July 2024

Follow @Paul_Hastings

LOOKING FOR LIQUIDITY IN FOREIGN PLACES: A LENDER'S GUIDE TO FINANCING GOODS LOCATED OUTSIDE THE US

By Christopher G. Ross, Stephen Sepinuck & Stacy Hopkins

Part I: Whose Law is it Anyway?

With elevated interest rates and rising labor and supply costs, many U.S. companies are looking for additional sources of capital to continue growing their businesses. Companies with asset-based revolving credit facilities are turning to their lenders for additional liquidity – asking them to lend against goods that the borrower has purchased (or contracted to purchase) but not yet received. Before agreeing, a lender should perform a detailed legal analysis to determine the extent to which goods located outside the United States should be included in the borrowing base of an asset-based credit facility.

The relevant facts can vary in a variety of important respects that can impact the lender's eligibility determination. The borrower might have paid for the goods in full, in part, or not at all. The borrower might be expecting to take possession of the goods, expecting an agent to take possession, or expecting the seller to retain possession and ship the goods directly to the borrower's customers. The goods might be in the possession of the seller in another country or might be in transit to the borrower. If in transit, the carrier might have issued a negotiable document of title for the goods or a non-negotiable document of title, or the carrier might not have issued any document of title.

Part I of this series discusses how to evaluate whether title to goods coming from overseas has passed to the U.S. purchaser. Part II of this series covers the considerations a lender must address when lending against goods that are in transit from overseas.

Ownership of the Goods

Generally speaking, goods that the borrower does not own should not be included in the borrowing base, because the borrower normally cannot grant a security interest in property that it does not own.[1] Consequently, the first question a lender must answer is whether the borrower owns the goods in question. Resolving this question requires examining the contracts under which the borrower purchased the goods. In particular, with respect to each purchase of goods, it is necessary to determine three interrelated things:

- What law governs the sales contract?

- What, if anything, does the sales contract state with respect to when ownership (that is, title to the goods) transfers to the borrower?
- What are the seller's obligations with respect to delivery of the goods?

A. What Law Governs

In a purely domestic sales of goods, Article 2 of the Uniform Commercial Code ("UCC"), discussed below, will almost always apply. In an international sale of goods, that might not be the case. Instead, there are typically four possible answers to what law governs:

- The United Nations Convention on the International Sale of Goods ("CISG");
- The UNIDROIT Principles of International Commercial Contracts;
- The law of a state of the United States (which, unless the state is Louisiana, includes that state's version UCC Article 2)[2] ; or
- The law of another country or a political subdivision of that country.

However, neither the CISG nor the UNIDROIT Principles addresses issues relating to ownership of the goods.[3] As a result, in addressing ownership issues, a court in the United States is likely to apply the law that the parties selected to govern the transaction and, in the absence of an effective choice, UCC Article 2. What law a court outside the United States would apply will depend on the choice-of-law rules in that country.

B. Ownership under the UCC

Under the UCC, unless the parties have agreed otherwise, title to goods passes from the seller to the buyer at the time and place at which the seller completes the seller's duties with respect to physical delivery of the goods.[4] The fact that those duties might be completed while the goods are located outside the U.S. makes no difference. Moreover, any retention or reservation of title by a seller of goods as to which the seller has completed its delivery obligations is limited to the reservation of a security interest.[5]

The default rule regarding delivery of goods to be shipped is that the seller is obligated only to: (i) put the goods in the possession of a carrier; (ii) make a reasonable contract for their transportation; (iii) obtain and promptly deliver to the buyer any necessary documents of title covering the goods; and (iv) promptly notify the buyer of the shipment.[6] In other words, the seller is obligated to ship the goods (referred to as a "shipment contract"), not to put the goods into the buyer's possession at the destination point (referred to as a "destination contract"). The two major consequences that flow from this are that: (i) the buyer has the risk of loss in transit; and (ii) title to – and hence ownership of – the goods passes to the buyer at the place of shipment. Parties are free to alter this rule by agreement, such as by creating a destination contract.[7] If they do, title will pass after the seller tenders the goods and any applicable documents of title to the buyer at the destination point.[8]

The upshot of this is, if the UCC governs ownership of goods that a borrower has contracted to purchase from a foreign seller, the borrower might be the owner of goods not yet received. Indeed, the buyer might be the owner of goods that remain in the seller's country. For that to be the case, either the seller must have completed its duties with respect to delivery of the goods or the sales agreement must have provided for the borrower to become the owner at an earlier point (e.g., at the time of contracting

or the time the goods are identified to the contract). It does not matter whether the borrower has paid the seller in full, in part, or not at all. If the sales agreement purports to keep title in the seller, that term is limited to the reservation of a security interest; the borrower becomes the owner when the seller completes its duties with respect to delivery.

C. Ownership under Other Law

The UCC's rules regarding title to goods will not be relevant if some other law governs the sales agreement. Thus, for example, if a borrower contracts to purchase goods pursuant to a contract governed by Hong Kong law, and the sales agreement provides that the seller retains title to the goods until the seller receives payment of the full purchase price, the borrower might not acquire title to and ownership of the goods – even though delivered – until the seller receives full payment. Indeed, this might be true even with respect to goods that have arrived in the United States.

D. Obtaining and Perfecting a Security Interest in the Goods

If, under domestic law, the buyer is the owner of the goods, then the normal rules apply regarding how to obtain and perfect a security interest in goods. In other words, the fact that the goods are not located in the U.S. is largely immaterial. The law of the debtor's location would govern the perfection and priority of a nonpossessory security interest in the goods.[9] That means having the debtor sign the security agreement and filing a financing statement against the debtor in the jurisdiction where the debtor is located is sufficient to obtain and perfect a security interest in the goods. However, the lender should be aware that in-transit goods may be covered by a document of title (discussed in more detail in Part II of this series), which may influence what method the lender uses to perfect its lien.

E. Practical Considerations

Even if a buyer and seller have selected the law of a state of the United States to govern their sales contact, a court in a foreign country might or might not respect that choice or might refuse to apply the choice to a question regarding title. Consequently, there will almost always be some uncertainty about ownership of goods not located in the United States. If the goods are located in another country, there will also usually be some difficulty, cost, and risk in trying to get physical control of those assets, even if the borrower would be deemed to be the owner of the goods by a U.S. court.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Los Angeles

Stephen Sepinuck
1.213.683.6146
stephensepinuck@paulhastings.com

Stacy Hopkins
1.213.683.6240
stacyhopkins@paulhastings.com

New York

Christopher G. Ross
1.213.318.6788
christopherross@paulhastings.com

1 See UCC § 9-203(b)(2) (for a security interest to attach to property, the debtor must have rights in the property or the power to convey rights in the property).

2 Louisiana is the only state that has not enacted Article 2 of the UCC.

3 See CISG Art. 4 ("except as otherwise expressly provided in this Convention, it is not concerned with . . . the effect which the contract may have on the property in the goods sold.").

4 § 2-401(2).

5 § 2-401(1). See also § 1-201(b)(25) (defining "security interest").

6 § 2-504.

7 Often, the parties will include as a delivery term in their agreement a term defined in the UCC – such as "F.O.B.," "F.A.S.," "C.I.F.," "C. & F.," or "ex ship." In such a case, consult the UCC definition to determine what the term means, what the sellers' duties are, and hence when title passes to the buyer. See §§ 2-219, 2-320, 2-321, 2-322. Other times, a sales agreement will expressly incorporate an Incoterm for the same purpose. Incoterms are essentially delivery terms with definitions published by the International Chamber of Commerce. Incoterms were last revised in 2020 (referred to as "Incoterms 2020") but some sales agreements continue to incorporate a previous version (e.g., "Incoterms 2010").

8 See § 2-503(3).

9 See § 9-301(1). The law of the country where the goods are located would govern the perfection and priority of a possessory security interest. Thus, it may be advisable to ascertain who has possession and whether that person claims a security interest for itself or on behalf of someone else.

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2024 Paul Hastings LLP.