

Haynes and Boone's Commodities Practice Group Represents Major International Bank in Crude Oil and Refined Products Intermediation Deal in the United States

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Haynes Boone Client

Major International Bank (“Bank”) with a global commodities business, but new to crude oil and refined product intermediation in the United States.

Counterparty

Largest Refining Complex on the Eastern Seaboard (“Refinery”).

Transaction Type – Inventory Monetization

Transaction structured to monetize the Refinery’s inventory, which involves intermediation of both crude oil and refined products. This structure results in full inventory ownership by the Bank until such time as the Refinery needs to buy crude for consumption or refined product for sale into the market. Intermediation allows for just-in-time inventory management, and also provides for full supply chain sourcing arrangements to be put into place.

Crude and refined product ownership by Bank is predicated on true sale title and risk transfer to Bank, which requires a true sale legal opinion to be issued by a law firm. Both legal and accounting true sale are expected. Accounting true sale involves off balance sheet treatment of the inventory. Legal true sale involves certainty of non-recharacterization risk in a bankruptcy scenario. In other words, parties to a true sale want to know that the absolute conveyance of the inventory (*i.e.*, the sale of the inventory) will be respected in a bankruptcy setting and not overturned.

Transaction Challenge

Refinery is in Chapter 11 bankruptcy with final piece of emergence plan requiring a new intermediation structure provided by Bank to cover all Refinery inventory.

Transaction Milestone

On August 7, 2018, Refinery announced that it completed its financial restructuring process and emerged from Chapter 11 following the earlier confirmation of its plan of reorganization by the United States Bankruptcy Court for the District of Delaware. Bank’s transaction with Refinery – a new \$900 million hydrocarbon intermediation facility – was a key component of the plan of reorganization to be phased in (in addition to Refinery restructuring more than \$635 million of funded debt and arranging for \$260 million in new financing).

Legal Complexities of Bank Engaging in a Physical Commodities Business

Because the transaction is based on full physical ownership by Bank of the inventory, the Bank is required to be licensed and set up to transact in the physical market for crude oil and refined products in states up and down the East Coast, in Gulf states, as well as in Western states. The licensing and approval scope cuts across federal, state, county and even city jurisdictions.

Also, because of the massive size of Refinery's operations, the daily purchase and sale activity requires intense coordination by trading and operations staff with respect to daily bookings, inventory sourcing, reporting and hedging activities.

As for storage and transport of the inventory, Bank is required to be set up in various locations across the United States and to be able to undertake various modes of transport (vessel, barge and pipeline).

Unique Transaction Attributes

This transaction is the first time a major refinery has emerged from Chapter 11 utilizing a true sale inventory monetization structure. Also, the true sale nature of this transaction is unique in that some top banks in this space elect to follow a lien-based intermediation structure. A lien-based structure may involve flash title, but relies heavily on a security interest in the inventory, which is different from full transfer and absolute conveyance and holding of the inventory of a true sale structure.