

STRUCTURED FINANCE FOR IMPORTED EQUIPMENT- THE KNOTTY ISSUES.

Quite often a bank or financial institution is involved in financing a client who intends to import a piece of equipment - a dredger or a sea-going vessel, or any other “heavy duty equipment” as they are typically called. These transactions may look simple but have a potential to get nasty. For example I recall a transaction where a bank financed the purchase of a sea-going dredger and when the dredger arrived they instructed a law firm to place a Ship Mortgage on the dredger since it fell under the definition of a vessel in the Merchant Shipping Act. This law firm in the course of requesting further information to proceed discovered that the foreign owners of the dredger actually had a lease/joint venture arrangement with the customer being financed. And off course the lease had a clause requesting the consent of the foreign owners before the dredger could be pledged as security. Even more complicated was the fact that the dredger was already registered in the ship registry in the country of origin. The bank was under the impression that their customer negotiated an outright purchase at the time Letters of Credit were issued. I am sure you can guess what happened – Litigation! What then are the knotty issues in navigating such financing deals? To answer this question I suggest we get a fundamental understanding that these transactions always have three basic inextricably related aspects. And these are:

- Stage 1. - Negotiating the purchase
- Stage 2 - Shipping
- Stage 3 - Emplacing a Bank security

In actuality it is advisable to take full picture decisions with all three aspects in mind before proceeding with the deal. Let us delve into the matters arising under these three heads:

1. NEGOTIATING THE PURCHASE

A fundamental error of most financiers in these transactions is for the bank to allow the customer negotiate the entire purchase while they remain subliminal. Let us assume that the financing is for the building of a new ship in New Orleans. In this scenario a financier should be interested in several issues as negotiation begins: Is there is a shipbuilding contract between the seller and your customer/buyer? If so, is it protective the banks investment? Is the ship builder giving any warranties and indemnities? How are they enforceable jurisdictionally? Is delivery time favourable given that interest on the loan kicks in as soon a Letter of Credit is issued? Are there penalties for late completion? Is payment mile-stoned properly to mitigate damage in event of a breach by the ship builder? Does the bank have privity of contract with the seller or any legal basis to be a party to an action in the event of ship builder’s breach? Which law is applicable to the contract and how is it protective of the bank’s interest? If it is an existing vessel then the financier must know before hand: Where is it registered? How is ownership transferred in that registry? Can we explore the option of placing a ship mortgage at the Port of registry? Apart from these and more legal

angles a physical inspection of the equipment by a qualified person is advisable. For example, a certified maritime inspector should be engaged to inspect the ship or review the building plan. Why? For one, this report gives confirmation on specifications and suitability for purpose. For example if the client intends to navigate creeks is the draft right sized? In some cases you want a confirmation whether the equipment is new or used. There is a chain link between the utility of the equipment to your customer and the ability to service the loan. So a financier needs to understand the capability of the equipment and its cash-flow potentials.

2. SHIPPING

The equipment will invariably need to be shipped and many issues are pertinent. Is it being shipped as a knockdown for assembly at point of destination? If so, have adequate arrangements been made for re-assembly by experts? Note that any delay or misfit in assembly process can adversely affect fortunes and invariably payback capability. Another issue often ignored is the shipping documents. The Bill of Lading is very important. Firstly it is advised that before shipment the details on the Bill of Lading should be crosschecked with the specifications of the Pro forma invoice. Why? In certain cases parts are missing on arrival at Port of destination due to mistakes from the factory. The Bill of Lading is also an instrument of title and by law allows the consignee to endorse to a third party even when the goods are in transit. They are various types of Bills of Lading and depending on the situation the bank should be properly advised on whether the Bill should be issued in the name of the bank or simply delivered (all originals) to the bank. Another issue is Marine Insurance. It is important to confirm that a proper insurance is in place for the full value of the shipment with the banks interest duly registered on the policy in appropriate terms that covers its exposure. In certain circumstances the bank may opt for a Cost and Freight shipping (C & F) rather than a rather than Cost, Insurance & Freight (CIF) shipping arrangement. The reason is that it may be better to take out Insurance with a domestic Insurer in the country of destination for reasons of convenience in pursuing claims if the need arises.

3. EMPLACING A BANK SECURITY

This is a crucial part of the deal structure that is often determined by several factors including: the nature of the equipment; whether the customer has a ready market by way of a fixed term/fixed rate contract; whether the customer has an equity in the purchase or the bank financed 100%; whether the purchase is for delivery to a third party in fulfilment of a Local Purchase Order and more. The options for securitisation may therefore vary with each situation and may include one or a mix of several options: a mortgage on the equipment by ship registration or debenture, a Lien, Domiciliation of payment, Sale and Lease back structure, finance leases, shareholding in the 24 shares of a ship and other possibilities. Several things should however be considered in taking a decision: Firstly wherever possible it is advisable to take additional security apart from the equipment particularly where the equipment is not tied to a set income. The ease and options for enforceability should be a key in structuring security for such transactions. Secondly an all-risk Insurance policy on the equipment should be priority. Thirdly, the idea of a bank buying the equipment in its name should be viewed with circumspection. Why? There is a possibility that the equipment is damaged, lost, destroyed or seized in enforcement of a judgment against the bank. Where does this leave the bank vis-à-vis the debt “owed” by the customer? Perhaps the customer may become the creditor in certain circumstances.

CONCLUSION

What makes the knots of this type of transactions? The answer would include the people involved, the country of origin of the equipment, the monetary value, the nature of the equipment, and the goals of the parties. May I say therefore that each situation should therefore be previewed (not reviewed) on the principle that transactions of this nature may be similar but are hardly same?

Ayuli Jemide is a Partner with Detail Solicitors