

MEMORANDUM

From: Bill Henning, Chair, Federal/State Task Force

To: UCOTVA Drafting Committee

Date: October 6, 2010

Re: Issues for Consideration at October 15-17 Drafting Committee Meeting

At E.M. Miller's request, the Federal/State Task Force has been considering issues related to the interplay between federal and state law. In this regard, I have participated in a series of telephone conferences among the members of a Maritime Law Association Working Group chaired by Bruce King. This memorandum sets out issues that we believe the drafting committee should consider at the meeting in Chicago.

1. Section 2(7) as currently drafted excludes a builder's certificate from the definition of certificate of origin. This might cause difficulties if a single document serves as both a builder's certificate and a certificate of origin. It was suggested that the problem might be resolved by adding the word "separate" to the exclusionary language so that it reads "[t]he term [certificate of origin] does not include a *separate* builder's certificate."

2. Section 6(e) as currently drafted provides that "[a] record submitted in connection with an application is part of the application and the office shall maintain the record, or an electronic version of the record, in its files." In the case of a record that is a document of origin, bill of sale, or title-transfer document it would be helpful for purposes of later moving into federal documentation if an office that chooses to create an electronic version of the certificate other than an image (*i.e.*, input key data from the record into an electronic file) could include whether the document was signed and, if so, by whom and in what capacity. We should consider whether this might create a fiscal note that would impede enactment and, if so, whether it makes sense for the requirement to be bracketed.

3. Section 14(h) as currently drafted provides a 30-day period of temporary perfection for a security interest in a vessel coming out of federal documentation. This is a hedge against the risk posed by a security interest being unperfected between surrender of the certificate of documentation and perfection under UCOTVA. There was some concern that 30 days is too short a time period. There was also concern caused by the fact that under Article 9 the governing law immediately after surrender of the certificate of documentation will be the debtor's location and if this is a non-UCOTVA state the secured party will not get the benefit of the provision. We can't fully solve the choice-of-law problem but we discussed whether the provision would give more protection to secured parties if it was redrafted as a relation-back rule. Subsection (h) might, for instance, be revised to state: "If a certificate of documentation for a vessel is [canceled] [surrendered to the Secretary of the Department of Homeland Security], a security interest in the vessel which is valid against third parties as a result of compliance with 46 U.S.C. § 31321 remains perfected until the earlier of i) four months after [cancellation] [surrender] of

the document, or ii) the time the security interest becomes perfected under this [Act].” A provision like this might be a nice selling point for UCOTVA.

4. Section 7(e) states the circumstances in which the office may cancel a certificate of title, and Section 4(c) provides, for purposes of choice-of-law, that a vessel ceases to be covered by a certificate of title when it ceases to be effective under the law of the issuing jurisdiction (or, if earlier, the time the vessel becomes covered by another certificate of title). A question was raised as to whether the connection between the two provisions should be made explicit in the text. If no textual change is needed, the connection can be explained in a comment.

5. Section 6(b)(8) excludes a foreign documented vessel from the titling requirement. Should we also exclude such a vessel entirely from the scope of the act?

6. Some states currently issue certificates of title that indicate expiration dates. Should UCOTVA contain a bracketed transition provision for those states providing that if the state’s pre-UCOTVA law or practice has been for certificates to expire after a period of time the expiration will not occur as a matter of law.

7. Should Section 14 contain a substantial compliance rule that would reduce the risk that a technical defect in an application related to a security interest will prevent a secured party’s from achieving perfection. As an analogy, UCC § 506(a) provides that “[a] financing statement substantially satisfying the requirements of this part is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.”

8. Should Section 6 provide that an applicant who provides seriously misleading information, including materially false documents, to the office is liable for damages incurred by a person who reasonably relies on the misleading information?

9. The following group of recommendations are taken directly from a draft of a report being developed by the MLA Working Group:

§§ 6 and 24. We discussed the problem when a COT vessel from State A moves to a registration State B, and then to COT State C. Some registration states (*e.g.*, Delaware) require that the owner surrender to it the COT from State A, even though the COT is still perfects the security interest noted on it. This is an invitation for a breakdown in the integrity of the system. The Working Group recommended:

(a) the comments to §6 should point out that when a vessel is coming to the UCOTAV state from a registration state, it is asking for trouble to accept a registration certificate from a registration state as the owner in the way the agency would accept that from NVDC or a foreign registry or COT state. This is a place to note that broad national participation in VIS would be useful. The Working Group noted that §6(d)(3) requires a chain of title back to the COT from State A in this situation. If, as has been reported with Delaware, the registration State B will have previously required a surrender to it of the State A COT, then what? If less than that COT will be accepted, which the Working Group thought might be a practical necessity, §6(d)(3) would need to be amended as follows. The Working Group recommends these changes to §6(d)(3) in any event to give the Office some flexibility, given the plethora of situations it will encounter:

- add “to the satisfaction of the of Office” to the end of the subsection.
- change “other documents of transfer” to “other records evidencing transfer” of the vessels, to allow electronic information to be used.
- allow receipt of an original MCO or a certified copy of any document issued by a governmental authority.

(b) §24 or another place should require the state office use the HIN to check the vessel’s status in VIS.

(c) §6(b)(8) should be expanded include affirmation that the boat is not documented (US or foreign), subject to a COT, or the subject of an application for any of those, other than a pending application to NVDC in the name of the applicant and, if the application for a COT includes a request to note a security interest, stating that the NVDC filing includes a preferred mortgage having been filed for the secured party noted in the COT application. This would be a good antifraud speed bump. It allows an applicant to comply with the state registration regime while USCG is working on the COD. 46 U.S.C. §12106 requires that the state COT be surrendered when the federal document issues. The group notes that 46 U.S.C. §12106 contemplates that USCG will adopt conforming regulations and that the statute might better be changed, *e.g.*, require disclosure to NVDC of the application for or existence of the state COT. Note that §4(c) terminates the COT as a matter of law when federal documentation occurs, and §7(e)(3) provides that the COT will be cancelled as matter of record by the Office when NVDC (or anyone) notifies the Office that the federal COD has been issued.

§6(d) (2) and (3). The terminology in these subsections should be modified to reflect this common practice for the deletion of vessels from foreign registry for transfer to another registry:

(a) Obtain documentation of deletion from registry, free and clear of mortgages, stating the name of the last owner of record. This may be a certificate of deletion, or that plus a closing certificate of ownership and encumbrance, or a letter issued by the foreign registry.

(b) Chain of title to applicant from last owner of record at the foreign registry to the applicant for a COT.

(c) Supplement text with an analogue to §6(d)(1)(A) to require a chain of title from a prior USCG or foreign registered owner. This may need a separate subsection.

§6(d)(3). The Working Group recommends that the state be permitted to accept a Builder’s Certification if it has the information needed to substitute for an MCO. The UCOTVA drafting committee should decide if it agrees, and if so, whether the language already accomplishes that. It might.

§6(b). The Working Group discussed a proposal to require, in an application for a COT, that the owner disclose whether the vessel is federally documented, or whether an application for federal documentation is pending - essentially the mirror of what it is are proposing for federal documentation. The consensus was that this would be useful, but as

with the federal suggestion, UCOTAV should state that inaccuracy in this regard will not affect the validity of the COT (to protect innocent secured parties and subsequent buyers who rely on the COT). Without this the Working Group would drop the suggestion.

10. The following recommendation is taken directly from the MLA Working Group draft report:

The following idea should be presented to the state officials on the UCOTVA drafting committee to see if this is a workable procedure for transfer from one COT state to another COT state:

New State requires:

(a) Old State's COT is to be presented by owner or transferee of prior titled owner (with evidence of title transfer signed off on the COT by former owner and with a consent from or with a release by the secured party)

(b) If old COT is lost:

(i) the applicant must go back to the Old State (and prior owner if that is the situation) to get a replacement COT under usual procedures to be able to present it present to the New State.

(ii) the New State has the authority to accept a communication acceptable to the New State from the Old State or VIS (if the Old State is a VIS participant) as to the identity of the titled owner and the identity of any secured parties.

(iii) the owner or purchaser who wants to title in the New State cannot present a lost COT affidavit regarding the lost Old State COT. This procedure would present an opportunity to clear off an unsuspecting lender.

(c) New State will mark the old COT as "Canceled" and send it to the Old State or send the Old State a confirmation that it has accepted a surrender of the old COT and titled the vessel, whereupon, UCOTVA will provide that the state, when it is an "Old State" will, on receipt of the canceled COT or such a communication, close its record and note that the vessel is titled in a New State.

11. The following recommendation is taken directly from the MLA Working Group draft report:

During the process of transferring from federal documentation to state titling suppose nefarious owner gets a second deletion letter from NVDC (since they will issue these to anyone on request). Then nefarious owner starts a chain of title in a second state before the intended state acts. Or, the nefarious owner takes an MCO and does this. In each case the nefarious owner could also lure a second lender into the picture. What will reduce this fraud opportunity? A mechanism is needed to allow access by interested parties to the basic information in both state and federal databases. Privacy concerns are valid, especially given the availability of social security or taxpayer identification numbers and the like. That said, potential purchasers and lenders, who could be

defrauded, have the same legitimate interest in ascertaining current ownership and liens, and a vessel's build and title history, that they do when the asset involved is real estate or airplanes. We can see no good reason why a mobile publicly registered asset should have its records protected in a way that invites fraud.

12. The following recommendation is taken directly from the MLA Working Group draft report. The term used in Section 2(20) to which the comment relates is "principally used on the waters of this state."

§2(20). One NCCUSL objective is for UCOTVA to result in a state regime that is compliant with the federal Vessel Identification System. The means having a definition for "state of principal operation" that tracks the federal law. Under the Notice of Proposed Rulemaking (NPRM), this language is being changed very slightly. The current federal definition of "use" (and the NRPM's definition of "operate") is "operate, navigate or employ." 46 CFR 173.3(i) (currently) 173.3 (proposed). Some states number, title and tax yachts that are in readiness for use which are moored or out of the water in a condition ready to drop in the water and use. USCG has accepted this under its regulations. This is broader than the plain English reading of the definitions of "use" or "operation." The Working Group recommends that:

(a) UCOTVA'S definition for the state of principal use should use the term "state of principal 'operation'" to track the language 46 USC §12301(a) and the NPRM's change to the statutory language. The federal definition be expanded to reflect federal and state practice regarding readiness to use, and the UCOTAV note should indicate that the intent is to track the USCG's changing regulatory definition of state of principal use/operation; and

(b) UCOTVA's definition should incorporate the meaning of the term "principally is operated" as used in 46 USC §12301(a), as defined by the USCG in regulations from time to time.

If unused at all during one year, a vessel can still be used in the state in the "readiness to use" sense, and taxed accordingly. (One group member pointed out that on average, consumers use their boats only 30 days per year.) Some on the committee believe that states will have problems with the current UCOTVA definition because it does not incorporate the readiness to use concept that they have worked out with the USCG, but which the USCG has not adopted in its regulations. This would create tension between UCOTVA and the USCG regulations.

13. The following issues relate exclusively to the Comments:

a. Can we use the Official Comments to encourage the Coast Guard to notify the title-issuing state as soon as possible after the documentation of a titled vessel?

b. In some states, a motor may be titled separately from a vessel. Under UCC § 9-334(d), if a titled motor becomes an accession and a security interest in the whole (the vessel and motor) is perfected by compliance with a certificate-of-title act, the security interest in the accession is subordinate to the security interest in the whole. This not really a UCOTVA

issue but the question was raised whether we can use the Official Comments to warn of the risk.

c. With regard to Section 6(b)(5) (requiring an application for a certificate of title to contain the vessel's HIN or, if none, an application for issuance of a HIN), should the Official Comments note that the Coast Guard can change the HIN (as it is currently proposing to do for some vessels in its Notice of Proposed Rulemaking). Offices should be encouraged to maintain a record of changes to the HIN?