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THE RIGHTING MOMENT

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US Coast Guard Adopts Temporary Certificates of Documentation

Falling Waters, WV: The US Coast Guard National Vessel Documentation Center ("NVDC") has announced as early as July 8, 2013 it will begin issuing Temporary Certificates of Documentation (TCOD) for both initial and reissue/exchanged applications for USCG documentation. Currently the NVDC is operating with an approximate 4 month backlog so the TCOD will allow the new owner of record to legally use the boat.

It is expected this program will favorably ease the legal limitation of operating a newly acquired documented vessel trapped in the delay of processing the required forms.

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IRS Scrutiny of Misclassified Independent Contractors

The Internal Revenue Service ("IRS") and Department of Labor ("DOL") continue to aggressively pursue employer misclassification of independent contractors. Misclassifying workers such as captain and crew subjects Yacht Ownership or Management Companies and "responsible officers" to liability for back payroll taxes and penalties, as well as potential adverse tax and ERISA consequences for benefit plans (e.g., pension, 401k, stock option).

We have observed an increase in misunderstanding for owners and managers of yachts in how to characterize their captain and crew particularly while the yacht is based in US waters. It is a complicated area which merits close scrutiny to state and federal taxing authority and a command of immigration law.

The IRS's Voluntary Classification Settlement Program (VCSP) allows participating employers to minimize potential payroll tax liability by reclassifying its independent contractors as employees. There are, however, significant risks and pitfalls that employers must consider before participating in the VCSP.

The IRS recently expanded the VCSP by eliminating certain eligibility requirements so more employers can participate. For example, the IRS modified the requirement that companies not currently be under audit and waived the rule that required companies to have filed 1099s for misclassified workers.

Competing interests between captain, crew and management in regard to compensation and compliance with tax authority can sour a relationship between parties. A misunderstanding of the law can be downright expensive as a result of miscalculations. Please don't hesitate to contact us if you have questions in this area.

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New Connecticut Sales & Use Tax Changes

In some exciting and encouraging news for the Connecticut marine industry and boating community, the State of Connecticut has made several key changes to loosen the requirements before sales or use tax liability could be incurred for use of a vessel in the state. For sales occurring on or after July 1, 2013, a vessel shall be exempt from sales tax provided the vessel is docked in Connecticut for sixty (60) or fewer days. Previously, the state had effectively taken the position that any use of a vessel in Connecticut could conceivably trigger use tax liability.

Now, with revisions to C.G.S. 12-411 effective July 1, 2013, the storage, acceptance or use of a vessel in Connecticut can be exempt from use tax provided the vessel is docked in the state for sixty (60) days or fewer in a calendar year. As this is an exemption, the burden of proof will be on the taxpaying vessel owner, so accurate and verifiable records of the vessel's location should at all times be maintained if a vessel owner seeks to take advantage of the 60 exemption.

The state also took steps to extend the existing exemption for the off-season storage and maintenance and repair of vessels. The date for the expiration of the off-season has effectively been extended an extra month, so that the off-season, which commences on October 1, is now extended through May 31 (previously April 30). C.G.S. 12-407(2)(M) and 12-413a describe how off-season storage and or repair and maintenance of vessels in the state are excluded from tax liability.

And finally, the State also eliminated the previous increased sales tax rate imposed on vessels with a sales prices exceeding $100,000. C.G.S. 12-408(1)(H) and 12-411(1)(H) had imposed a higher sales tax rate of 7% of the sales price. With the deletion, vessels subject to sales or use tax will be taxed at the going rate of 6.35% imposed on most other transactions.

What can subject a vessel and its owner to sale and / or use tax liability in State of Connecticut remains a complicated and nuanced matter. The Bohonnon Law Firm, with a century of experience handling these matters, can assist you with any questions you may have.

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When It Comes To Termination Statements Trust, But Verify

"Trust, but verify", an old Russian proverb adopted by President Ronald Reagan, will now define best practices for any transaction, including boat transactions, where a UCC (Uniform Commercial Code) search is part of the critical due diligence. Consider a simple buy sell transaction in a state where the vessel is not titled (like Connecticut which is one of sixteen (16) states in the United States of America with no certificate of title requirements for water vessels) and not documented (less than 1% of all boats in the U.S. are documented and the majority of all pleasure boats are not documented) with the Coast Guard at the National Vessel Documentation Center. Both buyer's attorney and an attorney for a purchase money lender have reviewed a UCC search performed by a well known commercial company that indicates that the vessel which client is purchasing from Seller Company is free and clear of all recorded UCC liens. A close inspection of the report indicates no current viable liens; it does reflect, however, a properly filed Form UCC-3 termination statement by ABC Bank, terminating the effectiveness of an earlier filed original financing statement by ABC Bank. The transaction closes with XYZ Bank funding the purchase price and lender's attorney recording a properly filed original financing statement to perfect XYZ Bank's newly minted first priority security interest in the vessel.

If it turns out that Seller Company either mistakenly or fraudulently filed the Form UCC-3 termination statement on behalf of ABC Bank, who wins in a priority battle between ABC Bank and XYZ Bank? According to two very recent bankruptcy court decisions, ABC Bank is not required to monitor for potentially erroneous UCC-3 filings. Rather the burden is on the prospective lender to determine the effectiveness of termination statements. See Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank N.A., 486 B.R. 596 (Bankr. S.D.N.Y. 2013); Primerock Real Estate Fund LP v. RAG East LP, et al, 2013 WL 796616 (Bankr. W.D. Pa. March 2013). The upshot is that unless the secured party of record authorizes the filing of a termination statement, it is ineffective, and there is no way of knowing from an examination of the termination statement itself whether or not it was authorized. See 9-509 of the UCC (a termination statement may only be filed if the "secured party of record authorizes the filing" or in certain limited circumstances the debtor may authorize the filing). Accordingly, a prospective lender or other interested party may need to check with the original lender to verify if it in fact authorized the filing of the termination statement -- advice that

President Reagan would eagerly endorse.

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New Connecticut Environmental Laws Impact Marinas and Coastal Development

The State Legislature passed new environmental laws specifically relating to the marine industry and waterfront projects. While touted as a significant boost for both sectors, only time will the actual extent of any benefits depending on how the Connecticut Department of Energy and Environmental Protection ("DEEP") implements the changes.

An Act Concerning Clean Marinas (Public Act 13-202) provides additional incentives for marinas which commit to the DEEP's Clean Marina Program. The Clean Marina Program has been around for a while and the bloom is off the rose. The new law provides incentives to invigorate the program by providing priority ranking for grant awards for sediment, dredging and dredge disposal activities for clean marinas. Also, such entities can qualify for an additional grant in an amount equal to 10% of the project cost. Depending on your needs and the timing of a specific project, this law could provide additional dollars to offset your costs, if you are a facility committed to the Clean Marina Program.

In the aftermath of Superstorm Sandy, the Legislature enacted changes to the State's Coastal Management Act relating to activities conducted within tidal wetlands and navigable waters. The Act Concerning a Best Practices Guide for Coastal Structures and Permitting (Public Act 13-179) also requires DEEP to develop a best practices guide book for coastal permitting structures. Of note, erosion and changes in rise in sea level as anticipated by the National Oceanic and Atmospheric Administration (climate change issues) must be taken into account in the permitting review process after October 1, 2013.

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USEPA Revised Vessel General Permit Casts Wide Net over Wastewater Discharges

The United States Environmental Protection Agency ("USEPA") issued its revised Vessel General Permit ("VGP") this spring. The revised permit

becomes effective December 19, 2013 and applies to certain large vessels. The permit requires covered vessels to file a Notice of Intent to obtain coverage under the permit. The permit covers wastewater discharges including deck runoff, ballast water, bilge water and gray water. It also includes new numeric effluent limits for ballast water to control the release of invasive species. Covered vessels must perform quarterly visual self-inspections and certify compliance by signing a specific form annually. Also, VGP Authorization and Records of Inspection must be maintained on board.

This permit applies to owners and operators of non-recreational vessels 79 feet and larger (for example, fishing and charter vessels, commercial vessels, ferries, cruise ships, water taxis, tour boats, tug boats and research vessels). It does not apply to recreational vessels. HOWEVER, private yacht owners should not breathe a sigh of relief, the term "charter vessel" may include private yachts under some circumstances. The USEPA has informally commented that the chartering of a private yacht would be considered commercial if it is subject to Coast Guard inspection and is engaged in commercial use or carrying paying passengers. The nuances of these definitions are muddy and each individual case should be evaluated based on the specific circumstances. Note, failure to comply with this permit could result in civil fines and penalties of up to $25,000 per day of violation and criminal fines and prison terms under the Clean Water Act. The revised 2013 Small Vessel General Permit is pending and we will keep you posted on related developments.

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WHETHER A WATERCRAFT IS A "VESSEL" IS A LITTLE BIT LIKE PORNOGRAPHY, I KNOW IT WHEN I SEE IT

Derecktor Shipyards Conn, LLC ("Derecktor"), located in Bridgeport Connecticut, was a world renowned custom boat builder that also engaged in the repair and retrofit of private, commercial and military vessels. The shipyard was significantly known for two defining and related events. It was the builder of the 281 foot M/V CAKEWALK (delivered in 2010), the largest private yacht built in the United States since 1930 when a Maine shipyard constructed a larger 343 foot yacht for J.P. Morgan's son. The yacht is stunning and compares favorably with foreign builds. The other defining event is less glamorous and as a result Derecktor is no longer an operating entity; instead it is liquidating its assets. During the build of M/V CAKEWALK, the shipyard experienced financial difficulties, resulting in serial chapter 11 bankruptcy filings by Derecktor, initially designed to reorganize the shipyard and now to liquidate it.

The initial bankruptcy filing in 2008 spawned diverse litigation of interest to the maritime industry and financiers, including litigation over whether Derecktor retained title to a vessel under construction where the construction contract expressly granted title to its customer upon payment of the first installment due. The resolution of that issue did not implicate federal maritime law, because as all maritime lawyers and lenders know, a

vessel under construction is not a “vessel” for purposes of admiralty law and maritime jurisdiction. In its most recent chapter 11 filing (in 2012) Derecktor, however, will be asking the Bridgeport Bankruptcy Court to answer the fundamental question that is the topic of this article -- what test is used to determine if a particular watercraft is a vessel?

That seemingly innocuous question has been asked and answered no less than four times since 1887 by the Supreme Court of the United States and most recently this year in Lozman v. City of Riviera Beach, 133 S. Ct. 735 (2013). The Lozman Court decided that a houseboat which was not self-propelled was not a “vessel” within the meaning of a federal statute that defines a vessel as including “every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water.” 1 U. S. C. §3 (“Section 3”).

Determining whether a particular watercraft or contrivance is a vessel is more than an academic exercise. It directly impacts the rights and remedies of individuals and entities, including lenders and vendors. If a watercraft qualifies as a vessel, for example, it may be eligible for registration with the National Vessel Documentation Center and in turn a lender, financing the vessel, will be able to obtain a preferred ships mortgage, granting it preferred status in relation to maritime liens and superior priority to other claimants. The unpaid holder of a preferred mortgage as well as unpaid vendors providing necessaries (for example repairs on order of the owner) to a “vessel”, can invoke the power of an admiralty court to arrest the vessel as security for obligations due them. That remedy is simply not available to ordinary claimants in a civil action. Therefore the question of whether a particular thing is a “vessel” is an important one.

The Lozman Court reversed the 11th Circuit which read the statutory directive in Section 3 to find that the houseboat was a vessel since it “was practically capable of transportation over water by means of a tow, despite having no motive or steering power of its own.” City of Riviera Beach v. Unnamed Gray, 649 F.3d 1259, 1269 (11th Cir.2011). The Lozman Court focused on the key words “capable of being used, as a means of transportation …” and said that the 11th Circuit’s construction of those words was too broad. It went on to reject the “anything that floats approach to defining vessels” adopted by many of the lower courts.

Justice Breyer, writing for the majority, notes:

> “Not every floating structure is a ‘vessel.’ To state the obvious, a wooden washtub, a plastic dishpan, a swimming platform on pontoons, a large fishing net, a door taken off its hinges, or Pinocchio (when inside the whale) are not ‘vessels,’ even if they are ‘artificial contrivances' capable of floating, moving under tow, and incidentally carrying even a fair-sized item or two when they do so.” Lozman, 133 S. Ct. at 740.

Therefore, simply because a contrivance has the literal capability of transporting persons or things on water does not make it a vessel; rather, the Court’s calculation of what is and what is not a vessel is reminiscent of possibly the most well known line in Supreme Court jurisprudence. Justice Stewart famously said in a case involving the question of whether a particular motion picture was hard core pornography or protected speech,

"... I know it when I see it ..." Similarly, Justice Breyer imports a subjective element into the inquiry of whether a contrivance is a vessel by invoking the test of whether a "reasonable observer, looking to the [contrivance]'s physical characteristics and activities, would consider it designed to a practical degree for carrying people or things over water."

Justice Breyer's formulation of the test for determining whether something is a vessel is new and its effect has already been felt in a recent case that considered whether a dry-dock was a "vessel". In Catlin (Syndicate 2003) at Lloyd's v. San Juan Towing and Marine Services, Inc. 2013 WL 1403264 (D. Puerto Rico), the district court looked at the physical characteristics and activities of the particular dry dock at issue and held that a "reasonable observer" would not conclude that it was designed to any practical degree to transport persons or things over water. Interestingly, the magistrate judge in charge of the case issued recommendations to the district court judge that the dry dock was a vessel based upon Supreme Court precedent that predated the Lozman case. By the time the magistrate's recommendation reached the court, Lozman was decided and changed everything.

Circling back to Derecktor, it too has a dry dock that it is in the process of liquidating. In the pre-Lozman world a vendor sued the dry dock in rem for necessaries (provided prior to Derecktor's second bankruptcy filing), asserting that it was entitled to a maritime lien against the dry dock. On July 3, 2013, Derecktor filed a complaint (Derecktor Shipyards Conn, LLC v. Titan Marine, LLC, case no. 13-05032, Bankr. D. Conn., July 3, 2013) against that vendor to determine the validity of the vendor's assertion of a maritime lien. In a post-Lozman world if Derecktor's dry dock was not self-propelled and was designed to provide a platform for boat repairs and if its primary function was to in fact facilitate repairs rather than the transportation of people or things on water, Derecktor's attorneys will channel Justice Stewart's immortal words and proclaim--- I know it when I see it and this dry dock is not a vessel.

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