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# *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 II: Ticket to Ride*

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 nonnegotiable document of title, or the carrier might not have issued any document of title.

Part II of this series covers the considerations a lender must address when lending on goods that are in transit from overseas. This analysis assumes that legal title to the goods – that is, ownership of the goods – has transferred to the borrower (for a discussion of the issues underlying this assumption, please see [Part I](#) of this series).

### **In-Transit Goods**

Assuming that the borrower is deemed to be the owner of the goods, a lender relying on those goods must address additional issues when the goods are in transit from the seller's country to the United States. These considerations affect the lender's ability to obtain possession of the goods, as well as the methods for perfecting and ensuring the priority of its security interest.

When goods are in transit, the carrier will commonly issue a document of title covering the goods (e.g., a bill of lading). A document of title will be either negotiable or nonnegotiable. This designation is based on the form of the document. A negotiable document of title is one that, "by its terms," provides that the goods "are to be delivered to bearer or to the order of a named person."<sup>1</sup> Thus a negotiable

document of title will state the goods are to be “delivered to bearer” or will state that the goods are to be “delivered to the order of [a named person].” Without those magic words – either “bearer” or “to the order of” – the document of title is nonnegotiable.<sup>2</sup>

Both negotiable and nonnegotiable documents can be tangible (*i.e.*, on paper) or intangible (*i.e.*, electronic), and the rules of perfection are similar for both tangible and intangible documents.

#### **A. Goods Covered by a Negotiable Document of Title**

If a carrier has issued a negotiable document of title covering the goods in the carrier’s possession, then ownership of the goods is effectively locked up in the document. To properly perfect a security interest in the goods, the secured party should perfect a security interest in the document of title.<sup>3</sup> This may be accomplished either by properly filing a financing statement that includes the document in the indication of collateral or by taking possession of the document of title.

Taking possession of the document is useful for reasons beyond perfection. A purchaser that acquires a negotiable document through “due negotiation” obtains not only title to *the document* but also title to *the goods* covered by the document.<sup>4</sup> In short, a negotiable document functions much like a negotiable instrument does. Just as a holder in due course of an instrument takes free of property claims to the instrument – including perfected security interests – a purchaser who acquires a negotiable document through due negotiation takes free of almost all property interests in the document or in the underlying goods.<sup>5</sup>

If the lender does obtain possession of the borrower’s negotiable documents of title – either directly or through an agent – the lender effectively makes it impossible for anyone else to acquire the documents through due negotiation. If the documents have also been duly negotiated to the lender (*i.e.*, indorsed if not issued in bearer form), the lender’s rights to the document and the goods become paramount. Moreover, given the importance of documents of title to international commerce, it is likely that a court in any country would enforce the rules applicable to documents of title. Consequently, absent casualty to the goods during transit,<sup>6</sup> the lender that takes negotiable documents through due negotiation can be reasonably certain of being able to obtain the goods if the borrower defaults, and should therefore be comfortable including the value of the goods in the borrowing base.<sup>7</sup>

#### **B. Goods Covered by a Non-Negotiable Document of Title**

Nonnegotiable documents of title do not encompass title to the goods. They are little more than receipts issued by the carrier. As a result, nonnegotiable documents can largely be ignored for the purposes of perfecting a security interest in the goods and determining the priority of a security interest in the goods.

Furthermore, a lender taking possession or control of a nonnegotiable document does not ensure itself access to the goods. If the seller of the goods consigned the goods to a carrier, which in turn issued a nonnegotiable document of title, the seller might in some circumstances have a right to stop delivery.<sup>8</sup> Moreover, even in the absence of that right, the carrier is permitted to honor instructions by the seller/consignor, even if borrower or lender (as the consignee) has given contrary instructions.<sup>9</sup> A carrier that follows such instructions has no liability to the borrower or lender.<sup>10</sup> For these reasons, a nonnegotiable document is weak assurance that the borrower or the lender can ever obtain possession of the goods. Consequently, most lenders either insist that the seller/consignor and carrier waive these rights or refuse to credit the borrowing base for in-transit inventory covered by a nonnegotiable bill of lading.

## CONCLUSION

A borrower seeking additional liquidity from their asset-based lenders may ask to include in the borrowing base goods that are not in the borrower's possession because they are located in foreign jurisdictions or are in transit. Before doing so, the lender needs to verify that the borrower owns the goods and that the lender can perfect and enforce its security interest in those goods, understanding that there may be practical hurdles in realizing upon that security interest. Paul Hastings LLP has a deep bench of attorneys that are highly experienced in structuring and documenting cross-border ABL financings. Please contact a member of the Global Finance team for your financing needs.

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*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](mailto:stephensepinuck@paulhastings.com)

Stacy Hopkins  
1.213.683.6240  
[stacyhopkins@paulhastings.com](mailto:stacyhopkins@paulhastings.com)

### New York

Christopher G. Ross  
1.213.318.6788  
[christopherross@paulhastings.com](mailto:christopherross@paulhastings.com)

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- 1 § 7-104(a).
  - 2 A document that has the magic words is nevertheless nonnegotiable if it is conspicuously marked as "nonnegotiable." § 7-104(c).
  - 3 See § 9-312(c)(1) & cmt. 7.
  - 4 See §§ 7-501, 7-502. A "due negotiation" is a transfer of the document to a purchaser that purchases in good faith, for value, without notice of any claim or defense to the document and in the ordinary course of business or financing. § 7-501(a)(5), (b)(3). Negotiation of a negotiable document of title issued in bearer form is effected through delivery of the document of title. § 7-501(a)(2). Negotiation of a negotiable document issued "to the order of" a named person requires delivery plus the named person's indorsement on the document. § 7-501(a)(1).
  - 5 There is an exception for a security interest that attached to the goods and was perfected before the carrier issued the document of title. See §§ 7-502(b), 7-503(a).
  - 6 A casualty could be the result of storm, piracy, or negligence by the carrier.
  - 7 Subject to whatever discounts or reserves are appropriate to account for net orderly liquidation value, shrinkage and similar concerns.
  - 8 See §§ 2-705, 7-403(a)(4).
  - 9 See §§ 7-303(a)(2), 7-403(a)(5).
  - 10 See § 7-504(c).

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