue under the Uniform Commercial Code for personal property are accessions. The counterpart for vessels are "appurtenances." Thus, perfected ship mortgages and maritime liens under maritime common law attach to vessels and their appurtenances. As you draft it is worth bearing in mind that appurtenances are unlike fixtures and accessions in that they do not need to be physically attached to the vessel to constitute appurtenances. A crescent wrench in the engineer's tool box in an engine room of a vessel is as much as an appurtenance as a deck winch that is welded to the deck. A brief discussion of the appurtenances concept appears at section III.B of my article.

In addition, because vessels often have leased equipment on board, there has been a fair amount of litigation over the years concerning the extent to which a ship mortgage or maritime lien

attaches to leased appurtenances on a vessel – a notion that is alien to the UCC. The outcome of these cases has tended to turn on whether the lien in question is a consensual security interest or is a maritime lien that arises as a matter of law, and should also turn on whether the lease in question is a true lease or a finance lease. I have discussed these cases in III.C and D of my article.

The federal ship mortgage statutes do not refer to appurtenances, and leave all of this to common law development. You may decide to do the same, but I thought it would be worthwhile bringing these concepts to your attention. A state court confronted with a priority battle between a security interest in a yacht and a purchase money security interest in a piece of the yacht's portable equipment would find that the security interest in the yacht attaches to the portable equipment if it followed the maritime appurtenances approach, but it would rule otherwise if it thought that the portable equipment should be treated as an accession. In a federal court maritime lien foreclosure case against the same yacht, as a general rule the portable equipment would be treated as an appurtenance, at least as to the maritime lien, and the other parties would argue about whether the UCC security interests in it would also attach. This situation would probably be a rare occurrence in the small craft arena, but if it arose a few times, one could anticipate the courts coming out all over the place on these questions.

Other Property

Watercraft that are issued certificates of title under state law are rarely commercial vessels. You can probably ignore this in your drafting, but I thought I would point out that there are two types of intangible personal property that are included in "appurtenances" under federal maritime law. Thus, under some—but not all—circumstances the lien of a ship mortgage and an ordinary maritime lien can attach to them. These two types of property are commonly known as "freights" and "fishing rights." When a vessel's commercial activity generates an account receivable, in maritime law that account receivable is known as a "freight," and, until the freight is collected, a ship mortgage or a maritime lien can attach to it under some circumstances (with priority over a security interest perfected under the UCC). Likewise, there is a nascent but growing body of case law indicating that ship mortgages and maritime liens can attach to fishing licenses, permits, and the like that are associated with the vessel. In the interest of avoiding unintended consequences in your drafting, if you adopt the loaded term "appurtenances" for any reason, you may want to limit it by definition to tangible property. I discussed the freights and fishing rights issues in my article at sections III.F through L.

Vessel Construction

I am loath to mention what may be just a local issue, but, in case it is also an issue elsewhere, I point out that there is an oddity under the Washington State certificate of title laws that would be useful to deal with in the model act. When a watercraft that is not federally documented is in the inventory of the builder or dealer, in all states of which I am aware (with the possible exception of Louisiana), the means of perfecting the security interest in it is through the filing of the UCC financing statement. When a watercraft is owned by a shipyard while under construction, the construction lender's security interest is thereby perfected at all stages at construction until the shipyard conveys title to the completed vessel to its customer. This is true whether the vessel under construction is on land, or whether it has been launched but has not yet been delivered to the customer. Often shipbuilding contracts provide that the customer owns the vessel during the construction period. In this situation, in the period of time before the construction project has progressed to the point where the vessel is a

Completed vessel in fact, the construction lender's security interest is perfected by filing a financing statement. After the project has become a vessel in fact, and has been launched and is in the waters of the state, under Washington's certificate of title statute the customer is obliged to obtain a certificate of title and note the security interest on it, or the customer must document the vessel with the Coast Guard and grant a preferred mortgage, in order to protect the lender's security.¹ Of course this is at a point before the shipyard is ready to deliver the vessel to the customer and before the shipyard will have been paid in full, so the shipyard will not surrender the documents necessary to enable the customer to document the vessel or obtain the certificate of title. Furthermore, if the customer did obtain a certificate of title, this is the point at which the watercraft comes to the attention of the state Department of Revenue, and they will be looking for an excise tax even if the customer is an out-of-state customer who might otherwise export the vessel on completion and not otherwise need to pay state taxes. There are probably several solutions to this dilemma. One might be to provide that the financing statement is the proper means to perfect a security interest in vessels under construction while in the possession of the builder or a dealer, regardless of who actually has title to the watercraft at any particular moment.

Please do not hesitate to give me a call if you would like to discuss any of these points.

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¹ This anomaly does not apply when the vessel is owned by the builder or dealer and is in its inventory, under Washington's version of UCC § 9-311(a)(2). For customers in title, however, the Washington vessel titling statute states that "no person may own or operate any vessel on the waters of this state unless the vessel has been registered . . .," RCW 88.02.020. Commonly when yachts and commercial vessels are built, they are essentially complete before they are launched. Sometimes they become complete when they are in the water. In any event, at the point when they are "owned" by someone, and are "vessels" (i.e., "used or capable of being used as a means of transportation on the water," RCW 88.02.010(1)), they become subject to the registration requirement of RCW Chapter 88.02. That makes them subject to the certificate of title statute, which states as follows: "Security interests in vessels subject to the requirements of this chapter . . . shall be perfected only by indication upon the vessel's title certificate." RCW 88.02.070(1).



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Re: UCOTA – Certificate of Title Act for Watercraft

Dear E.M

You may recall that we sat together at the Yacht Financing Committee meeting in New York, and that I promised to send you a copy of my article on the interplay between federal maritime law and the Uniform Commercial Code with regard to vessels. That article is enclosed for your reference.

As I sat in on the UCOTA conference call, it occurred to me that there are a few areas in federal maritime law that could have an impact on the judicial interpretation by state courts of the certificate of title act that is drafted by this committee. These general areas of law are discussed in some detail in my article, but I have also summarized them briefly in the enclosed memorandum. As you can see I have also forwarded that to Professor Sepinuck, along with a copy of my article. Ⓢ

Thank you for including me on the conference calls on this project. I look forward to dialing-in in the future.

Very truly yours,

GARVEY SCHUBERT BARER

By


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Ⓢ FYI - Tulane Law Review 2005
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