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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

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C. Edward Dobbs, Partner, **Parker Hudson Rainer & Dobbs**, Atlanta

Thomas Hemmendinger, Of Counselm, **Brennan Recupero Cascione Scungio & McAllister**, Providence, RI

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IN-TRANSIT INVENTORY FINANCING

C. Edward Dobbs
Anthony C. Cianciotti
Parker, Hudson, Rainer & Dobbs LLP
Atlanta, Georgia

I. INTRODUCTION

As used in this paper, in-transit inventory refers to goods that are in transit to the United States from an overseas manufacturer. This paper highlights legal issues that may arise in connection with lending against the security of in-transit goods. Additionally, this paper addresses steps that may be taken to obtain a perfected security interest in in-transit goods during the period commencing on the date the overseas manufacturer releases the goods to an ocean carrier through the date on which the goods arrive in the United States (the "In-Transit Period").

II. SOURCES OF LAW

A. Laws and Non-Statutory Definitions Applicable to Sales Transactions

1. Uniform Commercial Code ("UCC"), Article 2.

   To the extent the law of a jurisdiction in the United States applies, Article 2 of the UCC applies to all contracts for the sale of goods.

2. United Nations Convention on the International Sale of Goods ("CISG")

   The CISG will apply to most commercial contracts for the sale of goods when (a) the buyer and seller of goods are from different nations that have both adopted the CISG (this includes, among other countries, the United States, Canada, China (PRC), Mexico, Japan, and South Korea) and (b) the contract governing the sale does not expressly adopt the law of a specific jurisdiction. Also, countries that have adopted the CISG may do so with declarations that alter or delete certain of its provisions.

   The CISG addresses (a) contract formation, (b) risk of loss, (c) delivery and payment obligations, and (d) the rights of the parties upon breach. The otherwise applicable law (in the absence of the CISG) governs matters not addressed in the CISG, including the passage of title.

3. International Commercial Terms ("Incoterms")

The Incoterms are the most widely used non-statutory definitions in international trade. Adopted by the International Chamber of Commerce, the Incoterms define which party to a sales contract bears responsibility for costs relating to shipping and the risk of loss. Terms include, among others:

(a) Ex Works (EXW): Seller fulfills its obligations (and the buyer becomes responsible for the goods) when the seller makes the goods available at the seller's premises.

(b) Free On Board (FOB) Port of Shipment: Seller fulfills its obligation when the goods have passed over the ship's rail at the named port of shipment; this Incoterm requires the seller to clear the goods for export.

(c) Cost and Freight (CFR): Seller must pay the costs and freight necessary to bring the goods to the named port of destination but the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have been delivered on board the vessel, is transferred from the seller to the buyer when the goods pass the ship's rail in the port of shipment. The CFR term requires the seller to clear the goods for export.

(d) Cost, Insurance and Freight (CIF): Seller has the same obligations as under CFR but with the addition that it must procure marine cargo insurance against the buyer's risk of loss of or damage to the goods during the carriage. The seller contracts for insurance and pays the insurance premium. The CIF term requires the seller to clear the goods for export.

B. Laws Applicable to the Shipping of Goods

1. Article 7 of the UCC (applies primarily to bills of lading issued for the transportation of goods from a foreign country to the United States).

2. Federal Bills of Lading Act of 1916 (Pomerene Act), 49 U.S.C. § 80101 et seq. (applies to bills of lading issued for intrastate and interstate shipments and the export of goods from the United States to a foreign country).

3. Carmack Amendment to the Interstate Commerce Act, 49 U.S.C. § 11707 (codifies and preempts all state and common law claims

and provides the sole and exclusive remedy to a seller/shipper for any loss, damage, or destruction of goods in interstate transit, subject to certain exceptions).

4. Carriage of Goods by Sea Act of 1936 (COGSA), 49 U.S.C. § 1300 (concerned primarily with the duties, rights, responsibilities and liabilities of a carrier and a seller/shipper as they relate to the care and preservation of the goods on board).

III. ATTACHMENT AND PERFECTION OF SECURITY INTERSTS IN IN-TRANSIT GOODS

A. Attachment

1. For a security interest to attach to goods and be enforceable as to the debtor and third parties, the secured party must give value, the debtor must have rights in the goods and the debtor must grant a security interest pursuant to an executed security agreement. UCC § 9-203.

   (a) "Rights in the goods": Best case is for the seller and debtor to agree upon passage of title on or before delivery to carrier. Absent this, courts look to debtor's actual control over goods and when risk of loss passes.

   (b) Some courts have held that a debtor may acquire rights in collateral prior to the seller's shipment of goods. See Central National Bank v. Worden-Martin, Inc., 413 N.E. 2d 539 (Ill. 1980); In re Emergency Beacon Corp., 665 F.2d 36 (2d Cir. 1981); Hartford National Bank and Trust v. Essex Yacht Sales, Inc., 492 A.2d 230 (Conn. 1985).

2. Attachment of security interest to goods outside the United States:

   (a) UCC §1-105: "When a transaction bears a reasonable relationship to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties."

   (b) "Reasonable relationship": a jurisdiction bears a reasonable relationship to the transaction where a "significant enough portion of the making or performance of the contract is to occur or occurs." UCC §1-105.

   (c) Provided a reasonable relationship exists, it is likely a court in the United States would apply the law chosen by the secured party and the debtor. See generally Cohen &

Smith, International Secured Transactions and Revised UCC Article 9, 74 CHI.-KENT L. REV. 1191 (1999).

(d) If such law is applied, the security agreement may be sufficient to create a security interest in in-transit goods outside the United States.

B. Perfection

1. It is arguable that the UCC does not permit a secured party to perfect a security interest in in-transit goods during the In-Transit Period.

   (a) Old Article 9: No. Filing of a UCC-1 financing statement was governed by the law of the state in which the goods were "located." Hence, no filing jurisdiction was specified for goods located outside of United States.

   (b) Revised Article 9: Maybe. Filing of a UCC-1 financing statement is governed by the law of the debtor's location (which is the jurisdiction of organization for entity debtors). Revised Article 9 sets no express limits on its extraterritorial reach, allowing an argument that perfection may be accomplished by filing in the debtor's jurisdiction of organization. See Kuhn, Multi-State and International Secured Transactions Under Revised Article 9 of the Uniform Commercial Code, VA. J. INT'L L. 1009 (2000).

2. Foreign law may govern effect of perfection and priority.

   (a) Law governing the act of perfection (where to file) and the effect of perfection and priority of security interests are not always the same.

   (b) The effect of perfection and priority of a security interest are governed by the law of the jurisdiction in which the goods are located. UCC § 9-301(3)(c).

   (c) Choice of law provisions that purport to select law applicable to the effect of perfection and priority are not effective. UCC § 1-105(2).

   (d) Goods on "high seas" (>12 miles off shores of any nation, pursuant to U.N. Convention of the Law of the Sea, December 10, 1982, Art. 3 (not ratified by U.S.), and 54 Fed. Reg. 777 (1989)): It is not clear what law a court would apply to determine lien priorities with respect to goods during the In-Transit Period. A court might apply the law of the ship's registered country and whose flag it files. <u>See</u> U.N. Convention on the High Seas, April 29, 1958, Art. 6.

3. Bankruptcy trustee's attack on perfection.

   (a) The Bankruptcy Code authorizes a bankruptcy trustee, as a "hypothetical lien creditor" and "purchaser for value," to avoid liens that could be avoided under applicable law. Trustee may argue he is afforded the rights of a lien creditor under the "applicable law" of other countries. 11 U.S.C. § 544.

   (b) If law of foreign jurisdiction gives rights to lien creditor that prevails over perfected security interest, then the trustee may argue that he can avoid the secured party's lien.

4. Unwise to rely solely upon UCC-1 filing.

IV. PERFECTION OF SECURITY INTEREST THROUGH BILLS OF LADING

A. Bills of Lading in General

1. "Bill of lading" is a document of title which evidences that "the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers." UCC § 1-201(6).

2. U.S. laws governing bills of lading and the rights thereunder are found primarily in four sources:

   (a) Article 7 of the UCC;

   (b) Federal Bills of Lading Act of 1916 (Pomerene Act), 49 U.S.C. § 80101 et seq.;

   (c) The Carmack Amendment to the Interstate Commerce Act, 49 U.S.C. § 11707; and

   (d) Carriage of Goods by Sea Act of 1936 (COGSA), 49 U.S.C. § 1300.

3. Article 7 is primarily applicable to bills of lading issued for the transportation of goods <u>from</u> a foreign country <u>to</u> the United States.

B. Negotiable and Non-Negotiable Documents

1. Bills of lading and other documents of title are negotiable if, according to their terms, the underlying goods are to be delivered

either to the "bearer" of the document or "to the order of" a named person. UCC § 7-104(1)(a).

2. All other documents of title are non-negotiable. UCC §7-104(2).

3. Negotiability impacts the rights acquired by a transferee of the bill and the transferee's interest in the underlying goods.

C. "Master" and "House" Bills of Ladings

1. Master Bills of Lading: A master bill of lading is issued by the carrier (a steamship company) and is typically obtained by the shipper of record. Many times, the shipper of record is the manufacturer of the goods.

2. House Bills of Lading: Often, the shipper or debtor/purchaser of the goods will engage the services of a "non-vessel operating common carrier" ("NVOCC"), which provides consolidation and logistics services to assist in the transportation of the goods. In these cases, one or more "master" bills of lading are issued to the NVOCC for all goods that the NVOCC places with the carrier, and the NVOCC issues its own "house" bills of lading to its customers (i.e., the purchaser) covering the goods of each particular customer.

D. Perfection through Bills of Lading

1. Issuance of a bill of lading provides a secured party an alternate means of perfecting a security interest in in-transit goods.

2. Secured party should be granted a security interest in both the goods and the bill of lading covering the goods. UCC § 9-312(c).

3. If a bill of lading is negotiable, the security interest in the in-transit goods covered by such bill of lading may be perfected by perfecting a security interest in the document itself. UCC § 9-312(c)(1).

4. Perfection in the underlying goods by virtue of a perfected security interest in a negotiable bill of lading continues for so long as the goods remain in the possession of the bailee who issued the negotiable bill and for a period of 20 days after the secured party makes the bill available to the debtor for the sale or other handling or disposition of the goods. UCC § 9-312(f).

5. Perfecting a security interest in a non-negotiable bill of lading will not necessarily perfect a security interest in the underlying in-transit goods. To achieve such perfection, (a) the bailee must

name the secured party as consignee, (b) the bailee must receive notice of the secured party's security interest in the in-transit goods, or (c) the secured party must file a UCC-1 financing statement as to the goods. UCC § 9-312(d).

E. Methods of Perfection

1. Temporary perfection.

   (a) Secured party's security interest in a negotiable document is perfected for 20 days from the date of attachment without filing or possession. UCC § 9-312(e).

   (b) New value must be given. "New value" includes money and money's worth in property, but does not include an obligation substituted for another obligation. UCC § 9-102(57).

2. Perfection by filing.

   (a) If a negotiable bill of lading is physically within the United States, the secured party may rely upon a UCC-1 financing statement covering documents of title. It is an open question whether a secured party may perfect its security interest by filing if the bill of lading is located outside the United States.

   (b) Perfection by filing alone exposes the secured party to a fraud risk should the debtor or the holder of a negotiable bill "duly negotiate" it to a third party. UCC §§7-501, 7-502 & 9-331(a).

3. Perfection by possession.

   (a) A secured party may perfect a security interest in a negotiable bill of lading by possession of the original document. UCC § 9-313(a).

   (b) Perfection through possession may be effectuated through the possession by a secured party's agent, such as a customs broker or NVOCC. UCC § 9-313. However, possible dual-agency issues exist when "deputizing" the debtor's custom broker or NVOCC to act as the secured party's agent.

   (c) Risk of negotiation of a negotiable bill to a third party remains in international shipping, where the bill of lading is issued in triplicate.

F. Possible Effects of Bankruptcy

1. Perfection solely by filing as to the goods.

    (a) It is unclear whether the UCC allows for perfection of a security interest in goods during the In-Transit Period.

    (b) Trustee will assert that the automatic stay prevents perfection post-petition once in-transit goods arrive in the United States.

2. Effect of carrier's post-bankruptcy release of goods.

    (a) A perfected security interest in in-transit goods may be lost 20 days after surrender of the bill of lading to the debtor to facilitate off-loading of the goods upon arrival in the United States. UCC §9-312(f).

    (b) Secured party's options to attempt to preserve perfected status:

        (i) Prohibit release: Secured party may direct the customs broker or NVOCC not to release the bill of lading. Goods remain in the possession of the carrier and the security interest in the goods through the bill of lading should remain perfected. The secured party could then petition the court for adequate protection pursuant to an adequate possession order.

        (ii) Seek stay relief to foreclose: Secured party may seek relief from the automatic stay to foreclose upon its security interest in the negotiable bill of lading and to sell the document of title itself (perhaps to the debtor).

3. Possible limits to trustee's ability to avoid security interest.

    (a) Section 546(b) of Bankruptcy Code provides that the general avoidance rights and powers of a trustee are subject to any "generally applicable" law that:

        (i) permits perfection of an interest in property to be effective against an entity that acquires rights in the property before the date of perfection; or

        (ii) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in the property before the date on which action is taken to effect such maintenance or continuation.

(b) While law is uncertain, secured party might assert that Section 546(b) prohibits action by trustee because the rights to the goods are a continuation of the rights in the goods pursuant to the duly perfected security interest in the bill of lading.

(c) While law is uncertain, secured party might assert that goods are the "proceeds" of the bill of lading, eliminating any gap in the period of perfection before and after the filing of a bankruptcy petition.

G. Issues Surrounding Electronic Documents of Title

1. Electronic documents of title recognized in jurisdictions that have adopted Revised Article 7 or the Uniform Electronic Transactions Act (the "Acts").

2. Acts respond to unique problem created with negotiable documents because parties must have certainty that only one original electronic record exist. Acts require "control" in lieu of possession.

3. "Control" may be possible if electronic documents are maintained with a secure registry system; however, no systems have been tested in court with respect to bills of lading.

4. Two states have yet to adopt either Act (New York and Washington).

5. Absent universal adoption of one of the Acts, a secured party may not be able to perfect its security interest because the applicable law may not recognize an electronic document for purposes of either "control" or filing.

V. THE LENDER AS CONSIGNEE

A. Overview

1. To protect its interest in in-transit goods, a secured party may be named as consignee in a bill of lading.

2. If the document is issued "to the order of" the secured party, the secured party becomes the "holder" of the negotiable document by "due negotiation."

3. The secured party, as holder of a negotiable document, acquires title to both the document and the goods covered by the document and that title is superior to that of subsequent creditors. UCC §§ 7-502 and 7-602.

4. "Due negotiation" requires that the document be negotiated to a holder who purchases it for value and in good faith and without notice of any defense against or claim to it. UCC § 7-501(4).

   (a) "Purchase" and "value" are broadly defined and generally apply to lenders that extend credit in return for collateral.

   (b) No "due negotiation" occurs if the negotiation is not in the ordinary course of business or financing.

   (c) No "due negotiation" occurs if the document is received in settlement of payment of a money obligation.

B. Advantages of Lender as Consignee

1. If the lender takes by due negotiation, the lender acquires the rights specified by UCC Article 7, which include:

   (a) title to the document;

   (b) title to the goods;

   (c) all rights accruing under the law of agency or estoppel; and

   (d) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by him except those arising under the terms of the document or Article 7. UCC § 7-502.

2. Additionally, the lender can control the ultimate disposition of the goods. UCC § 7-303.

VI. DUAL AGENCY

A. Employing a Dual Agent

1. It is impractical for a secured party to present the bill of lading to the carrier for offloading of in-transit goods. A secured party is better served by appointing an agent to hold and present a document of title on its behalf.

2. Debtor also requires an agent to clear the goods through customs and deliver them to the debtor's location.

3. Ideally, one customs broker can serve both the secured party and debtor.

B. Permissibility of Dual Agent

1. Agency law generally disapproves of an agent serving two principals whose interests might conflict, but does not prohibit such a relationship. See Restatement (First) of Agency § 391 & 394; 3 Am. Jur. 2d Agency § 236 (2003).

2. Some courts have held that dual agency relationships are not void per se, but only when "the fact that the agent represented both parties was not known to each." Spratlin, Harrington & Thomas, Inc. v. W.R. Hawn, 156 S.E.2d 402, 405 (Ga. App. 1967). Snider v. State ex rel. Oklahoma Real Estate Com'n, 987 P.2d 1204, 1208 (Okla.1999).

C. UCC Limitations on Dual Agency

1. The UCC imposes limitations beyond those found in agency law on dual agencies involving a debtor and a secured party. UCC § 9-313, cmt. 3.

   (a) A debtor may not serve as an agent for a secured party.

   (b) A party closely connected to or heavily controlled by a debtor may not serve as agent for a secured party.

2. Dual agency for purposes of perfection may be permissible if the agent is not closely connected to or heavily controlled by the debtor. Looney v. Nuss (In re Miller), 545 F.2d 916 (5th Cir 1977).

D. Customs Broker, NVOCC and Carrier Agreements

1. Reaching an appropriate agreement is not "one-size fits all." You must understand the nature of services that the third party provides to the debtor to determine who can best serve the interests of lender as an agent and bailee for purposes of perfection.

2. Traditionally, customs brokers needed an original bill of lading to clear the goods through customs. In recent years, the process has changed. Customs broker typically clear goods through customs with only a photocopy, 19 C.F.R. § 141.83(c)(2), and often do so while the goods are still on the carrier's vessel. As a result, a customs broker that does not physically handle the goods or hold the bill of lading may not be an appropriate candidate to act as lender's agent.

3. A customs broker that also serves as NVOCC may be a more appropriate choice. In this case, the customs broker serving as NVOCC may handle the goods as part of the shipping process.

4. The carrier may also be an appropriate entity to act as the lender's agent, particularly in cases where a NVOCC is not involved and the carrier is in possession of goods from the port of origin until the destination named in the bill of lading.

VII. RIGHTS OF THIRD PARTIES

A. Carrier Liens

1. A carrier may have liens or security interests in the goods "for charges subsequent to the date of its receipt of the goods for storage or transportation…and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law." UCC § 7-307(1). A carrier also possesses lien rights under maritime law for fees and expenses incurred in respect of goods in the carrier's possession.

2. Lien Notice filed with Bureau of Customs while in-transit goods are in the possession of customs will prevent delivery. 19 U.S.C. § 1564; 19 C.F.R. 1411.112.

3. Carrier's liens have priority over Article 9 security interests. UCC § 9-333.

B. Customs Broker Liens

1. A customs broker has the right to obtain a lien for duties it has paid on goods and any taxes paid to the IRS.

2. Such a lien will have priority over a security interest in the goods so long as the goods are in the custody or subject to the control of customs. See 19 C.F.R. § 141.1(d); UCC § 9-333.

C. Unpaid Sellers

1. Title retention.

   (a) Reservation of title by a seller is, under the UCC, the reservation of a security interest and is automatically perfected without filing until the debtor obtains possession of the goods. UCC § 9-110.

(b) A seller's title retention will normally prevail over a secured party's prior perfected security interest. UCC § 9-110.

2. Seller's security interest under negotiable documents.

(a) Seller's procurement of a negotiable document prior to shipment reserves to the seller a security interest in the goods. UCC § 2-505.

(b) Seller's procurement of a non-negotiable bill of lading reserves a security interest only if (i) buyer is named as consignee and shipment is a "conditional delivery" or (ii) seller names itself or a nominee (other than buyer) as consignee. UCC § 2-505; In re Ault, 6 B.R. 58 (Bankr. E.D. Tenn. 1980).

(c) Seller's security interest is automatically perfected without filing until the debtor obtains possession of the goods. Parties' agreement as to when title passes is not considered. UCC § 9-110.

(d) Seller's security interest will prevail over secured party's interest until buyer obtains possession of the goods. See In re Flo-Lizer, Inc., 946 F.2d 1237 (6th Cir. 1991).

3. Seller's right to withhold delivery.

(a) A seller's right to withhold delivery generally prevails over a secured party's security interest. UCC § 2-703(a); Crocker National Bank v. Division of Dresser Industries, Inc., 839 F.2d 1104 (5th Cir. 1988).

(b) The right of stoppage of delivery in transit once goods are in the possession of a carrier are cut off by the negotiation of a negotiable document of title to the buyer. UCC § 2-705; see Ramco Steel, Inc. v. Kesler, 620 F.2d 767 (10th Cir. 1980).

(c) Absent a negotiable document, the seller's right to stop delivery extends to the time of "receipt" of the goods by the debtor at its place of business or designated destination. Passage of title and risk of loss are not relevant considerations. See In re Trico Steel Co., L.L.C., 282 B.R. 318 (Bankr. D. Del. 2002).

(d) Time of "receipt" may occur after goods arrive at U.S. port (e.g., receipt of debtor's warehouse) if shipped under a multi-modal bill of lading that designates an inland destination as the place of delivery.

4. Seller's right of reclamation.

   (a) An unpaid seller who has delivered goods to an insolvent buyer has a right to reclaim goods provided that the demand is made within 10 days after delivery of the goods. UCC § 2-702.

   (b) A prior perfected security interest in the goods will typically trump a seller's right of reclamation if the secured party qualifies as a "good faith purchaser." See UCC §§ 2-702(3) & 2-403; 11 U.S.C. § 546(c)(1); In re Pester Refining Co., 964 F.2d 842, 845-46 (8th Cir. 1992); In re Advanced Mktg. Servs., Inc., 360 B.R. 421, 426 (Bankr. Del. 2007). But see Phar-Mor, Inc. v. McKesson Corp., 534 F.3d 502 (6th Cir. 2008) (holding that UCC § 2-702(2) as adopted in Ohio grants a properly reclaiming vendor a right to reclaim its goods and that § 2-702(3) does not allow a secured creditor's claim to defeat that right).

   (c) The holder of a negotiable document who took by "due negotiation" also will defeat the seller's right of reclamation. UCC § 7-502(2).

   (d) The reclaiming seller normally prevails over the holder of a non-negotiable bill of lading. UCC § 7-504.

D. Claims of Other Secured Parties

1. When goods are in the possession of a bailee (e.g., a carrier in an in-transit goods context) and the goods are subject to a negotiable document:

   (a) A secured party's security interest in the goods perfected through possession of the bill of lading takes priority over other security interests in the goods perfected while goods are with the bailee. UCC § 9-312(c).

   (b) No lien will attach by virtue of any judicial process unless the document is first surrendered to the bailee or its negotiation is enjoined. UCC §7-602.

2. When goods are in the possession of a bailee and the goods are subject to a non-negotiable document, a secured party (lender) may lose to other secured parties who take a security interest in the goods unless the lender:

(a) obtains a non-negotiable document of title in its own name;

(b) notifies the bailee in possession of the goods of the lender's interest; and

(c) files an appropriate UCC-1 financing statement as to the goods. UCC § 9-312(d).

E. Liens Under Foreign Law

1. Foreign laws may impact in-transit goods while such goods are located at a foreign port or on the high seas.

2. A ship is generally treated like a "floating island," having the nationality of the country whose flag it flies. See U.N. Convention of the Law of the Sea, December 10, 1982, Art. 92 (ratified by over 140 nations, but not the United States).

3. Possible application of foreign law opens the possibility that specific foreign liens may attach to in-transit goods located on the high seas.

DUE DILIGENCE CHECKLIST FOR
IN-TRANSIT INVENTORY FINANCING

C. Edward Dobbs
Parker, Hudson, Rainer & Dobbs LLP
Atlanta, Georgia

1. **Obtain a list from Borrower** of each third-party entity that assists in the transportation and importation of goods. This may include:

   a. *Carrier (the Shipping Company)*

      The carrier issues a bill of lading which is a receipt for the goods and the contract regarding the carriage of goods.

   b. *NVOCC ("Non-Vessel Operating Common Carrier")*

      This entity is one type of freight forwarder. They do not use their own ships, but provide logistics support by booking space on ships and selling it in smaller quantities and consolidating freight. It issues its own ("house ") bill of lading to the consignee.

   c. *Freight Forwarder*

      This entity prepares and processes the documentation and performs related activities pertaining to international shipments. Unless it also functions as NVOCC, it does not issue its own bill of lading.

   d. *Customs Broker*

      Responsible for clearing goods through customs upon arrival in the United States. In some instances, the customs broker never actually possesses the goods or an original counterpart of the bill of lading.

   NOTE: (1) Sometimes, one company may serve more than one of the above roles (i.e., same company serving as both a NVOCC and customs broker). (2) When an NVOCC is involved, the bill of lading issued by the carrier (called a "master bill of lading") is to the NVOCC. The bill of lading issued by the NVOCC (called a "house bill of lading") is to the consignee (the person named in the bill of lading who is entitled to receive the goods).

2. **Determine from Borrower**:

   a. *From what foreign vendors Borrower purchases goods?*

      If it is an affiliate of Borrower or supplier over which Borrower has influence, you may wish to pursue a vendor agreement, in which the foreign vendor waives any rights as an unpaid seller and subordinates or waives any liens it may have in the goods.

   b. *Are goods purchased on open account or are they paid for in advance of shipping?*

      If the Borrower pays for the goods before shipping, ask whether the goods are paid for by a documentary letter of credit or some other method.

c. *Does the sales contract provide the foreign vendor any continuing rights in the goods?*

This could include a reservation of title by the foreign vendor or grant of a security interest in the goods.

d. *Does the sales contract provide for risk of loss?*

Risk of loss should pass to Borrower as soon as possible, and no later than the delivery of goods to the carrier.

e. *What are the shipping terms used by parties?*

Consistent with (d), above, the parties' contract should contain terms that terminate the foreign vendor's obligation to pay for shipping costs no later than the delivery of goods to the carrier. The appropriate terms to reference are Incoterms 2000, as UCC Article 2 is not used in international shipping. Avoid terms that require the foreign vendor to bear transportation costs after delivery of the goods to the carrier.

f. *Does the Borrower maintain marine cargo insurance?*

If not, Borrower must obtain such insurance. Lender must also obtain evidence and a certificate of insurance naming lender as a lender's loss payee and a loss payable endorsement for the policy.

NOTE: Many Borrowers that purchase goods from foreign vendors have one or more employees responsible for coordinating logistics. This person can usually provide responses to questions above.

3. **Arrange a telephone call** with a representative of the NVOCC/Freight Forwarded/Customs Broker to understand the function the entity performs.

a. Have the representative describe the process of the steps that occur to get the goods from the foreign vendor to the domestic purchaser and provide a narrative regarding the movement of the bill of lading from the moment it is issued by the carrier through its tender at the U.S. port for the goods.

b. Questions to ask:

(1) Who is named as consignee on the bill of lading from the carrier?
(2) How many original counterparts are issued?
(3) Does the entity issue its own bill of lading?
(4) Does the entity process the goods through customs?
(5) Which entities possess the bill of lading while the goods are in-transit?
(6) At what point does the particular entity possess the bill?
(7) Are all bills of lading in tangible/paper format?

NOTE: *Do not confuse a PDF of a tangible bill with an electronic bill. An electronic bill of lading seeks to duplicate the rights embodied in a tangible bill of lading in an electronic format.*

4. **Obtain copies of typical bills of lading** that Borrower receives. Be aware that:

a. Words "to order of" designate that the bill is negotiable (sometimes called an "order bill")

b. All other bills are non-negotiable (sometimes called a "straight bill")
c. Notify Party: listing a party as a party to be notified does not create rights in favor of that party

5. **Obtain copies of sales documentation** that Borrower provides and receives from its foreign vendors. Look for the following terms:

a. Any retention of title/reservation of security interest by the foreign vendor
b. Statement of when title passes (may be express in contract)
c. Shipping terms employed (determines when risk of loss passes)
d. Choice of law (in the absence of express choice of law, the United Nations Convention on Contracts for the International Sale of Goods may apply)

GLOSSARY OF "GOODS IN TRANSIT" TERMS

Brennan, Recupero, Cascione, Scungio & McAllister, LLP
362 Broadway
Providence, RI 02909
tel. 401.453.2300
fax 401.453.2300
themmendinger@brcsm.com

Ad Valorem. Latin for "according to value." An Ad Valorem Duty is based on the value of the goods. This is the most common type of duty (*compare to* Compound Duty or Specific Duty).

Admiralty Law. *See*, Maritime Law.

Air Waybill. A bill of lading for air transportation. Air waybills are not issued in negotiable form.

Anti-Dumping Duties. These are additional Customs duties imposed to discourage foreign vendors from flooding the U.S. market with cheap goods and hurting U.S. manufacturers.

Arrival Notice. Notification by the carrier, freight forwarder, or customs broker, stating that the goods have arrived at destination. Often the arrival notice states the allowed free time before storage charges begin.

Automated Broker Interface (ABI). This system allows customs brokers to make entries electronically. It is part of U.S. Customs & Border Patrol's Automated Commercial System (ACS).

Automated Clearing House (ACH). This system allows importers and exporters to pay duties and fees by electronic funds transfer. It is part of U.S. Customs & Border Patrol's Automated Commercial System (ACS).

Automated Commercial System (ACS). U.S. Customs & Border Patrol's integrated system for making entries and paying duties. The ACS includes the Automated Broker Interface (ABI), the Automated Clearing House (ACH), and the Automated Manifest System (AMS).

Automated Manifest System (AMS). This system allows submission of ocean bills of lading and air waybills to be submitted electronically. The AMS provides inventory control and release notifications.

Bank Release. A document issued by a bank consignee, authorizing the carrier to deliver the shipment.

Bill of Lading. A document issued by a carrier or forwarder, showing the receipt of goods, the destination for delivery of the goods, and the terms and conditions of carriage (the contract of carriage). The bill of lading may be negotiable or non-negotiable. *See*, UCC § 1-201(6) (2003); UCC § 1-201(6) (1962). *See also, Norfolk Southern Railway Company v. James N. Kirby, Pty Ltd.*, 543 U.S. 14, 18-19 (2004) ("A bill of lading records that a carrier has received goods from the party that wishes to ship them, states the terms of carriage, and serves as evidence of the contract for carriage").

Bond. A surety bond to secure payment of Customs duties and fees. Also, a shipment is made "in bond" if the goods are moved from one U.S. port to another without first clearing Customs or if the goods are stored in a bonded warehouse. The duty is paid when the goods arrive at the second U.S. port or when they leave the bonded warehouse.

Bonded Warehouse. A warehouse where goods still subject to customs duties can be temporarily stored, without requiring payment of duties.

Break Bulk Cargo. *See*, Bulk Cargo.

Bulk Cargo and **Break Bulk Cargo**. Cargo which is not placed in containers before loading onto the vessel; or cargo which is not placed onto unit loading devices (ULD's) before loading onto an aircraft. Bulk cargo occupies the entire hold; break bulk cargo occupies only part of the hold.

Bulk Shipment. A shipment that is loaded directly into a vessel and is not packaged.

Carmack Amendment. 49 U.S.C. §§ 14706 *et seq*. The Carmack Amendment allows interstate carriers to limit their liability for lost or damaged cargo, if the carrier gives the shipper the option to declare a higher value and pay an additional charge. The Amendment also allows carriers to require that cargo claims be made in writing within nine months. The Carmack Amendment preempts state law liability rules for interstate carriers.

Carriage of Goods by Sea Act (COGSA). 46 U.S.C. App. §§ 1300 to 1315. Enacted in 1936, COGSA sets forth the rules for a carrier's liability for lost or damaged cargo in shipments to or from ports of the U.S. The liability limit is $500.00 per package or (for goods not shipped in packages) per customary freight unit, unless the shipper declares a higher value and pays additional charges. COGSA applies "tackle to tackle," but in the contract of carriage, the parties may agree that COGSA's rules apply to portions of the route not otherwise covered by COGSA.

Carriage Paid to (CPT). An international trade term, under which the seller satisfies its delivery obligation by clearing the goods for export and by nominating and paying the carrier to the place or port of destination, but the buyer bears the risk of loss when the first carrier receives the goods at origin; CPT is generally used for container shipments by air or ocean and for roll-on roll-off shipments.

Carriage and Insurance Paid to (CIP). An international trade term, with the same term as "Carriage Paid to (CPT)," except the seller must also procure minimum insurance on the goods.

Carrier. A person who transports goods for others; a carrier is any person that issues a bill of lading, so it includes non-vessel operating common carriers (NVOCC). UCC § 7-102(a)(2) (2003). A common carrier holds itself out to the public as engaged in the business of transporting goods for hire. A private carrier or contract carrier transports goods only for specific parties, for example, under a charter agreement.

Carrier's Lien. The carrier's lien upon cargo to secure payment of charges related to the transportation or storage of that cargo. The carrier's lien may arise under maritime law (*see* "Maritime Lien"), the Uniform Commercial Code (UCC § 7-307), the Pomerene Act (49 U.S.C. § 80109), the common law (*see*, *e.g.*, *Pittsburgh, Cincinnati, Chicago & St. Louis Railway Co. v. Fink*, 250 U.S. 577, 582 (1919)), foreign law, or contract. Under Revised Article 7, the carrier's lien also covers proceeds in the carrier's possession. UCC § 7-307(a) (2003).

Certificate of Insurance. A document summarizing the terms and conditions of an insurance policy covering goods in transit.

Certificate of Origin. A document that certifies the country of origin of particular goods. Sometimes a certificate of origin requires a governmental signature or stamp.

CFR. *See*, Cost and Freight.

CFS. *See*, Container Freight Station.

CIF. *See*, Cost, Insurance and Freight.

CIP. *See*, Carriage and Insurance Paid to.

Clause Paramount. A clause in a bill of lading, invoking the limits on carrier liability for lost or damaged cargo, as permitted by COGSA or other applicable law.

Clean Bill of Lading. A bill of lading on which the carrier has noted that the goods were not damaged in loading aboard the ship/aircraft.

Clearance. The process of paying customs duties and obtaining governmental approval to import or export a specific shipment of goods.

COGSA. *See*, Carriage of Goods by Sea Act.

Collect Freight (or **Freight Collect**). Freight charges payable at destination.

Commercial Documents. Generally this refers to the commercial invoice, bill of lading, certificate of insurance (on sales such as CIF terms), and any other documents required for clearing the goods through customs (such as visas or manufacturers statements of origin).

Commercial Invoice. The vendor's bill of sale for goods, in invoice form, showing the type, quantity and price of the goods and the terms of sale.

Compound Duty. A duty calculated based on multiple criteria (e.g. value and weight).

Container. A sealable rectangular metal container in which goods are shipped by ocean. The most common sizes are 20', 40', and 45' lengths. *See also*, Forty Foot Equivalent Unit (FEU) and Twenty Foot Equivalent Unit (TEU).

Container Freight Station (CFS). A facility for loading, unloading and handling shipments (primarily less than container load (LCL) shipments).

Contract of Carriage. The agreement between the shipper and the carrier, setting forth the terms and conditions for the transportation of goods. The contract of carriage includes the bill of lading.

Consignee. The person named in a bill of lading to whom or to whose order the bill promises delivery. UCC § 7-102(a)(3) (2003); UCC § 7-102(1)(b) (1962).

Consignor. The person named in a bill of lading, usually the vendor, as the person who has tendered the goods to the carrier for shipment. UCC § 7-102(a)(4) (2003); UCC § 7-102(1)(c) (1962). In common parlance, "consignor" and "shipper" are synonymous.

Consolidation. The loading of multiple shipments into one container or onto one pallet. Consolidation shipments are documented on one master bill of lading or master air waybill.

Convention on Contracts for the International Sale of Goods (CISG). Official title, "United Nations Convention on Contracts for the International Sale of Goods," Apr. 11, 1980, S. Treaty Doc. No. 98-9 (1983), 19 I.L.M. 668 (1980), reprinted at 15 U.S.C. App. (entered into force Jan. 1, 1988). A treaty which supplements private law on international sales transactions. CISG addresses contract formation and certain obligations, but it does not cover issues as to the validity of the underlying contract or property rights in goods.

Cost and Freight (CFR). An international trade term, under which the seller clears the goods for export and pays costs and freight to carry the goods to a named destination, but the risk of loss passes to the buyer when the goods pass the ship's rail at origin, and the buyer is responsible for insurance; CFR is generally used for bulk or break bulk ocean shipments. The UCC's comparable term is "Cost and Freight (C&F)." UCC § 2-320 (1962).

Cost, Insurance and Freight (CIF). A trade term, defined both in UCC § 2-320 (1962) and INCOTERMS 2000. The seller clears the goods for export and pays the cost and freight to a named destination, plus the seller must procure insurance at its own cost; the seller's obligation is to deliver Commercial Documents (including proof of insurance), rather than the goods themselves; CIF is generally used for bulk and break bulk ocean shipments. The seller completes its delivery obligation by getting the carrier to load the goods and issue a bill of lading and by obtaining insurance on the goods. The seller must obtain only minimum insurance coverage; if the buyer wants greater protection, then the parties must expressly agree to higher coverage, or the buyer must arrange for higher coverage.

Countervailing Duty, An additional Customs duty to counter imported goods that are unfairly subsidized.

CPT. *See*, Carriage Paid to.

Customs Broker. A person or company licensed to enter and clear goods through customs on behalf of importers. Sometimes also called a "Customhouse Broker."

Customs & Border Patrol (CBP). The U.S. Customs & Border Patrol, part of the U.S. Department of Homeland Security. Formerly the U.S. Customs Service.

DAF. *See*, Delivered at Frontier.

DDP. *See*, Delivered Duty Paid.

DDU. *See*, Delivered Duty Unpaid.

Delivered at Frontier (DAF). An international trade term, where the seller completes its delivery obligation by tendering the goods at the place of delivery on their arriving means of transport, but neither unloaded nor cleared for import.

Delivered Ex Quay (DEQ). An international trade term, where the seller completes its delivery obligation at a named port of destination, unloaded from the vessel, but not cleared through customs; risk of loss passes to the buyer upon unloading from the vessel; DEQ is used only for ocean and inland waterway transport. Under INCOTERMS prior to 2000, the seller was obligated to clear the goods for import.

Delivered Ex Ship (DES). An international trade term, where the seller completes its delivery obligation at a named port of destination, but not unloaded from the vessel and not cleared for import; risk of loss passes when the ship arrives at destination; DES is used only for ocean and inland waterway transport. The UCC's trade term for delivery "ex ship" differs slightly, in that the UCC term requires the seller to discharge all carrier's liens and put the carrier under a duty to deliver the goods, and the risk of loss passes when the goods leave the ship's tackle or are otherwise properly unloaded. UCC § 2-322 (1962).

Delivered Duty Unpaid (DDU). An international trade term where the seller completes its delivery obligation at a named destination, but without clearing the goods through customs; the risk of loss remains with the seller until delivery of the goods; DDU can be used for any mode of transportation.

Delivered Duty Paid (DDP). An international trade term where the seller completes its delivery obligation at a named destination, but cleared through customs; the risk of loss remains with the seller until delivery of the goods; DDP can be used for any mode of transportation.

Delivery Order. Instructions to a the issuer of a document of title, to deliver the goods to a specific location. *See*, UCC § 7-102(a)(5) (2003); UCC § 7-102(1)(d) (1962).

Demurrage. Charges payable for unduly delaying a vessel in port beyond a stated period. The term also applies to charges for failure to return shipping containers on or before the last free day (also sometimes referred to as Detention).

Detention. Charges payable for unduly delaying the return of shipping containers (also sometimes referred to as Demurrage).

DEQ. *See*, Delivered Ex Quay.

DES. *See*, Delivered Ex Ship.

Devan. To remove goods from a shipping container.

Direct Shipment. A shipment that travels on a steamship line's or airline's bill of lading, with no forwarder's or NVOCC's house bill.

Dock Receipt. A document issued by an ocean carrier, acknowledging receipt of goods at the dock or warehouse.

Dock Warrant. A document of title covering goods warehoused at a dock.

Document of Title. A document which, in the regular course of business or financing is treated as adequately evidencing that the person in possession or control of the document is entitled to receive, control, hold, and dispose of the document and the goods it covers. The term includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt, and order for delivery of goods (delivery order). UCC § 1-201(15) (2003); UCC § 1-201(15) (1962).

Door Move. A contract of carriage, under which the carrier engages to transport the goods from the shipper's place of business to the consignee's place of business, without discharging or reloading the goods.

Drawback. A mechanism whereby an exporter of manufactured goods can obtain a refund for part of the Customs duties paid on imported components.

Drayage. The movement of freight by truck.

Due Negotiation. The process by which the transferee of a negotiable document of title may acquire rights in the document and in the goods it represents greater than the rights held by the transferor; analogous to the holder in due course principle for negotiable instruments under UCC Article 3. The elements of due negotiation are: (1) the transferor indorses the document and delivers it to the transferee (bearer documents need only be delivered); (2) the transferee "purchases" the document (*see* UCC § 1-201) for value, in good faith, and without notice of any claim or defense by any person; (3) the negotiation is in the regular course of business or financing; and (4) the negotiation is not in settlement or payment of a money obligation. UCC § 7-501(a) (2003); UCC § 7-501(4) (1962). The Pomerene Act contains similar provisions.

Duty. The tax imposed by a government on imported goods.

Entry. (1) The formal documentation which must be filed with U.S. Customs, to secure the release of imported merchandise into the stream of commerce. (2) The act of filing such documentation.

Equitable Subrogation. An equitable principle that protects a party who pays the debt of another which, in good conscience, should have been paid by the one primarily liable. *See, e.g., Paul Harris Stores, Inc. v. Expeditors International of Washington, Inc. (In re Paul Harris Stores, Inc.)*, 342 B.R. 285 (Bankr. S.D. Ind. 2006) (carrier who delivered goods without presentation of bill of lading and had to pay vendor could recover that amount from the ultimate consignee). This principle was also used in *Evergreen Marine Corp. v. Six Consignments of Scallops*, 4 F.3d 90 (1st Cir. 1993), to defeat a security interest claimed in the consignee's goods.

Ex Ship. *See*, Delivered Ex Ship (DES).

Ex Works (EXW). An international trade term, meaning that the seller's delivery obligation is completed at a stated location (usually the seller's place of business), where the goods are made available to the buyer, but are not loaded onto a vehicle, vessel or aircraft, and not cleared for export; the seller does not contract for transportation.

Examination. The customs authorities' inspection of goods, to confirm whether they comply with the customs entry documents and are eligible for entry into the country.

Express Bill of Lading. A bill of lading which allows release of cargo without presentation of the original bill. Only non-negotiable bills may be express bills. Whereas originals of conventional bills of lading are issued, generally only copies of express bills are issued.

EXW. *See*, Ex Works.

FAS. *See*, Free Alongside Ship.

FCA. *See*, Free Carrier.

Federal Bill of Lading Act (Pomerene Act or **Pomerene Bill of Lading Act**). 49 U.S.C. §§ 80101 to 80116. This statute sets forth certain rules for bills of lading for transportation of goods by common carrier within the U.S. (including certain shipments routed through a foreign country) and from the U.S. to a foreign country. The Act contains rules on negotiable bills of lading, non-negotiable bills of lading, carrier's liens, and the rights and obligations of the carrier, shipper, consignee, and holder of negotiable bills.

FCL. *See*, Full Container Load.

FOB. *See*, Free on Board.

Foreign Trade Zone (or **Free Trade Zone**) **(FTZ)**. A port designated as duty-free, where goods may be stored, displayed, manufactured, and sold without imposition of Customs duties. Customs duties are imposed when the goods leave the FTZ.

Forty Foot Equivalent Unit (FEU). A unit of measurement to describe the number of 40' containers; equal to two twenty foot equivalent units (TEU).

Free Alongside Ship (FAS). A trade term, defined both in UCC § 2-319 (1962) and INCOTERMS 2000. The seller completes its delivery obligation by delivery to a named port of shipment, cleared for export, but not loaded onto a vessel; the buyer nominates and hires the carrier and must clear the goods for export.

Free Carrier (FCA). An international trade term, under which the seller completes its delivery obligation by delivery to the carrier's custody at origin, cleared for export. If the seller receives the bill of lading from the carrier, it satisfies its delivery obligation by tendering the document.

Free on Board (FOB). A trade term, defined both in UCC § 2-319 (1962) and in INCOTERMS 2000. Under INCOTERMS, the seller completes its delivery obligation by having the goods loaded onto a ship at the named port of shipment, cleared for export; FOB is used mainly for ocean and inland waterway transport. Under the Uniform Commercial Code, the term may be FOB place of shipment, FOB vessel, or FOB place of destination.

Freight Broker. An intermediary who matches shippers and carriers. Freight brokers are paid a commission and generally do not accept responsibility for the shipment.

Freight Collect. The agreement between the seller and buyer that the buyer will pay for transportation charges.

Freight Forwarder. A person who makes arrangements for the transportation of others' goods and performs related services incident to such transportation.

Freight Prepaid. The agreement between the seller and buyer that the seller is responsible for transportation charges. In common usage, it does not necessarily mean that these charges have been paid before the seller's delivery of goods to the carrier.

Full Container Load. The loading of a shipping container to its capacity with the goods of one shipper.

General Average. An admiralty law principle, under which the vessel and cargo share losses resulting from the voluntary sacrifice of part of the vessel or cargo to save the whole from an imminent danger. *See, Barnard v. Adams,* 51 U.S. (10 How.) 270, 303 (1850).

General Order or **G.O.** If goods do not clear U.S. Customs within a specific number of days after arrival, the goods are placed into government custody, in the care of a bonded warehouse authorized by the government to store the goods.

Gross Weight. The full weight of a shipment, including the goods and packaging.

Hague Rules of 1924. The International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, dated August 25, 1924, 51 Stat. 233, entered into force in the United States, December 29, 1937. This Convention addresses liability issues in the carriage of goods by sea and prompted enactment of COGSA in 1936. In 1968, the Visby Amendments modified the Hague Rules, but the United States has not ratified the Visby Amendments.

Harmonized Tariff Schedule (HTS). An international tariff classification system. This harmonizes the tariff schedules of many large trading nations. The U.S. has participated in the HTS since 1989.

Harter Act. 46 U.S.C. §§ 30701 to 30707. Enacted in 1893, this Act regulates certain responsibilities of ocean carriers; but it has been largely superseded by COGSA for international ocean transport.

High Cube (HC or **HQ)**. An ocean shipping container 9'6" high rather than the more common 8'6" high.

Himalaya Clause. A clause in a bill of lading which extends the carrier's own defenses and limitations of liability to the carrier's agents and subcontractors. *See, e.g., Norfolk Southern Railway Company v. James N. Kirby, Pty Ltd.*, 543 U.S. 14 (2004). The term derives from the leading case, *Adler v Dickson (The Himalaya)*, [1955] 1 QB 158.

House Bill of Lading or **House Air Waybill**. The bill of lading issued by a freight forwarder or non-vessel operating common carrier. The house bill of lading generally names the vendor as consignor and the buyer as consignee. On the contract of carriage evidenced by the house bill of lading, the forwarder/NVOCC acts as a carrier and has the rights, obligations and liabilities of a carrier. The forwarder/NVOCC engages a steamship line or airline to physically transport the goods. Under that contract of carriage, the steamship line or airline issues a Master Bill of Lading/Master Air Waybill to the forwarder/NVOCC.

Immediate Transportation (IT). A Customs document allowing freight to transfer from one port to another, before it is cleared.

INCOTERMS (international commercial terms). A set of rules for interpreting common terms in international sales of goods, developed by the International Chamber of Commerce in 1936. The latest version of INCOTERMS was in 2000. These terms address the rights and obligations of the seller and buyer as to contract of carriage, delivery, insurance, risk of loss, storage, and duty, taxes and customs clearance. The terms are grouped as follows:

- Group E – Departure
  - *Ex Works (EXW)*

- Group F – Main Carriage Unpaid
  - *Free Carrier (FCA)*
  - *Free Alongside Ship (FAS)*
  - *Free on Board (FOB)*

- Group C – Main Carriage Paid
  - *Cost and Freight (CFR)*
  - *Cost, Insurance and Freight (CIF)*
  - *Carriage Paid to (CPT)*
  - *Carriage and Insurance Paid to (CIP)*

- Group D – Arrival
  - *Delivered at Frontier (DAF)*
  - *Delivered Ex Ship (DES)*
  - *Delivered Ex Quay (DEQ)*
  - *Delivered Duty Unpaid (DDU)*
  - *Delivered Duty Paid (DDP)*

Intermodal. In U.S. parlance, the transportation of goods by one or more methods in one contract of carriage (e.g., by ocean, rail and truck). In other countries, this is sometimes called multimodal.

Issuer. (1) The issuer of a document of title or the person who has issued an unaccepted delivery order. UCC § 7-102(a)(8) (2003); UCC § 7-102(1)(g) (1962). (2) A bank who has issued a letter of credit. UCC § 5-102(a)(9) (1995).

Lading. The loading of cargo onto a vessel.

Last Free Day. The last day for the consignee to return a container, before demurrage charges begin to accrue.

Less than Container Load (LCL). A small shipment, not sufficient to justify the use of a container for such shipment alone.

Liquidation. Customs & Border Patrol's final determination of Customs duties on an import shipment.

Manifest. An itemized list of the type and quantity of cargo loaded onto a vessel or aircraft.

Maritime Law. The law that governs activities in navigable waters. Maritime law is comprised of federal statutes, international treaties and conventions, and federal common law. This is one of the few areas in which there exists federal common law, because of the need for nationwide uniformity. Thomas J. Schoenbaum, ADMIRALTY AND MARITIME LAW § 2.1, pp. 84-88 (West 2004).

Maritime Lien. The lien of a carrier on goods transported by sea. This lien arises under general maritime law of the United States. *See, e.g., The Bird of Paradise*, 72 U.S. 545 (1866); *4,885 Bags of Linseed*, 66 U.S. 108 (1861). The lien is possessory and is based on the right to withhold delivery of the cargo. The lien is a specific lien, in that it secures only charges related to the goods in the carrier's possession, custody or control. It does not secure charges for previous shipments. Generally, unconditional delivery of the goods will extinguish the lien. However, courts have found that delivery is not conditional, and the lien survives, in the following situations:

(1) Where the goods are delivered or deposited into warehouse for inspection. *Kimball v. The Anna Kimball*, 14 F. Cas. 481 (C.C. D. Mass. 1861), *aff'd*, 70 U.S. 37 (1865).

(2) Where there is an understanding or agreement that the lien survives delivery. *4,885 Bags of Linseed*, *supra*, 66 U.S. at 114-115; *Arochem Corp. v. Wilomi, Inc.*, 962 F.2d 496, 500 (5th Cir. 1992) (bill of lading provision preserving maritime lien after delivery is effective to preserve lien after delivery); and *Capitol Transportation v. United States*, 612 F.2d 1312, 1324-25 (1st Cir. 1979) (tariff provision preserving maritime lien after delivery is effective to preserve lien after delivery).

(3) Where the carrier retains constructive possession of cargo. *Costello v. 734,700 Laths*, 44 F. 105 (E.D. N.Y. 1890). *See, also*, *4,885 Bags of Linseed*, *supra*, 66 U.S. at 115; *Evergreen Marine Corp. v. Six Consignments of Scallops*, 4 F.3d 90 (1st Cir. 1993); and *Paul Harris Stores, Inc. v. Expeditors International of Washington, Inc. (In re Paul Harris Stores, Inc.)*, 342 B.R. 285 (Bankr. S.D. Ind. 2006).

Master Bill of Lading or **Master Air Waybill**. The bill of lading issued by the steamship line or airline who physically transports the goods for the freight forwarder or non-vessel operating common carrier. The master bill of lading generally names the forwarder or NVOCC as both the consignor and the consignee. Therefore on the contract of carriage evidenced by the master bill of lading, the forwarder/NVOCC is the shipper, and it has the rights and obligations of a shipper. The forwarder/NVOCC in turn issues its own bill of lading (the House Bill of Lading) to the party identified as shipper in the underlying contract for the sale of the goods.

Negotiable Bill of Lading. A bill of lading which, by its terms are to be delivered to bearer or to the order of a named person. UCC § 7-104(a) (2003); UCC § 7-104(1) (1962). Under former Article 7, a bill of lading was also negotiable if, where recognized in overseas trade, the bill ran to a named person or assigns. UCC § 7-104(1) (1962). All other bills of lading are non-negotiable. UCC § 7-104(b) (2003); UCC § 7-104(2) (1962). A negotiable bill of lading is "commodity paper", in that a party acquires rights in the goods by acquiring the bill of lading.

Net Weight. The weight of goods, without counting their packaging.

Non-Negotiable Bill of Lading. Any bill of lading other than a negotiable bill of lading; a non-negotiable bill is also called a "straight bill of lading." A non-negotiable bill of lading is a receipt for the goods and a contract of carriage, but (unlike a negotiable bill of lading) it does not necessarily embody rights in the goods themselves.

Non-Vessel Operating Common Carrier (**NVO** or **NVOCC**). A carrier who does not own or operate ships, aircraft, or trucks, so it engages others to physically transport the goods. An NVOCC acts as a carrier as to the shipper of the goods and the ultimate consignee, and is the shipper and consignee as to the carrier who physically transports the goods. *See, e.g., Logistics Management, Inc. v. One (1) Pyramid Tent Arena*, 86 F.3d 908, 913-914 (9th Cir. 1996). An NVOCC issues its own (house) bill of lading to the shipper, and is itself the holder of the (master) bill of lading issued by the carrier who physically transports the goods.

Ocean Transportation Intermediary (OTI). The term used in the Ocean Shipping Reform Act of 1998 (46 U.S.C. App. §§ 1701 *et seq.*) for an ocean freight forwarder or non-vessel operating common carrier.

Person Entitled under the Document. The person generally entitled to obtain goods covered by a document of title. In the case of a negotiable document of title, this is generally the holder of the document. In the case of a non-negotiable document, this is generally the person to whom delivery of the goods is to be made by the terms of the document. UCC § 7-102(a)(9) (2003); UCC § 7-403(4) (1962).

Pomerene Act. *See,* Federal Bill of Lading Act.

Pre-Alert. The forwarder's initial notice of an incoming shipment, with shipping details.

Prepaid Freight (or **Freight Prepaid**). Freight charges payable at origin.

Pro Forma Invoice. A preliminary invoice issued during the process of contract formation. The term also includes an invoice prepared for transactions where there is no commercial invoice.

Replacement Lien. In the context of goods in transit, this is a security interest which the shipper or consignee grants to the carrier to secure credit extended by the carrier. *See*, *e.g.*, *In re Colortran, Inc.*, 218 B.R. 507 (Bankr. 9th Cir. 1997), *aff'd* 165 F.3d 35 (9th Cir. 1998); *Expeditors International v. Wang Laboratories, Inc.*, 1995 WL 791935 (D. Mass. 1995); *Paul Harris Stores, Inc. v. Expeditors International of Washington, Inc. (In re Paul Harris Stores, Inc.)*, 342 B.R. 290 (Bankr. S.D. Ind. 2006). *See, also, Expeditors International of Washington, Inc. v. Liquidating Trust (In re Schwinn Cycling & Fitness, Inc.)*, 313 B.R. 473 (D. Colo. 2004) (approving NVOCC's security interest in identifiable cash proceeds of goods). Regarding the relative priorities of replacement liens and other security interests, *see, e.g.*, UCC §§ 9-103 (and Official Comment 3 thereto), 9-203, 9-301, 9-307, 9-312, 9-313, 9-315, 9-316, 9-322, 9-324; *Paul Harris Stores, Inc. v. Expeditors International of Washington, Inc. (In re Paul Harris Stores, Inc.)*, 342 B.R. 290 (Bankr. S.D. Ind. 2006); *Joint Holdings & Trading Co. v. First Union National Bank*, 50 Cal. App.3d 159 at 164-65, 123 Cal. Rptr. 519, 524 (1975); White & Summers, UNIFORM COMMERCIAL CODE §31-21 pp. 219 and 220 (4th ed. 1995).

SDR. *See*, Standard Drawing Right.

Shipper. The person who enters into a contract of transportation with a carrier (the contract of carriage). UCC § 7-102(a)(12) (2003). *See, also*, "Consignor."

Shipper's Agent. A person who arranges for transportation of goods on the shipper's behalf. A shipper's agent is neither a carrier, freight forwarder nor broker.

Shipper's Letter of Instructions (SLI). The exporter's or importer's written instructions to the freight forwarder, specifying the terms and conditions under which the goods are to be transported.

Specific Duty. A Customs duty based on the volume, weight, or item count, rather than on value. Specific duties are not common.

Standard Drawing Right (SDR). A floating composite currency unit based on a standard basket of various currencies (including the U.S. Dollar, the British Pound Sterling, the Japanese Yen, and the Euro), traded in U.S. Dollars. The formula for calculating the SDR was changed effective January 1, 2006, *see* www.imf.org for more information. To illustrate, as of March 1, 2010, one SDR equaled $1.527710 (U.S.).

Straight Bill of Lading. A non-negotiable bill of lading.

Subrogation. *See*, Equitable Subrogation.

Tare Weight. The weight of packaging, without counting the weight of the goods.

Tariff. (1) A duty or tax levied on goods transported from one nation to another. (2) The posted rates and terms under which carriers transport goods.

Transport Document. A generic term for the document governing the transportation of goods (bill of lading, sea waybill, air waybill).

Transportation and Exportation (T&E). A Customs document allowing imported freight to transfer from one port to another before the freight is exported. These goods are never cleared and never enter interstate commerce.

Transship. To transfer cargo from one vessel to another, by discharging the goods onto the wharf, before loading onto the second vessel.

Twenty Foot Equivalent Unit (TEU). A unit of measurement to describe the number of 20' containers, using the 20' International Standards Organization container size (20' x 8' x 8'6").

Unit Loading Device (ULD). A pallet or container used to load cargo onto aircraft; the International Air Transport Association (IATA) has issued specifications for standard ULD types.

Visby Amendments. *See*, Hague Rules of 1924.

Visa. A document used to control importation of certain products (mainly textiles) to the U.S. The visa may be a separate document (export control license) or may be a stamped and endorsed commercial invoice. The original visa must be presented, in order to clear the goods.

Warehouse or **Warehouseman**. A person engaged in the business of storing goods for hire. *See, e.g.,* UCC § 7-102(a)(13) (2003); UCC § 7-102(1)(h) (1962).

Warehouse Lien or **Warehouseman's Lien**. A warehouse's possessory lien upon goods for storage or transportation of the goods, expenses to preserve the goods, and for related charges. UCC § 7-209(a) (2003); UCC § 7-209(1) (1966). A warehouse can also expressly reserve a general lien for charges related to other goods, even if the other goods are no longer in the warehouse's possession. UCC § 7-209(a) (2003); UCC § 7-209(1) (1966). Under former UCC Article 7, this general lien must be stated in a warehouse receipt, UCC § 7-209(1) (1966), but under Revised Article 7, the warehouse can state this general lien in either a warehouse receipt or a storage agreement. UCC § 7-209(a) (2003). Under Revised Article 7, this lien also covers proceeds in the warehouse's possession. UCC § 7-209(a) (2003).

Warehouse Receipt. A document of title issued by a warehouse or warehouseman. UCC § 1-201 (42) (2003); UCC § 1-201(45) (1962).

Warsaw Convention of 1929. Officially, the "Convention for the Unification of Certain Rules Relating to International Carriage by Air." The treaty addresses damage claims for personal injury, death, baggage, or cargo damage in air transportation.

<u>INVENTORY AGREEMENT</u>

Made as of this ____ day of _____________, 20__, by and among ________________________________ ("Borrower"), __________________________ ("Logistics Provider"), and _____________________________ ("Lender"), and is made with reference to the following facts:

(a) From time to time, Logistics Provider performs logistics services and makes advances for Borrower with respect to now owned and hereafter acquired goods, documents of title and other property (collectively, with proceeds of the foregoing, the "Collateral"). Logistics Provider holds (1) carrier's and/or warehouse liens upon the Collateral under Article 7 of the Uniform Commercial Code or other applicable law and (2) consensual security interests in the Collateral under Article 9 of the Uniform Commercial Code or other applicable law.

(b) Lender is extending certain financial accommodations to Borrower pursuant to certain financing arrangements, and in that connection has obtained, or is obtaining, a security interest in certain assets of Borrower including the Collateral.

(c) The parties desire to establish the relative priorities of Logistics Provider's and Lender's liens and security interests.

NOW, THEREFORE, the parties hereto agree as follows:

1. Logistics Provider acknowledges that it has notification of Lender's security interest in the Collateral and that it holds the Collateral as bailee for Lender's benefit. Lender acknowledges that it has notification (a) of Logistics Provider's liens and security interests and (b) that Logistics Provider has or expects to acquire a purchase-money security interest in the Collateral. Lender is deemed to have such notification each time Logistics Provider performs services or makes advances with respect to Collateral. Logistics Provider's liens and security interest have priority over Lender's security interest.

2. Upon payment in full of all accrued and unpaid fees and charges which Borrower may owe to Logistics Provider (collectively, the "Charges"), Logistics Provider shall, upon written direction by Lender: (a) deliver any or all Collateral in Logistics Provider's possession or control to Lender or its stated designee; and (b) not comply with instructions originated by Borrower, its agents, employees or other representatives with respect to the disposition, delivery or release of Collateral in Logistics Provider's possession or control.

3. Borrower hereby releases Logistics Provider from any and all claims and liability arising from Logistics Provider's acting in accordance with any directions which Logistics Provider in good faith believes to have originated from Lender. Lender shall indemnify and hold harmless

Logistics Provider for any claims for damages or personal injury or property damage arising out of: (a) Logistics Provider acting in accordance with any directions which Logistics Provider in good faith believes to have originated from Lender; or (b) any acts or omissions by Lender, its agents, employees or other representatives while on Logistics Provider's premises.

4. Logistics Provider acknowledges and agrees that it will not sell the Collateral without giving ten (10) days' prior written notice thereof to Lender. During such 10-day period, Lender may cure Borrower's default by paying all Charges to Logistics Provider.

5. Prior to any delivery of Collateral pursuant to ¶ 2, upon Lender's request Logistics Provider shall: (a) give Lender an aged listing of unpaid invoices; and (b) permit Lender to enter Logistics Provider's premises upon reasonable notice during business hours for purposes of inspecting the Collateral, so long as such inspection does not interfere with Logistics Provider's business operations or impose any liability on Logistics Provider to shippers, consignees, holders of documents of title, or governmental authorities.

6. This Agreement does not impose any obligation or duty on Logistics Provider other than those expressed herein.

7. Notwithstanding any course of dealing or other conduct, no provision of this Agreement may be waived or modified, except by a writing signed by all parties.

8. This Agreement shall be construed under the internal substantive laws of the State of ____________________. In the event of an action to enforce the terms of this Agreement, the prevailing party shall be entitled to its attorneys' fees and costs.

____________________________ (Borrower)

By__________________________
Name:
Title:

_____________________ (Logistics Provider)

By__________________________
Name:
Title:

____________________________ (Lender)

By__________________________
Name:
Title:

Perfection of UCC Article 9 Security Interests in Goods Located in Most Foreign Jurisdictions or in International Transit:
<u>Does a Secured Party Need to Do More Than File a UCC Financing Statement?</u>

A commercial finance company (the "Secured Party") is contemplating providing asset-based financing to a Delaware corporation (the "Borrower") located in the United States. The security agreement between the Secured Party and the Borrower provides for a blanket security interest, and for it to be governed by the law of a certain state in the United States. The Secured Party intends to file a UCC Financing Statement covering "all assets" in the jurisdiction of organization of the Debtor (*i.e.*, Delaware) in the United States. The Borrower, however, has significant goods physically located in foreign countries, as well as other significant goods physically located on foreign flagged vessels in transit to the United States. At times, these goods may be covered by negotiable documents physically located in foreign countries.

In a bankruptcy of the Borrower filed in the United States, does a trustee, or the debtor-in-possession, have the right to avoid the Secured Party's security interest in goods physically located in the foreign countries or on the foreign flagged vessels, or in the negotiable documents physically located in the foreign countries (and the goods covered thereby) pursuant to 11 U.S.C. § 544(a)'s strong-arm provisions if the Secured Party has failed to comply with applicable foreign law regarding perfecting a security interest in goods located in that country? In short, probably yes.

11 U.S.C. § 544(a) provides:

> The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by-
>
> (1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
>
> (2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; . . .

The purpose of section 544 is to provide standing and a procedural vehicle by which a trustee can avoid an unperfected security interest as a hypothetical judicial lien/unsatisfied execution creditor. The rights of the trustee as a hypothetical judicial lien/unsatisfied execution creditor, however, do not exist under section 544. Instead, the trustee must look to "applicable non-bankruptcy law" to determine the appropriate "rights and powers" of a hypothetical judicial lien/unsatisfied execution creditor. *See In re Michigan Lithographing Co.*, 997 F.2d 1158 (6th Cir. 1993). The "applicable non-bankruptcy law," however, is not necessarily the law of a particular state of the United States. *Cf., In re Velikopoljski*, 54 B.R. 534 (Bankr. S.D. Fla. 1985) (where the Court applied the provisions of the federally enacted Ship Mortgage Act, which pre-empts state law, because the property in dispute was a vessel documented in the United States).

To determine the "applicable non-bankruptcy law," a court will first examine the appropriate choice of law principles. *See Usinor Industeel v. Leeco Steel Products, Inc.*, 209 F.Supp.2d 880, 885-86 (N.D. Ill. 2002); *see also* Hans Kuhn, *Multi-State and International Secured Transactions Under Revised Article 9 of the Uniform Commercial Code*, 40 VA. J. INT'L L. 1009 (2000). Such an examination is necessary because the existence of the hypothetical judicial lien/unsatisfied execution creditor in the foreign country makes this dispute more than a two-party dispute between the Borrower and the Secured Party. Therefore, the security agreement's choice of law provision does not control, and a court will apply the appropriate choice of law principles. *See Usinor v. Leeco*, 209 F.Supp.2d at 885-86.

In federal question cases with exclusive jurisdiction in federal court, such as bankruptcy, the federal, not forum state, choice of law principles apply. *See In re Lindsay*, 59 F.3d 942, 948 (9th Cir. 1995). Generally, though not always, federal courts sitting in non-diversity jurisdiction apply the Restatement (Second) of Conflicts of Laws. *See Pescatore v. Pan American World Airways, Inc.*, 97 F.3d 1, 12 (2d Cir. 1996); *see also Usinor v. Leeco*, 209 F.Supp.2d at 885-86.

In *Usinor*, a French steel trade vendor asserted reclamation rights under French law, which would provide the trade vendor with superior title. The French trade vendor asserted French law applied because the Convention on Contracts for the International Sale of Goods (the "CISG"), to which both the United States and France are signatories, pre-empted state law. The recipient of the steel asserted that Article 9 of the UCC governed because LaSalle Bank had a perfected its security interest by filing a Financing Statement with the Illinois Secretary of State.

The *Usinor* Court determined that because this was not a two-party dispute, the domestic law of one country applied, as opposed to any provision in the CISG. *See Usinor v. Leeco*, 209 F.Supp.2d at 885-86. To determine which country's law applied, the Court applied the choice of law principles set forth in the Restatement (Second) of Conflicts of Laws, which directed the Court to apply the "most significant contacts rule." *See id*. The Court specifically noted Comment e to Section 188 of the Restatement, which states that "[t]he state where the thing or the risk is located will have a natural interest in transactions affecting it . . ." *See id*. In applying the "most significant contracts rule," and Comment e in particular, the Court determined that the physical location of the steel was the most significant contact.[1] *Id*. Since the steel was physically located in the United States, the Court applied the law of the forum state, Article 9 of the UCC.

Similarly, in *In re Duplan Corporation*, a trade vendor from the Netherlands asserted it had a valid reservation of title, under the laws of either the Netherlands or England, on certain goods shipped from the Netherlands. The sale contract designated English law in its governing choice of law provisions, but the goods were physically located in South Carolina when the bankruptcy was filed. The trade vendor asserted that its reservation of title was superior to any right of the debtor or trustee.

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[1] The *Usinor* Court noted that if it had applied state law choice of law principles (which *Pescatore v. Pan American* implied might be acceptable), it would have examined section 1.105 of the UCC, prior to any examination of Article 9. And, based upon the "appropriate relation" test set forth in section 1.105 of the UCC, it would have reached the same conclusion: the location of the steel had the most appropriate relation. *Usinor v. Leeco*, 209 F.Supp.2d at 886-87.

The *Duplan* Court analyzed which country's law applied, and noted that in cases involving a trustee's hypothetical judicial lien under section 70(c) of the Bankruptcy Act (the predecessor to section 544 of the Bankruptcy Code) and a legal relationship possibly controlled by varying state and national laws, the obligation to apply the forum state's conflict of laws rules is absent, and the law of the situs of the property at the time the bankruptcy is filed applies. *See In re Duplan Corporation*, 455 F.Supp. 926, 929 (S.D.N.Y. 1978). Since the goods were physically located in the United States when the bankruptcy was filed, the Court applied the law of the forum state, Article 9 of the UCC. *Id*. Consequently, although the trade vendor had a security interest under the laws of England and the Netherlands, its failure to perfect its security interest under South Carolina law resulted in the trustee avoiding the trade vendor's security interest. *Id*., at 929-30.

Both *Duplan* and *Usinor* applied the law of the jurisdiction in which the goods were physically located, which in each case was, coincidentally, Article 9 of the UCC. Both courts based their holding on the physical location of the property, not because of any provision of Article 9 of the UCC, or the putative extraterritoriality application of Article 9 (as contained in the comments to section 9.301) to the perfection of security interests in goods and negotiable documents physically located outside the United States.

Under our facts and existing case law, a court would apply the Restatement (Second) of Conflicts of Law and examine the most significant contacts. Based upon *Usinor* and *Duplan*, the most significant contact is the physical location of the goods in the foreign country or on the foreign flagged vessel, and the security agreement's choice of law provisions are not relevant. A court in the United States, therefore, would apply the law of the foreign country or the foreign flagged vessel in which the goods are located to determine the “rights and powers” of a trustee as a hypothetical judicial lien/unsatisfied execution creditor.

Although little guidance exists, the authority that has addressed this issue appears to lead to one probable conclusion: even if the transaction bears a reasonable relation to the United States or a particular state thereof (because the goods are owned by a U.S. corporation and secured by a lender in the United States), this does not constitute the “most significant contact” because the goods are not physically located in the United States. Indeed, the rights in question here are those of a person asserting a lien in the jurisdiction in which the goods are physically located, not the rights of the parties to a security agreement. As such, the rights of the person asserting a lien in the jurisdiction in which the goods are physically located appear to be the likely applicable non-bankruptcy law.

Accordingly, it appears that a court probably would apply the law of the foreign country in which the goods are located to determine whether or not the Secured Party’s security interests were perfected under those laws and, consequently, whether the trustee has the right to avoid the Secured Party's security interests. And, assuming the foreign country in which the goods are located has personal property priority laws and rules similar to Article 9 of the UCC, it appears that a trustee, or the debtor-in-possession, could avoid the Secured Party’s security interest in goods physically located in the foreign country or on the foreign flagged vessels, or in the negotiable documents physically located in the foreign country (and the goods covered thereby) pursuant to section 544(a)’s strong-arm provisions.

James C. Chadwick
Dallas, Texas, June 26, 2006
(214.758.1575; jchadwick@pattonboggs.com)

ELECTRONIC BILLS OF LADING

C. Edward Dobbs
Anthony C. Cianciotti
Parker, Hudson, Rainer & Dobbs LLP
Atlanta, Georgia

I. Introduction

This paper addresses the law regarding electronic bills of lading and the adverse impact that the use of such electronic documents might have on a lender's rights as a secured party absent universal adoption of Revised Article 7. In this paper, we have focused on negotiable documents of title and do not address non-negotiable documents.

As discussed below, the emerging use of electronic documents of title is not governed by a single law. Most states have enacted one of two model acts adopted by the National Conference of Commissioners on Uniform State laws (the "National Conference"). However, three states have not adopted either law and it is doubtful, under the law of those jurisdictions, whether an electronic document will confer upon a secured party a first-priority, perfected security interest in either the document of title or underlying goods under Article 9 of the Uniform Commercial Code.

Interpretive case law regarding the area of electronic documents of title is scant given the relative newness of the laws. Hence, this paper relies heavily on analysis of the relevant laws, buttressed by the opinions of legal commentators.

II. Overview: The Laws Governing Electronic Documents of Title

Two major model acts address electronic documents of title -- Revised Article 7 of the Uniform Commercial Code ("UCC"), which the National Conference adopted in 2003, and the Uniform Electronic Transactions Act (the "UETA"), which the National Conference adopted in

1999 (Revised Article 7 and the UETA are together referred to as the "Model Acts"). The UETA is superseded by Revised Article 7 to the extent a jurisdiction has adopted both Model Acts. *See* UETA § 3(b)(2) ("This Act does not apply to a transaction to the extent it is governed by The Uniform Commercial Code other than Sections 1-107 and 1-206, Article 2, and Article 2A").

A primary purpose of the National Conference in promulgating Revised Article 7 was to provide a framework for the further development of electronic documents of title. *See* Prefatory Note to Revised Article 7. As of this paper, thirty-six states have adopted Revised Article 7.[1] As part of Revised Article 7, the National Conference also promulgated conforming amendments to other Articles of the UCC, including, among others, Article 1 (general provisions and definitions) and Article 9 (secured transactions) (the "Conforming Amendments"). The Conforming Amendments are designed to incorporate the electronic document of title references in appropriate sections of the UCC.[2]

In the absence of Revised Article 7, the "model" statutory authority governing electronic documents of title is the UETA. While the scope of the UETA is far broader than documents of title, Section 16 expressly addresses "transferable records," which are defined in the Act as an electronic record that would be a note under UCC Article 3 or a document under UCC Article 7 if the electronic record were in writing. UETA § 16.

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[1] The 36 states that have enacted Revised Article 7 are Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Virginia and West Virginia. Legislation has also been introduced in Georgia to adopt Revised Article 7. H.B. 451, LC 29 3769S (Ga. 2010)

[2] See, e.g., UCC § 1-201(5) (defining "bearer" to include "a person in control of a negotiable electronic document of title"); *id* § 1-201(15) (defining "delivery" to mean, "with respect to an electronic document of title", the "voluntary transfer of control"); and *id.* § 1-201(21)(C) (defining "holder" to include "a person in control of a negotiable electronic document of title").

The National Conference intended Section 16 of the UETA to bridge the gap regarding documents of title until such time as it could adopt (and states enact) revised Article 7, and specifically contemplates application to negotiable documents of title in the absence of Revised Article 7. UETA § 3(b)(2). Forty-seven states, the District of Columbia and the United States Virgin Islands have enacted the UETA. The three states that have not are Illinois, New York and Washington. For each state that has not adopted the UETA, the fallback legislation is that state's unique legislation pertaining to electronic documents which may or may not address electronic documents of title.

III. Electronic Records

Electronic records are not new to the UCC or secured transactions. Revised Article 9 modified its provisions in recognition of the use of non-tangible media for retaining information. *See* UCC § 9-102(69) (defining "record" to include information "which is stored in an electronic or other medium and is retrievable in perceivable form"). Article 9 also recognizes the use of electronic chattel paper. UCC § 9-102(31). However, documents of title have certain unique characteristics which are not addressed by merely permitting tangible documents to be recorded in an electronic medium. As the National Conference noted:

> Paper negotiable instruments and documents are unique in the fact that a tangible token - a piece of paper - actually embodies intangible rights and obligations. The extreme difficulty of creating a unique electronic token which embodies the singular attributes of a paper negotiable document or instrument dictates that the rules relating to negotiable documents and instruments not be simply amended to allow the use of an electronic record for the requisite paper writing.

Comment 1, UETA § 16. *See also* Patricia B. Fry, *Introduction to the Uniform Electronic Transactions Act: Principles, Policies and Provisions*, 37 IDAHO L. REV. 237, 269 (2001) ("the one area of civil law where electronic records clearly cannot serve the functions of writing is in the area of negotiable instruments"). These rights also include the rights accorded a "holder" of a document of title, which can be conferred by "due negotiation" of the document. Section 16 is also designed to address this important benefit. Comment 1, to UETA § 16 ("Section 16 provides for the creation of an electronic record which may be controlled by the holder, who in turn may obtain the benefits of holder in due course and good faith purchaser status").

Both Model Acts expand the definition of documents of title by specifically providing that the document of title may be retained in an electronic form. *See* Conforming Amendments, UCC § 1-201(15) (a document of title is defined to include a record that "is treated as adequately evidencing that the person in possession or control of the record is entitled to receive, control, hold, and dispose of the record and the goods the record covers"); UCC § 7-102(10) ("Record" means "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form"); UETA § 16 (a "transferable record" is an electronic record that would be a document of title under UCC Article 7 "if the electronic record were in writing"). The Model Acts further introduce the concept of "control" of the electronic document as the electronic equivalent of possession of a tangible document, a concept previously employed under Article 9 with respect to electronic chattel paper. UCC § 9-314.

Despite these similarities, an important distinction exists between the two Model Acts regarding the creation of the electronic document of title and the ability to move between electronic and tangible medias. The UETA imposes on the issuer of the electronic document of title (such as a carrier or non-vessel operating common carrier ("NVOCC")) a requirement that the issuer of the electronic record expressly agree that the record be considered a transferable record. UETA § 16(a)(2). Thus, it is not possible for a tangible document of title to be converted into an electronic document at a later time. Comment 2, UETA § 16. ("[t]he purpose of such a restriction is to assure that transferable records can only be created at the time of issuance by the obligor").[3]

Revised Article 7 does not require any express agreement by the issuer at the time of issuance regarding the transferability of an electronic document. Revised Article 7 also allows the issuer of an electronic document of title to "substitute" a tangible document of title for an electronic document at any time after the original issuance of the electronic document, and *vice versa*. Pursuant to Section 7-105:

> (a) Upon request of a person entitled under an electronic document of title, the issuer of the electronic document may issue a tangible document of title as a substitute for the electronic document if:
>
> (1) the person entitled under the electronic document surrenders control of the document to the issuer; and
>
> (2) the tangible document when issued contains a statement that it is issued in substitution for the electronic document.
>
> (b) Upon issuance of a tangible document of title in substitution for an electronic document of title in accordance with subsection (a):
>
> (1) the electronic document ceases to have any effect or validity; and
>
> (2) the person that procured issuance of the tangible document warrants to all subsequent persons entitled under the tangible document that the warrantor was a person entitled under the electronic document when the warrantor surrendered control of the electronic document to the issuer.

UCC § 7-105(a) & (b). Subsections (c) and (d) of Section 7-105 sets forth analogous provisions permitting the substitution of an electronic document for a previously issued tangible document.

The inconsistencies between Revised Article 7 and the UETA require that a lender be aware whether the law of a Revised Article 7 or UETA jurisdiction controls the creation of the electronic document of title so that, in a UETA jurisdiction, (i) the borrower secures the

[3] Note, however, the UETA is silent as to whether an electronic document of title can be converted into a tangible document of title.

agreement by the carrier (or NVOCC) upon issuance that the electronic document of title is a transferable record; and (ii) the carrier (or NVOCC), borrower, and secured lender make arrangements with any third party custodian of the electronic record that no tangible document of title be substituted for the electronic document.

A. <u>Perfection in Electronic Documents of Title</u>

Two methods have traditionally existed by which a secured party can perfect its security interest in a negotiable document of title -- perfection by filing or perfection by possession of the document of title.[4] UCC § 9-312. Coogan, Hogan, Vagts, McDonnell, *Secured Transactions Under the UCC* § 6D.02[9][b] ("Coogan"); William Henning and Linda Rusch, *The New Uniform Commercial Code: Intersections of Articles 2, 7 and 9,* SK038 ALI-ABA 23, 29 ("Intersection") (available on Westlaw). Perfection by possession provides significant benefits over filing because (i) a party that possesses the negotiable document has title to both the document and the goods covered by the document, UCC § 7-502; and (ii) possession of the document will avoid the possibility that the document is duly negotiated to a third party who, in certain circumstances, will take title to the document and underlying goods free of any prior security interest in the goods, whether or not perfected pursuant to a secured party's previously filed financing statement. UCC § 7-501, 7-502 & 9-331(a).

An electronic document of title, however, cannot be possessed. Both Revised Article 7 and the UETA substitute the concept of "control" for possession when dealing with electronic documents of title issued in accordance with Revised Article 7 or the UETA, or an electronic

[4] Article 9 also provides that a secured party's interest in a negotiable document of title is perfected without the necessity of either a UCC-1 filing or the taking of possession of the document for a period of 20 days from the time that the security interest attaches, to the extent that the security interest arises for "new value" given under a security agreement. UCC § 9-312(e).

document of title that has been substituted for a tangible document consistent with UCC Section 7-105. Comment 3, UETA § 16; Official Comment 1, UCC § 7-106.

The statutory language regarding control under both Model Acts is identical. Both Revised Article 7 and the UETA provide that a person has "control" of an electronic document of title if "a system employed for evidencing the transfer of interests in the electronic document <u>reliably establishes</u> that person as the person to which the electronic document was issued or transferred." UCC § 7-106(a) (emphasis added); UETA § 16(b) (emphasis added). The Model Acts then set forth certain "safe harbor" provisions, the satisfaction of which conclusively demonstrates control. Under the Model Acts, a person is deemed to have control if the document is created, stored, and assigned in such a manner that:

> (1) a single authoritative copy of the document exists which is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;
>
> (2) the authoritative copy identifies the person asserting control as:
>
> > (A) the person to which the document was issued; or
> >
> > (B) if the authoritative copy indicates that the document has been transferred, the person to which the document was most recently transferred;
>
> (3) the authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;
>
> (4) copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;
>
> (5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and
>
> (6) any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

UCC § 7-106(b); UETA § 16(c) (the "Safe Harbor Provisions").

Parties may not contractually agree as to whether control exists or whether the Safe Harbor Provisions have been satisfied. Official Comment 4, UCC § 7-106. However, the comments to both Model Acts suggest that third party registry systems may satisfy the Safe Harbor Provisions. Comment 3, UETA § 16. As discussed in the Official Comments to Revised Article 7:

> The key to having a system that satisfies this test is that identity of *the* person to which the document was issued or transferred must be reliably established. Of great importance to the functioning of the control concept is to be able to demonstrate, at any point in time, *the person* entitled under the electronic document. For example, a carrier may issue an electronic bill of lading by having the required information in a database that is encrypted and acceptable by virtue of a password. If the computer system in which the required information is maintained identifies the person as *the* person to which the electronic bill of lading was issued or transferred, that person has control of the electronic document. That identification may be by virtue of passwords or other encryption methods. Registry systems may satisfy this test.

Official Comment 3, UCC § 7-106 (emphasis in original). *See* Comment 3, UETA § 16 (the main goal of the Safe Harbor Provisions is "to securely and demonstrably be able to transfer the record to others in a manner which assures that only one 'holder' exists").[5]

Moreover, the comments to both Model Acts refer with approval to the system sponsored by the U.S. Department of Agriculture ("USDA") and employed in connection with cotton warehouse receipts under 7 C.F.R. § 735, *see* Official Comment 2, UCC § 7-106; Comment 3, UETA § 16, although one commentator believes this system is inapposite because the USDA

[5] The Official Comment to Section 7-106 discuss "closed systems" in which participants sign onto a master agreement that provides for the rights among members and the against the registry system, and the document of title never leaves the system. Official Comment 5, UCC § 7-106.

must first approve the third party registry system before it can be used for maintaining warehouse receipts. *See* Coogan, *Secured Transactions*, § 6D.02[9][b].[6]

The endorsement of such systems suggests that the use of a third party registry system is preferred to ensure compliance with the Safe Harbor Provisions and to avoid any future dispute whether a secured party properly exercises control over the electronic document.

B. Legal Basis for Perfection

Although the methods for establishing control are identical under the Model Acts, only Revised Article 7 includes Conforming Amendments to Revised Article 9. As a result, the legal analysis for demonstrating that a secured party possesses a first-priority perfected security interest in a electronic document of title will vary based on whether the jurisdiction has adopted Revised Article 7 or the UETA.

1. *Perfection Under Revised Article 7*

Revised Article 7's conforming amendments to Article 9 make clear that control establishes a perfected and prior security interest. As "conformed," Section 9-314, entitled "Perfection by Control," states:

> A security interest in investment property, deposit accounts, letter-of-credit rights, electronic chattel paper, <u>or electronic documents</u> may be perfected by control of the collateral under Section 9-104, 9-105, 9-106, 9- 107, or <u>7-106</u>.

UCC § 9-314(a) (emphasis added). As a result, so long as the method used to transfer the electronic document of title satisfies Section 7-106, then transfer to the secured party will perfect that secured party's rights. *Intersection*, SK038 ALI-ABA at 29.

[6] Both Model Acts contemplate that new systems may develop that satisfy the statutory requirement as technology advances. Comment 3, UETA § 16; Official Comment 2, UCC § 7-106; Fry, *Introduction to the UETA*, 37 IDAHO L. REV. at 271.

2. *Perfection Under the UETA*

A similar conclusion is reached under a different legal analysis in jurisdictions that have not adopted Revised Article 7 (together with the Conforming Amendments), but have enacted the UETA. Section 16 of the UETA provides that:

> Except as otherwise agreed, <u>a person having control of a transferable record</u> is the holder, as defined in [Section 1-201(20) of the Uniform Commercial Code], of the transferable record and has the same rights and defenses as a holder of an equivalent record or writing under [the Uniform Commercial Code], including, if the applicable statutory requirements under [Section 3-302(a), <u>7-501</u>, or 9-308 of the Uniform Commercial Code] are satisfied, <u>the rights and defenses of a holder in due course, a holder to which a negotiable document of title has been duly negotiated, or a purchaser</u>, respectively. Delivery, possession, and indorsement are not required to obtain or exercise any of the rights under this subsection.

UETA § 16(d) (emphasis added). Section 7-501, in turn, provides that

> A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that <u>purchases it in good faith</u>, without notice of any defense against or claim to it on the part of any person, <u>and for value</u>, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a monetary obligation.

UCC § 7-501(5). Both the terms "purchases" and "value" are defined broadly enough in the UCC to include commercial financing transactions. *See* UCC § 1-201(32) (purchase includes "taking by "mortgage, pledge, lien [or] security interest"); *id*. at § 1-201 (a person give value "in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not it is drawn upon").[7] Therefore, the negotiation of an electronic document of title to a secured party satisfies the prerequisites of Section 16 of the UETA and the secured

[7] Notably, due negotiation does not require "new value," *see* UCC § 7-501 Official Comment 1, which is defined in Section 9-102(57) to mean money; money's worth in property, services or new credit; or the release by a transferee of an interest in property previously transferred to the transferee. UCC § 9-102(57).

party obtains all rights and defenses of a holder in due course of a tangible document of title. Fry, 37 IDAHO L. REV. at 271.[8]

Second, the secured party's status as a holder in due course of the electronic document of title confers priority over prior, perfected security interests. Pursuant to Section 9-331 of the UCC, Article 9 "does not limit the rights of a holder in due course" and "[t]hese holders . . . take priority over an earlier security interest, even if perfected, to the extent provided in Articles 3, 7, and 8 of this title." UCC § 9-331; *Intersection*, SK038 ALI-ABA at 29.

IV. <u>Choice of Law Considerations</u>

Given the non-uniform landscape among U.S. jurisdictions, it is important to examine what law may apply to determine whether an electronic document of title is valid and can be used to enforce a secured party's rights to goods. The Uniform Commercial Code generally permits the parties to select the law to control the parties' agreement. UCC § 1-105 (permitting parties to choose the law to apply to their commercial agreement so long as the transaction bears a "reasonable relation" to the chosen forum's laws). Thus, the parties can specify in their loan agreement what law governs, among other things, the creation of a security interest, the manner in which the security interest attaches, and whether a document of title can be created in one medium (whether electronic or tangible) and be substituted in the alternate medium pursuant to Revised Article 7.

However, questions regarding perfection and priority are not subject to the agreement of the parties. Section 9-301 provides, in relevant part:

> (1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

[8] The rights acquired include both title to the document and title to the underlying goods covered by the document. UCC § 7-502(1).

> (2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

UCC § 9-301(1) & (2).[9]

These two rules, when read together, suggest that the law that applies may differ based on whether the document of title is in either tangible or electronic form.

A. Tangible vs. Electronic Documents of Title

Because a tangible document of title is a physical item, it has the ability to be located in a jurisdiction. Under Section 9-301(2), the appropriate law applied is the law of the jurisdiction in which the collateral is located. Since every U.S. jurisdiction recognizes tangible documents of title pursuant to Article 7, the law regarding perfection and priority will be uniform regardless of where the tangible document is located (with the exception of any non-confirming amendments among the states).

An electronic document, in contrast, is not located in a jurisdiction and, pursuant to the provisions in Section 9-301(1), is governed by the law of the jurisdiction in which the debtor is located. The Conforming Amendments to Section 9-301(3) buttress this interpretation by providing for certain additional choice of law considerations for "*tangible* negotiable documents" that are "located in a jurisdiction" as opposed to all negotiable documents. *See* Prefatory Note, Revised Article 7 ("[i]f a rule is meant to be limited to one medium or the other, that is clearly stated"). *See also* 9-301(3) (providing for similar choice of law considerations for "tangible chattel paper" as opposed to chattel paper in whatever form).

[9] Section 9-301(3) further address negotiable documents, providing that the governing law for a negotiable document that not is the possession of the secured party is the law of the jurisdiction in which the negotiable document is located. UCC § 9-301(3)(c).

For debtors that are organized under the laws of a particular state (whether a corporation, limited liability company or otherwise), the controlling law would be the law in which the debtor is organized. UCC § 9-307(e).[10] Therefore, a secured party must look to the jurisdiction in which the borrower is organized to determine if the secured party can properly perfect and enforce a security interest in an electronic document of title.

B. <u>Organized in Revised Article 7 Jurisdiction</u>

Absent definitive case law, there is uncertainty whether a secured party can rely safely on perfection by control of an electronic document of title. Relying on the express language of Revised Article 7, the Conforming Amendments and the interpretative comments discussed herein, it appears that in instances where a borrower is organized in a Revised Article 7 jurisdiction, a lender can perfect a security interest in electronic documents of title over which it exercises "control" within the meaning of Section 7-105. The lender's security interest in the electronic document is perfected pursuant to Section 9-314(a)[11] and, as with either a tangible or electronic document, the rights to the underlying goods are derived from the secured party's status as a holder in due course. *See* UCC §§ 7-501, 7-502 & 9-331. A lender should also be able to perfect its security interest by the filing of a UCC-1 financing statement because electronic documents are recognized under Articles 1 and 7, and incorporated within the meaning of "document" in Section 9-102(20). Coogan, § 6D.02[9][b]; *Intersection*, SK038 ALI-ABA at 29; Sandra Stern, *Secured Lending Issues in Revised Article 7*, 860 PLA/Comm 345, 350 (available on Westlaw).

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[10] The choice of loan provisions may also create concerns for a lender where a borrower has taken advantage of the ability under Revised Article 7 to convert a document of title to a tangible medium from an electronic form, or *vice versa*. Following the express language of Section 9-301, the applicable law governing perfection could change with each conversion of media of the document of title.

[11] The analogous perfection of a tangible document of title is through possession, which is addressed in Section 9-313(a).

C. <u>Organized in UETA Jurisdiction</u>

If a borrower is organized in a UETA jurisdiction, the express language of the UETA and interpretative comments discussed herein suggest that a lender can perfect a security interest in an electronic documents of title so long as the lender relies on control -- and not filing -- as its method of perfection in the document of title.

Because UETA jurisdictions do not have the benefit of the Conforming Amendments to Article 9, an electronic document is not an expressly recognized category of collateral, and filing with respect to such category will not perfect a security interest therein. *Intersection*, SK038 ALI-ABA at 29. However, control of the electronic document which has been duly negotiated to the secured party confers upon the secured party the status of a holder in due course pursuant to Section 7-501, which provides title to both the document and the underlying goods pursuant to Section 7-502, and, in turn, provides the secured party priority over any other secured party pursuant to Section 9-331. *Id*., Fry, *Introduction to the UETA,* 37 IDAHO L. REV. at 271.

D. <u>Organized in Jurisdiction Without Revised Article 7 or the UETA</u>

In the absence of either Revised Article 7 or the UETA, a secured party is not likely to be able to perfect its security interest in an electronic document of title and likely will be without any rights or recourse against the goods covered by such document.[12] First, the secured party has no recognized basis for perfecting by filing. Because the jurisdiction's version of Article 9 does not recognize an electronic document of title, it is arguably not a category of collateral to which the secured party can perfect a security interest. Second, the secured party has no ability to perfect through possession or control. The party cannot possess an electronic document, therefore, Section 9-313 cannot apply. Moreover, because electronic documents are not

[12] This conclusion exists even though the parties may have a choice of law provision in their loan agreement that provides for the laws of a Revised Article 7 jurisdiction. As previously discussed, the parties' choice of law will govern creation of the security interest, but not matters relating to perfection or priority. UCC § 9-301.

recognized in the absence of the Conforming Amendments, there is no ability either to (i) control the electronic record within the meaning of Section 9-314(a), or (ii) assert holder in due course status, as permitted when reading the UETA and Section 9-331 together.

IV. Conclusion

A lender should be cautious if asked to lend against electronic documents of title. Although significant progress has been made to enact uniform laws throughout the United States that recognize and validate the use of electronic documents of title, the laws are not truly uniform until every state has adopted them. Until then, choice of law considerations regarding perfection, effect of perfection and priority of a security interests subject a secured party to unnecessary risk.

In addition, neither Revised Article 7 nor the UETA has been in force for a sufficient period of time to allow for the development of an established body of case law regarding the methods of creation and transfer of a negotiable document of title, and whether the systems used by to maintain electronic documents of title satisfy the Safe Harbor Provisions and create "control" within the meaning of the Model Acts. The better mechanism, at least for now, is to rely on documents of title in their tangible form.

ELIGIBLE IN-TRANSIT INVENTORY FINANCING -- DEFINITIONS AND OTHER CREDIT AGREEMENT PROVISIONS

C. Edward Dobbs
Parker, Hudson, Rainer & Dobbs LLP
Atlanta, Georgia

Consider use of the following definitions in connection with In-Transit Inventory financings:

Acceptable BOL: with respect to In-Transit Inventory, a tangible, negotiable bill of lading that (i) is issued either by a common carrier which is not an Affiliate of the applicable Vendor or Borrower and which is in actual possession of such Inventory or by an Eligible NVOCC; (ii) covers only such In-Transit Inventory; (iii) is issued to the order of Borrower or, if so requested by Lender, to the order of Lender; (iv) names Lender as a notify party and bears a conspicuous notation on its face of Lender's security interest therein (unless such bill of lading is issued to the order of Lender); (v) is subject to Lender's duly perfected, first priority security interest and no other Lien that is not a Permitted Lien; and (vi) is otherwise in form and content acceptable to Lender.

Customs Broker: a Person that is engaged by Borrower to clear In-Transit Inventory through U.S. Customs.

Eligible Foreign Vendor: a Foreign Vendor which (i) is located in ____________________ or any other country acceptable to Lender in its discretion, (ii) has received timely payment or performance of all Debts and other obligations at any time owed to it by Borrower (whether such Debts or other obligations arise from Borrower's purchase of goods or otherwise), (iii) has not asserted (and has no right to assert) any reclamation, repossession, diversion, stoppage in transit, Lien or title retention rights in respect of such In-Transit Inventory, and (iv) if so requested by Lender, has entered into and is in full compliance with the terms of a Vendor Agreement that is in full force and effect.

Eligible In-Transit Inventory: on any date, Inventory of Borrower that satisfies all of the requirements for Eligible Inventory on such date (including the requirement that such Eligible Inventory be subject to Lender's duly perfected, first priority Lien and no other Lien that is not a Permitted Lien) other than the requirement that it be located in the United States, but only if (i) under the terms of sale, title and risk of loss with respect to such Inventory have passed from the Foreign Vendor to, and such Inventory is owned by, Borrower; (ii) such Inventory is fully insured, to the extent of at least 100% of its cost, by marine cargo or other insurance in such amounts, with such insurance companies, subject to such deductibles and against such risks (including war risks) as are satisfactory to Lender and in respect of which Lender has been named as sole loss payee pursuant to a loss payee endorsement acceptable to Lender; (iii) the Foreign Vendor with respect to such Inventory is an Eligible Foreign Vendor; (iv) such Inventory is in the possession of a common carrier or Eligible NVOCC that has issued an Acceptable BOL; (v) any NVOCC with respect to such Inventory is an Eligible NVOCC and has issued an Acceptable BOL; (vi) all original counterparts of Acceptable BOLs in respect of such Inventory (whether issued by a carrier or an NVOCC) are in the possession, in the United States, of Lender or an agent of Lender (including an Eligible NVOCC, a Customs Broker or a carrier serving as such agent under an Imported Goods Agreement) or in the possession of Borrower as a result of Lender's delivery to Borrower to facilitate offloading of such Inventory at the port of entry; (vii) the NVOCC and Customs Broker (or the carrier, if so required by Lender) in respect of such Inventory has entered into an Imported Goods Agreement with Lender that is in effect on such date; and (viii) such Inventory shall not have been in transit for more than ninety (90) days.

Eligible NVOCC: with respect to any In-Transit Inventory, an NVOCC for such Inventory that (i) is not an Affiliate of Borrower or the applicable Vendor and is otherwise acceptable to Lender; (ii) is engaged by Borrower as freight forwarder with respect to such Inventory; (iii) has received from the carrier a tangible bill of lading with respect to such Inventory that names such NVOCC as consignee and, if so requested by Lender, has granted Lender a security interest in such bill of lading as security for the Obligations; (iv) has issued to the order of Borrower or, if so requested by Lender, to the order of Lender, a tangible, negotiable bill of lading in respect of such Inventory (and any bill of lading so issued to the order of Borrower shall name Lender as a notify party and conspicuously state on its face that it is subject to Lender's security interest); (v) is a party with Lender to an Imported Goods Agreement; and (vi) has not asserted any adverse claim or Lien against any such Inventory.

Foreign Vendor: a Person that sells In-Transit Inventory to Borrower.

Imported Goods Agreement: an Imported Goods Agreement in the form annexed hereto as **Exhibit __** or otherwise in form and substance satisfactory to Lender.

In-Transit Inventory: Inventory of Borrower that is in the possession of a common carrier and is in transit from a Foreign Vendor of Borrower from a location outside the continental United States to a location of Borrower (or a location designated by Borrower) that is in the continental United States.

NVOCC: with respect to any In-Transit Inventory, a non-vessel operating common carrier engaged as a freight forwarder or otherwise to assist in the importation of In-Transit Inventory.

Vendor Agreement: a Vendor Agreement between Lender and a Foreign Vendor that is in the form of **Exhibit ___** annexed hereto or otherwise in form and substance satisfactory to Lender and pursuant to which, among other things, the parties shall agree upon their relative rights with respect to In-Transit Inventory of Borrower purchased from such Foreign Vendor.

Consider use of the following definition when the Borrower's purchase of In-Transit Inventory is to be financed with a letter of credit:

Eligible LC Inventory: Inventory which would otherwise be Eligible Inventory (other than for its location) as to which: (i) the Inventory is purchased with and subject to a Letter of Credit issued hereunder; (ii) the Inventory is then in transit (whether by vessel, air or land) from a location outside of the United States of America to a location permitted hereunder and for which Agent shall have received such evidence thereof as Agent may reasonably require; (iii) the title of the Inventory has passed to, and such Inventory is owned by, Borrower and for which Agent shall have received such evidence thereof as Agent may reasonably require; (iv) Agent has received each of the following: (A) a copy of the certificate of marine cargo insurance in connection therewith in which Agent has been named as an additional insured and loss payee in a manner reasonably acceptable to Agent and (B) a copy of the invoice, packing slip and manifest with respect thereto; (v) the Inventory is either (A) subject to a negotiable bill of lading: (1) that is consigned to the Issuing Bank (unless and until such time as Agent shall require that the same be consigned to Agent, then thereafter, that is consigned to Agent either directly or by means of endorsements), (2) that was issued by the carrier in respect of such Inventory and (3) is either in the possession of the customs broker, freight forwarder or other third party handling the shipping and delivery of such Inventory acting on behalf of Agent or the subject of a telefacsimile or other electronic copy that Agent has received from the Issuing Bank with respect to the Letter of Credit and as to which Agent has also received confirmation from such Issuing Bank that such document is in transit to Agent or the customs broker, freight forwarder or other third party handling the shipping and delivery of such Inventory acting on behalf of Agent or (B) subject to a negotiable cargo receipt and is not the subject of a bill of lading (other than a negotiable bill of lading consigned to, and in the possession of a consolidator or Agent, or their respective agents) and such negotiable cargo receipt is (1) consigned to Issuing Bank (unless and until such time as Agent shall require that the same be consigned to Agent, then thereafter, that is consigned to Agent either directly or by means of endorsements), (2) issued by a consolidator in respect of such Inventory and (3) either in the possession of Agent or the customs broker, freight forwarder or other third party handling the shipping and delivery of such Inventory acting on behalf of Agent or the subject of a telefacsimile or other electronic copy that Agent has received from the Issuing Bank with respect to the Letter of Credit and as to which Agent has also received a confirmation from such Issuing Bank that such document is in transit to Agent or the customs broker, freight forwarder or other third party handling the shipping and delivery of such Inventory; (vi) such Inventory is insured against types of loss, damage, hazards, and risks, and in amounts, reasonably satisfactory to Agent; and (vii) such Inventory shall not have been in transit for more than ninety (90) days.

Consider use of the following affirmative covenants in connection with In-Transit Inventory financings:

Section ___. Bills of Lading and Other Documents of Title. If any Inventory is in transit to the United States ***[or Canada]*** and is intended by Borrower to be "Eligible In-Transit Inventory" pursuant to the definition thereof, then, with respect to such Inventory: (a) Borrower shall cause all bills of lading and other documents of title in respect of such In-Transit Inventory to name Borrower as consignee, unless and until Lender directs otherwise in its discretion; (b) at such time and from time to time as Lender may direct, Borrower shall cause all bills of lading and other documents of title in respect of such In-Transit Inventory to name Lender or such other Person as Lender may specify to be named as consignee; (c) without limiting any other rights of Lender hereunder, Lender shall have the right to endorse and negotiate on behalf of, and as attorney-in-fact for, each Obligor any bill of lading or other document of title with respect to such In-Transit Inventory naming an Obligor as consignee to Lender; (d) there shall be three (3) originals of each such bill of lading or other document of title which, unless and until Lender shall direct otherwise, shall be delivered as follows: (i) one original to such Customs Broker as Borrower may specify (so long as Lender has received an Imported Goods Agreement duly executed and delivered by such Customs Broker), and (ii) two originals to Lender or to such other Person as Lender may designate for such purpose; (e) Borrower shall obtain a copy (but not the originals) of such bill of lading or other documents of title in respect of such Inventory unless delivered to Borrower by Lender in its discretion; and (f) Borrower shall cause the bill of lading or other document of title with respect to such Inventory to be an Acceptable BOL.

Section ___. Payments to Customs Brokers, etc. Pay in a timely manner all applicable duties, freight, charges and like fees and charges of the United States Customs Service, Customs Brokers, shippers, freight forwarders, carriers and warehousemen.