Financing In-Transit Inventory: Legal Risks to Lenders
Structuring In-Transit Financing to Protect Lenders From the Risk of Borrower Insolvency
A Live 90-Minute Teleconference/Webinar with Interactive Q&A

Today's panel features:
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Wednesday, March 31, 2010
The conference begins at:
1 pm Eastern
12 pm Central
11 am Mountain
10 am Pacific

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Financing In-Transit Inventory: Legal Risks to Lenders
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Financing Goods in Transit

- Competitive Advantages for your Lender clients
  - Provides additional liquidity for borrowers
  - If done properly, risk profile is comparable to a letter of credit structure
  - Enhanced collateral position for the Lender
  - Reduces credit risk resulting from interruptions in borrower’s supply chain
Practical Example

• Damascus Steel Transaction
  - $135,000,000 credit facility
  - Steel being transported from China and other countries to the United States was the primary source of raw materials for the borrower
  - The lender was able to perfect its interest in the in-transit steel and provide up to $40,000,000 additional availability
  - The ability to do the deal allowed the lender to establish a business relationship that can now be extended into other banking products
To take advantage of the benefits of financing goods in transit, you need to be perfected at every point in this chain:

- Not every financial institution has this capability, but by mastering this material, you can be prepared to assist your clients with their opportunities to finance goods in transit.

- Note that goods in transit can also be financed through a letter of credit structure, which does not present the same issues as the types of transactions we will discuss today.

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Basics of Goods in Transit

• Common Modes of Transportation
  - Ocean Vessel, Aircraft, Rail and Motor Truck
Basics of Goods in Transit

• Terminology
  - Seller and Buyer
  - Shipper, Consignor, Consignee
  - Vessel Owner, Carrier, NVOCC, Charter Party
  - Customs Broker
  - Customs Bonded Warehouse and Free-Trade Zone
Basics of Goods in Transit

• Documentation
  - Bill of Lading (Clean On Board)
    • Sets forth the contractual terms of carriage
    • Possibly evidences title to the goods
      - Straight Bill of Lading – Not Negotiable
      - Order Bill of Lading – Negotiable and Title is “Locked Up” in the Bill
  • Carrier obligation to deliver
  • Master bills vs. house bills
Basics of Goods in Transit

- Documentation
  - Commercial Invoice
  - Certificate of Inspection
  - Evidence of Insurance
  - Arrangements with Other Parties Expected to Receive Possession of the Goods
    - Freight Forwarders
    - Customs Brokers
    - Storage Companies

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Potentially Applicable Laws

- Many laws can govern the rights of the parties in the goods
- Here’s what we need to know:
  - Where are the goods coming from?
  - Where are they going?
  - How are they getting there?
  - How do the parties plan to document their arrangement?
  - Where will the documents be located?
Potential Applicable Laws

- **UCC Articles 2, 7 or 9**
  - We are seeing more discussion of electronic bills of lading as Revised Article 7 has been adopted by more states

  - Addresses contract formation, risk of loss, delivery and payment obligations and rights of parties upon breach

- **U.N. Convention on the High Seas**
Potentially Applicable Laws

- Law of the Sea
  - Though not ratified, the United States generally complies with this body of law
- U.S. Carriage of Goods by Sea Act
- International Commercial Terms ("Incoterms") adopted by the International Chamber of Commerce
  - Be aware that defined terms in international commerce are very different than those used in domestic commerce.
Perfecting a Security Interest in Goods in Transit

- Attachment with respect to the goods
  - The choice of law, extraterritorial reach of applicable law and commercial standards will determine when the Borrower obtains “rights” in the goods

- Perfection of a security interest in the goods
  - Perfection by filing under the UCC
  - Perfection by possession of the goods
  - These may be affected by the applicability of 11 U.S.C. §544
Perfecting a Security Interest in Goods in Transit

- Generally, the laws of most countries will recognize the rights of a secured lender that is:
  - The holder of an order bill of lading
  - The consignee of a straight bill of lading
  - A party to an attornment letter where the buyer is a consignee of a straight bill of lading

- Controlling the package of documents is important in protecting the secured lender’s interest in the goods
Competing Claimants to Goods in Transit

- In any transaction, expect that there will be competing interests for the goods
  - Manufacturer/Seller
  - Carrier
  - Customs Broker
  - Other Secured Creditors
  - NVOCC
  - Lien Creditors and Title Retention Creditors
  - Borrower (sometimes known as the “trustee in bankruptcy”)
Common Complications

• Claims of sellers and the creditors of sellers
  - Stoppage in transit
  - Reclamation
  - Possible impact of §2-505 of the UCC
  - Title retention laws and conditional sales contracts
  - Possible implications of CISG and Incoterms

• Dealing with logistics providers
  - Letters of indemnity may help smooth this process

• Double-pledging of goods or documents

• Customs problems

• Political risk

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Bankruptcy Concerns

- Lien Avoidance Issues
  - If you have considered the applicable law and taken the appropriate perfection actions, the Trustee in Bankruptcy will not be able to avoid your lien

- Motion for Adequate Protection

- DIP Financing and Third-Party Priming Liens

- These issues will typically arise in the bankruptcy of a seller or buyer, but the bankruptcy of a carrier, broker or other logistics provider can also be a problem

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Strategies for Goods in Transit Transactions

- Recognize that it may be impossible to maintain a pristine first priority lien at all times and in all places.

- Control the shipping documents and all duplicate originals, if possible.

- Utilize insurance to the extent practical.
Strategies for Goods in Transit Transactions

- Utilize intercreditor agreements to the extent practical to neutralize claims of third parties
  - Lien priorities
  - Indemnification issues
  - Bailee issues
  - Extent of obligations secured by custom broker's/NVOCC's/carrier’s liens
  - Consent of Borrower
Strategies for Goods in Transit Transactions – Due Diligence

- Understand the involvement of third parties
- Understand the sale terms and governing law
  - If the transaction is significant, retain local counsel to provide analysis of governing law
- Understand the shipping terms
- Review the standard forms of the shipping documents
  - Bills of Lading
  - Invoices and sales documents
  - Evidence of insurance
Strategies for Goods in Transit Transactions – Loan Documentation

• Carefully define each of the following:
  - Eligible foreign vendors
    • Attempt to obtain a vendor agreement
  - Eligible in-transit goods
  - Eligible NVOCC
    • Attempt to obtain an imported goods agreement

Acceptable Bill of Lading
Parting Thoughts

- Obtaining a perfected security interest in goods in transit can provide a significant benefit to your lender clients.
- Always identify where the goods and documents will be at all stages of the transaction.
- By mastering this material, you can be prepared to assist your clients with their opportunities to finance goods in transit.
All Questions Answered . . . All Knowledge Shared
Thank You For Your Time and Interest!

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