



G A R V E Y S C H U B E R T B A R E R

MEMORANDUM

TO: E.M. Miller

CC: Stephen Sepinuk
William Henning
David McI. Williams
James Stewart
Cindy Squires
MLA Working Group

FROM: Bruce A. King

DATE: March 16, 2011

RE: UCOTAV – Substantive Comments

These are my substantive comments on the most recent draft of UCOTAV. There has not been enough time to consult with the MLA Working Group, so these comments, like those I submitted last week, should be considered to be my own.

2(a)(32) – Intangible Property. We have not taken intangible property (*e.g.*, fishing rights and receivables generated by the vessel) out of the definition of “vessel.” This was requested by the President of Alaska Commercial Fishing and Agriculture Bank with regard to the fishing rights and the like. The suggestion was to add 2(a)(32)(H) to the exclusions in the definition: “(H) intangible property”. CFAB was established with state capitalization in order to finance fishermen, and it acts as an agent of the state in administering limited entry fishing permits in Alaska. The exclusion of intangible property from the definition of vessel is an important consideration for the bank with respect to fishing permits, licenses and related property. Given who CFAB is (they are not a client of mine), I think we should assume that if they are not accommodated, either UCOTAV will not be adopted in Alaska, or it will be adopted in altered form with a lack of uniformity on an important multistate point. Many fishing vessels operated in Alaska are owned by people in Washington, and we would be ill-served in this region by a difference in state laws on this point. Personally, I do not think that dealing with this issue in the comments will suffice. The First Circuit decided in the *McGowan* case that fishing permits issued to a vessel are appurtenances of the vessel. It follows, then, that for purposes of the federal definition of vessel they are as much as part of a vessel as a deck winch. Under the federal statute and UCOTAV, the definition of vessel is the same. This being so, it is only a matter of time before a state court would decide that a security interest perfected by notation on a COT on a small fishing vessel perfects a security interest in permits issued to the boat – something that CFAB wants to avoid.

4(b) – Governing Law. I tread cautiously into this stretch of UCC territory given the company I am keeping in the drafting committee, but don't we need to insert the underlined in the first line of Section 4(b)?:

A vessel becomes covered by a certificate of title when a valid application for a certificate of title and the applicable fee are delivered to the office

This will bring Section 4(b) in line with UCC § 9-303(b), because under that a certificate of title must be “valid” in order for it to “cover” a vessel. I believe this answers the question raised by David Williams last week, which was: What is the status of the vessel, and its being covered by a COT, if the COT may be cancelled by the office under Section 7(e)? The grounds for cancellation under Section 7(e) are the grounds that rendered the application filed by an owner materially insufficient for the issuance of a COT. Would not a court decide that a materially inaccurate or false application does not result in a valid application and COT? If so, the “valid” UCC § 9-303(b) and the missing “valid” in Section 4(b) would indicate that a vessel is not covered by a COT for which the application was materially deficient or false. If “valid” were not be inserted in Section 4(b), we could have a vessel “covered” by a COT within the terms of UCOTAV, but not “covered” by the COT for the purposes of UCC § 9-303(b), which would be a very confusing place to be. UCOTAV Section 17 is not relevant here, because that only covers the situation in which the information on an application is not accurately transferred to the COT. This valid business has an unfortunate side effect for lenders: if an owner files an application that is materially insufficient – such as excluding a necessary brand indication or other important information – the validity of the issued COT is jeopardized, and the perfection of the security interest noted on it is imperiled because the vessel being “covered” by a valid COT is a precondition to exiting the financing statement regime under UCC § 9-303(b). This puts a burden on lenders to make sure that their borrowers’ applications for COTs are accurate in all material respects. Because UCC § 9-303(b) includes the word “valid,” I see no way around this without amending the UCC. I assume that this group thrashed this out in the automobile version of the statute, and I am prepared to defer to the group’s superior knowledge of the UCC, but at least that is how I see the issue at this point.

9(b) – Branding. Section 9(b) requires the office to deliver the new branded certificate or record pursuant to Section 11(a). At that point the holder of the new COT will hold two COTs for the vessel. Unless I am missing something, it would seem that we need to impose a requirement on the holder of the old, unbranded COT to surrender it to the office, because it could become an instrument of a fraud.

14(g) – Perfection of a Security Interest. Section 5 excuses a list of vessels from the application of UCOTAV. If, however, an application is filed for those excused vessels, then notation on the COT becomes the exclusive means of perfection under Section 14 unless they are specifically exempted under 14(g). If, permissively, an excused vessel is issued a COT and perfection by notation occurs, then the provisions of 14 would apply. Therefore, the introductory phrase in 14(g) should state that “Section 14(a) does not apply to a security interest in . . .” instead of “This section does not apply . . .” Also, I think we should delete documented vessels and foreign-documented vessels from Section 14 by adding them to the list of exclusions in Section 14(g).

14(h) – Transition from Coast Guard Documentation to State Titling. This is the provision which adopted Bill Henning’s very good idea that when a mortgaged vessel is deleted from Coast Guard documentation, the mortgage be deemed perfected under UCOTAV for a period of four months, to give

the owner and the secured party ample time to get the vessel titled under state law and to continue the perfection of the lender's security interest. The assumption was that the Coast Guard would allow, with mortgagee's consent, a vessel to be deleted from Coast Guard documentation with the mortgage remaining of record and perfected under federal law as of the moment of deletion. While in Chicago, I sent the Coast Guard an email to confirm that its regulations would permit this procedure. (I believe the regulation does permit this procedure, *see* 46 C.F.R. § 67.171.) Despite this, the Coast Guard advised me yesterday that they do not, and that when a vessel is deleted, they expect that the mortgage will be satisfied or released. A satisfaction is a release of the mortgage and an acknowledgment of the satisfaction of the debt, and a release is a release of the mortgage that assumes that the debt continues. I had a further exchange of e mails overnight, and reached this conclusion with them. NVDC will delete a vessel from documentation if the mortgagee files a release that permits USCG to delete the mortgage of record but that does not release the mortgage *inter se*. The two USGC communications are as follows, from Denise Harmon at NVDC:

First NVDC Communication:

We would not issue a deletion without all outstanding "preferred" mortgages being release/satisfied/discharged. The mortgagee consent form allows for surrender of the Certificate of Documentation to either withdraw the application or for changes such as vessel name/managing owner/trade endorsement, etc. The Certificate of Documentation (but not its trade endorsements) remains valid if there is an outstanding preferred mortgage on the vessel. The only instance where we would issue a deletion with an outstanding mortgage would be mortgages that did not gain preferred status before 1/1/89. We do not place deletion information on the Abstract of Title.

My Follow-up Question:

On deletion of the vessel from documentation, would a Release of Mortgage be acceptable for which the operative language, after identifying the vessel and mortgage, is as follows:

"Mortgagor hereby consents to the release of the Mortgage from its records [or "of record"] by the National Vessel Documentation Center"?

NVDC Reply:

Yes, we have accepted this language in the past.

Below, I suggest a revision to 14(h) that takes this nuance into account, and that takes into account USCG terminology on deletion. (Vessels are deleted, certificates of documentation are not.) In addition, I checked to see if we need this 4 month transition provision for inbound vessels from a foreign registry, since a US resident alien purchasing a vessel can get a state title but not a federal document. Accordingly, I have also included the foreign vessel scenario in this revision of Section 14(h):

(h) If a vessel is deleted from documentation under 46 U.S.C. § 12105 or is deleted from documentation or registry under the laws of a foreign country, or its certificate of documentation,

foreign certificate of registry or the like is cancelled, a mortgage of an interest in the vessel that was valid against third parties as a result of compliance with 46 U.S.C. § 31321 or that was a preferred mortgage under 46 U.S.C. § 31301(6)(B) immediately before deletion (whether or not it was released of record without releasing the security interest immediately before deletion of the vessel) remains perfected until the earlier of four months after deletion or the security interest becomes perfected under this act.

The underlined phrase contemplates mortgages of vessels and of a fractional interests in vessels, which occur and have been contemplated for yachts in the manner of fractional interests in executive jets. 46 U.S.C. § 31301(6)(B) is the federal statute that defines a foreign preferred mortgage, and is the analogue to 46 U.S.C. § 31321. (I do not know if a foreign preferred mortgage under this section can encumber a fractional interest, and I doubt that we'll see any instances of a foreign vessel financed with fractional mortgaged interests whose owners will seek a state COT.) I see no need to define foreign registry and certificates of registry, as these are well-understood terms, but if you want to, the buzz words you could use are in 46 U.S.C. § 31301(6)(B).

FYI – the Maritime Law Association has formed a working group to suggest a comprehensive set of modifications to its vessel documentation regulations so that they catch up with the last decade of statutory activity. We already plan to use this as a vehicle to propose some changes to the Coast Guard regulations so that they coordinate more closely with UCOTAV. This would provide an opportunity to have Coast Guard establish an interface would more specifically contemplate Section 14(h).

27 – Transition. Section 27(e) gives the secured party three years of perfection within which it needs to get the owner of the vessel to apply for a COT and note the secured party's interest on it. The two big risks here are (a) owner does nothing and the perfection lapses, or (b) owner applies for a COT and ignores the lender, setting up a fraud potential. I have two suggestions, since many existing security agreements will not be able to protect against these risks:

- that the secured party be given the authority to apply for a certificate of title on the owner's behalf if – say – by month 30 the owner has not applied for the certificate of title that notes the security interest (which is only useful if the secured party has access to the necessary documents and information to make the application on the owner's behalf)
- that the secured party have a statutory right to accelerate the debt and foreclose if the owner has failed to cooperate with the secured party to accomplish this within that 30 months time after being asked to do so by the secured party.