

## Harmony at Last? – Coast Guard Takes Steps to Embrace State Titling Laws

On September 22, 2021, the U.S. Coast Guard published a Notice of Proposed Rulemaking (NPRM), which would implement various changes relating to the certification of states' titling systems for undocumented vessels. The NPRM aims to align state titling systems with the Uniform Certificate of Title Act for Vessels (UCOTA-V), which will likely increase state participation in the Vessel Identification System (VIS), and provide states with the ability to allow undocumented vessel owners and lenders to have access to preferred mortgages.

### Background

The overwhelming majority of vessels in the United States are not required to be documented by the Coast Guard and are, therefore, "undocumented" in the eyes of the federal government. Most of these vessels are less than five net tons (which includes most recreational vessels) or barges operating on inland waters. Registration and titling of these undocumented vessels occurs at the state-level, with variations in laws from state-to-state. In order to track undocumented vessels, for both law enforcement and general awareness, in 1988, the Coast Guard created the VIS as a voluntary, centralized database to house title and registration information from state sources. Congress previously incentivized state participation in the VIS by making undocumented vessels eligible for "preferred" mortgages if the Coast Guard certified a state's titling laws. A preferred mortgage creates a lien against the mortgaged vessel in the amount of the mortgage indebtedness including outstanding interest and mortgagee expenses, and has priority over most other non-preferred maritime liens and all non-maritime liens in certain in-rem foreclosure proceedings. Access to preferred mortgages is also beneficial to vessel owners as they generally include substantially lower interest rates given the additional protections afforded to the mortgagee.

### Proposed Changes by the Coast Guard

Since adoption of the UCOTA-V in 2011 and enactment by numerous states, various maritime groups such as the National Association of State Boating Law Administrators and the National Boating Safety Advisory Council have recommended that the Coast Guard update its own guidelines so that states with UCOTA-V-compliant titling statutes could be certified. This NPRM represents the Coast Guard's acceptance of that recommendation, creating a new regime in which states with titling statutes modeled from UCOTA-V will be eligible for certification, and therefore have access to preferred mortgages in addition to providing data to the VIS.

The Coast Guard believes that adoption of the proposed rule will enhance uniformity among state titling statutes and boost consumer protection while facilitating secured loans on undocumented vessels. The NPRM also notes that adoption of the rule will deter "title washing," in which buyers make cosmetic repairs to vessels previously sold for salvage and then resell the vessel at a profit without disclosing the previous damage. With increased use of VIS, such activity would be substantially more difficult as the title of an undocumented vessel that has sustained significant damage would be "branded" or permanently marked to disclose such damage.

Notably, the NPRM would have a positive impact on both lenders and consumers by facilitating the procurement of secured loans on undocumented vessels. Because a preferred mortgage mitigates



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the lender's risk, new lending opportunities may develop in previously underserved markets (such as smaller, undocumented recreational vessels). The timing could not be better with the strong growth of the recreational boating market projected to continue for the foreseeable future. Indeed, in a just-released report, Meticulous Research estimates that the recreational boating market will grow at a compound annual growth rate of 7.8 percent, increasing from \$37.7 billion in 2020 to \$54.9 billion by 2027.

The public comment period for the NPRM ends on November 22, 2021. Although enactment of regulations may not occur in 2021, undocumented vessel owners and lenders, may want to consider their state's titling regime to determine if there will be forthcoming access to preferred mortgages as part of Coast Guard's proposed changes. Cozen O'Connor will continue to monitor the status of this NPRM and update this alert accordingly with any changes.

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