

## Goods in Transit

### BACKGROUND

One question that can arise in an ABL transaction where a financier is lending against inventory is whether and, if so, the degree to which it is prepared to lend against the value of such inventory whilst in transit (either from a supplier, between group entities or between different locations of the same entity).

### WHAT ARE THE ISSUES?

The concerns are practical ones. Where inventory is being moved, there are a number of risks, from items going astray, being damaged or lost on route, to a question of the ability to track and trace the assets if an enforcement commences before the goods have arrived at their destination.

Where goods are moving cross border, the concerns increase as the distances and numbers of jurisdictions involved increase.

- When does ownership of the goods pass, as opposed to risk?
- What security should be taken over the goods (and when) and will this be effective? The general rule followed by most legal practitioners is that the governing law of the security should match that of the jurisdiction in which the asset is located, in order to ensure minimal issues in relation to recognition and enforceability. However, where the goods are in transit on land, they would likely pass through many jurisdictions and, if travelling by sea, will likely be in international waters for much of the journey.
- How can you take control of the assets given the more widespread locations in which the goods may find themselves at the time of an enforcement, and what other parties (such as shipping agents or hauliers) may have a claim over the assets either contractually or pursuant to liens?

### WHAT ARE THE OPTIONS?

Assuming there is not simply a blanket exclusion on goods in transit forming part of the borrowing base, what is permitted can vary on a deal by deal basis, depending on the level of comfort of the financier with the situation and the levels of protections surrounding the assets.

**Include a basket:** Perhaps the most straightforward way of dealing with the issue is to simply set a basket for the maximum value of goods in transit that can be included in the borrowing base. While no analysis is done and no additional protections are taken, and so there are additional risks in recovery compared with inventory in a warehouse, distribution centre or even in a retail space, to the extent that the amount included is relatively small compared with the overall portfolio of assets, there is scope for a commercial decision to include that inventory. Even if there are issues with tracking, recovery and effectiveness of the security, it is likely that a proportion of the goods in transit will make it to their destination and, depending on the jurisdiction, fall within the security net.

**Include reserves:** Reserves may be taken to cover the fees of any third parties involved in the transport process (e.g. hauliers, carriers, stevedores, shipping agents) so that the financier can pay to release the goods from the possession of any such person and any lien they may have. Reserves can be taken on their own or, more commonly, in conjunction with one of the other methods mentioned.

**Take supporting documentation / additional perfection measures:** Another common method is to include additional perfection requirements before goods in transit can be included in the borrowing base. Any such protections will be aimed at obtaining more control over the goods while in transit and also at the port of destination when moving cross border.

In this scenario, a financier may ask for copies of bills of lading or other shipping documents (such as sea waybills) to evidence the existence of and title to the goods. Even better would be to hold the originals with, if they are negotiable, an endorsement in favour of the financier, but this may be impractical, as they may take time to be received and also may be needed by the customer's agent (for example at the destination port in order to permit the agent to recover the goods off the ship) or need to be obtained from a third party financier to the extent the customer's counterparty is obtaining finance against the goods at any time while they have title to the goods.

To effect those arrangements, the financier may choose to enter into a tripartite agreement with the customer and the shipping agent whereby the shipping agent would hold the relevant documents on trust for the financier. This would permit the customer to run its business but also allow the financier to take control of the relevant documents upon a trigger.

This sort of arrangement is often paired with a basket to limit the risks, although that basket may be a more generous one than if there had not been any additional protections.

**In-depth analysis:** Where there is a significant amount of goods in transit which the customer wants to have in the borrowing base without a basket or other limit, a financier may be willing to conduct an in-depth analysis of the transport arrangements to fully assess the risks. Such an analysis will, by definition, need to be comprehensive and so there is a timing implication to going down this route.

By necessity, these reviews are conducted on a case by case basis, but would generally require consideration (both commercial and legal) in relation to, amongst other matters:

- Each relevant transport route - point of departure; destination; duration and method.
- The relevant transport documentation – whether an original is required to claim the goods and, if so, what happens to that in practice/to whom is it sent/how long it takes before arriving at the destination.
- The point during the journey at which (on average) title passes to the customer and therefore the point at which the customer is potentially able to grant security. This will depend in part on the terms and conditions of sale and also in part on the form of the shipping documentation (possession of which may be required to claim the goods).
- What arrangements are made to get the goods from the port of arrival to their final destination (e.g. the customer's warehouse or factory).
- What laws may be applicable to the goods at each point and, accordingly, a consideration of the best laws to govern the security. A legal analysis will need to be taken in relation to how effective the relevant security will be at any point in time; in particular, in the event that goods only arrive in jurisdiction after the commencement of insolvency proceedings.
- Whether the goods can be identified and/or tracked accurately.
- What reporting can be made in relation to the goods while in transit.

If you have any questions or require specific legal advice in respect of any of the English law matters discussed in this publication, please click [here](#) and get in touch with any of the **Key Contacts**.