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# The Timing of Receipt of Goods in International Transactions Could Be Hazardous to Section 503(b)(9) Priority Status

Trade creditors received significant additional protection by the addition of Section 503(b)(9) to the Bankruptcy Code. Section 503(b)(9) grants goods sellers an administrative priority claim for the value of goods sold in the ordinary course of business and received by a debtor within 20 days of its filing.

At first glance, Section 503(b)(9) appears to be rather straightforward. However, there has been significant litigation over the meaning of many of Section 503(b)(9)'s terms, including the meaning of the term received. The meaning of received can often be determinative as to whether a creditor is entitled to an administrative claim under Section 503(b)(9). While the Bankruptcy Code does not define the term receive, many courts have relied on state law, and, specifically, the Uniform Commercial Code ("UCC"), to hold that a debtor receives goods when it has taken physical possession.

However, as the U.S. District Court for the Eastern District of Pennsylvania (the "District Court") made clear in *In re: World Imports, Ltd.*, the term receive is susceptible to different meanings, depending on whether the seller is involved in a domestic or international transaction. The *World Imports* case involved an international transaction where two Chinese companies had sold goods to a U.S. debtor, World Imports, Ltd. ("World Imports").

The court relied on the CISG to conclude that World Imports had received the goods when they were loaded on vessels in China, and not when World Imports took physical possession of the goods in the U.S.

The *World Imports* court relied on international commercial law, the Convention on Contracts for the International Sale of Goods (the "CISG"),<sup>1</sup> a treaty to which the United States and China are parties, instead of U.S. state law, the UCC, to ascertain the meaning of the term received. While the CISG does not define receive, it incorporates Incoterms (International Commercial Terms)<sup>2</sup> that reflect current trade practices and expecta-

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tions. The Incoterm at issue in the *World Imports* case was "free on board" ("FOB"), where the risk of loss passed to the buyer when the goods were loaded on board the ships at the named ports of shipment in China. The court relied on the CISG to conclude that World Imports had received the goods when they were loaded on vessels in China, and not when World Imports took physical possession of the goods in the U.S. Based on this alternative definition of receipt, World Imports had received the goods more than 20 days before its bankruptcy filing, and the Chinese vendors thereby lost priority status under Section 503(b)(9). Had the court applied the UCC's definition of receive, the sellers would have had allowed Section 503(b)(9) priority claims because World Imports had fallen possession of the goods in the U.S. within 20 days of World Imports' bankruptcy filing.

The District Court's reliance on the CISG, instead of the UCC, to hold that a debtor received goods purchased from abroad on an earlier date, when the goods were loaded on a carrier (which will usually occur more than 20 days before bankruptcy), might have significant implications in a broad category of international



transactions. Based on the *World Imports* decision, a foreign seller delivering goods to a financially distressed U.S. buyer on FOB terms port of origin of the goods risks losing the benefits of a Section 503(b)(9) priority claim that a U.S. seller of goods would otherwise enjoy. However, the *World Imports* holding might not be the last word on the meaning of received. There will likely be significant future litigation over the applicability of the CISG or UCC in determining the timing of a debtor's receipt of goods with respect to goods sellers' Section 503(b)(9) priority claims.

### Factual Background

World Imports filed its Chapter 11 petition on July 3, 2013 ("Petition Date"). On Oct. 23, 2014, two of World Imports' Chinese vendors, Haining Wansheng Sofa Co., Ltd. ("Haining") and Fujian Zhangzhou Foreign Trade Co., Ltd. ("Fujian"), filed motions for allowance and payment of administrative expense claims under Section 503(b)(9) of the Bankruptcy Code.

All of the goods that Haining and Fujian had delivered to the Debtor were shipped based on FOB named ports of shipment in China. Haining's claim included goods shipped from Shanghai, China on May 26, 2013 (more than 20 days before the Petition Date). World Imports took physical possession of the goods in the United States on June 21, 2013 (within 20 days of the Petition Date). The Fujian claim included goods shipped from Xiamen, China on May 17, May 31 and June 7, 2013 (more than 20 days before the Petition Date) directly to

World Imports and its customers in the U.S. It was not exactly clear when World Imports and its customers physically received the Fujian goods, but the parties agreed that receipt occurred within 20 days of the Petition Date.

A foreign seller delivering goods to a financially distressed U.S. buyer on FOB terms port of origin of the goods risks losing the benefits of a Section 503(b)(9) priority claim that a U.S. seller of goods would otherwise enjoy.

### The Bankruptcy Court's Decision

The sole question before the Bankruptcy Court was whether Haining's and Fujian's claims qualified for administrative priority status under Section 503(b)(9). The answer depended on the definition of received to be applied by the Bankruptcy Court. That, in turn, required the court to determine whether international commercial law, the CISG, or U.S. state law, the UCC, governed the parties' transactions. If the court relied on the CISG, based on FOB designated ports in China, Haining's and Fujian's claims did not have priority status under Section 503(b)(9) because World Imports had received the goods when they were loaded on the vessels more than 20 days before



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the Petition Date. If the court relied on the UCC, Haining's and Fujian's claims would have enjoyed priority status because World Imports had received the goods when it took physical possession in the U.S. within 20 days of the Petition Date.

The Bankruptcy Court applied the CISG to hold that World Imports had received the goods purchased from Haining and Fujian when the goods were loaded on ships in China, not when World Imports had taken physical possession of the goods in the United States. As a result, Haining's and Fujian's claims were not entitled to administrative priority status because World Imports had not received any of the goods within 20 days of the Petition Date.

### The District Court's Decision

The District Court affirmed the Bankruptcy Court's decision. The District Court also applied the CISG and upheld the denial of administrative priority status in favor of Haining and Fujian because World Imports had received the goods upon their shipment outside of the 20-day Section 503(b)(9) priority window.

Haining and Fujian argued that the Bankruptcy Court should have looked to the UCC for the definition of the term received. UCC §2-103(1)(c) defines receipt as "taking physical possession of [the goods]". Applying this definition, Haining's and Fujian's claims would have qualified for administrative priority status because World Imports received the goods when it took physical possession in the U.S. within twenty (20) days of the Petition Date.

Where beneficial, foreign vendors and other vendors shipping goods from countries that are signatories to the CISG to U.S. buyers should consider changing their contracts to explicitly exclude the CISG or specifically incorporate the UCC as the governing law.

World Imports argued that the term received should be defined based on international commercial law—the CISG—because the transaction were an international sales of goods and the parties did not include a provision in their contracts stating that the CISG did not apply. Based on the CISG and FOB delivery terms, Haining and Fujian had transferred the goods to World Imports when the goods were loaded on the ships in China. Therefore, World Imports did not receive the goods within 20 days of the Petition Date, and Haining's and Fujian's claims were not eligible for priority status under Section 503(b)(9).

The District Court held that the CISG, not the UCC, governed the definition of the term received in this context. The CISG is a treaty that applies to "contracts of sale of goods between parties whose places of business are in different states... [w]hen the States are Contracting States." Since both the U.S. (where

World Imports is located) and China (where Haining and Fujian are located) are signatories to the CISG, the CISG would govern any dispute between the parties, unless they expressly excluded its application. The District Court determined that the Bankruptcy Court was correct in applying the CISG as Haining, Fujian and World Imports were involved in international sale transactions and their contracts did not exclude the CISG's application.

Incoterms standardize the meanings of commonly used trade terms in international trade and provide buyers and sellers clear and unambiguous guidance on their respective rights and responsibilities for the delivery of goods.

The District Court also observed that the CISG incorporates common trade practices, known as Incoterms (International Commercial Terms), to fill in any gaps in the law where the CISG is, otherwise silent, such as the meaning of the term received.<sup>3</sup> These "Incoterms" have been memorialized by the International Commerce Commission to standardize the meanings of commonly used trade terms in international trade and provide both buyers and sellers that are parties to international sales contracts with clear and unambiguous guidance on their respective rights and responsibilities for the delivery of goods. Courts have previously held that these Incoterms are incorporated into the CISG through Article 9(2).

Although the Incoterms do not explicitly define the term receive, the District Court concluded that the Incoterm's definition of FOB is instructive because both the Haining and the Fujian goods were shipped FOB at ports in Shanghai and Xiamen, China, respectively. The term FOB means:

that the *seller delivers* the goods on board the vessel nominated by the buyer at the named port of shipment or procures the goods already so delivered. The *risk of loss of or damage to the goods passes when the goods are on board the vessel*, and the buyer bears all costs from that moment onwards.

The District Court relied on this definition to hold that World Imports had constructively received the goods when the sellers (Haining and Fujian) had delivered the goods to the carriers at which point the risk of loss or damage had immediately passed to World Imports. Accordingly, the relevant date for determining World Imports' receipt of goods was when the goods were loaded on the ships, not when World Imports received them upon their arrival in the U.S. As World Imports had received the goods when they were loaded on the carriers more than 20 days prior to the Petition Date, Haining's and Fujian's claims were denied administrative priority status under Section 503(b)(9) and were relegated to lower priority general unsecured claim status.



## Conclusion

The District Court's holding on the meaning of the term received in international commercial transactions is yet another reminder that Section 503(b)(9)'s terms are anything but straightforward. This decision points out the risk of multiple definitions of the same term, received, instead of a uniform definition applicable under all circumstances. The meaning of received can now vary depending on whether a vendor is shipping goods from a foreign country that is a signatory to the CISG<sup>4</sup> or within the United States.<sup>5</sup> Since Canada, Mexico and certain member countries in the European Union are also signatories to the CISG, sellers of goods from these countries to U.S. buyers might also be bound by the same definition of received as were Haining and Fujian.

Debtors and their secured lenders will likely rely on the *World Imports* decision and argue that the meaning of the term received should be grounded by the CISG, and not the UCC, in international sales transactions where the CISG is the governing law. This could minimize the allowed amount of Section 503(b)(9) priority claims to the detriment of foreign goods or suppliers. Creditors will likely oppose this position and rely on the UCC's definition of received. This could lead to expensive and unpredictable litigation.

In the meantime, where beneficial, foreign vendors and other vendors shipping goods from countries that are signatories to the CISG to U.S. buyers should consider changing their con-

tracts to explicitly exclude the CISG or specifically incorporate the UCC as the governing law. ■

1. As of Feb. 8, 2016, 84 countries have adopted the CISG. See <http://www.cisg.law.pace.edu/cisg/countries/cntries.html>.

2. Incoterms® 2010 (emphasis added).

3. Article 7(2) of the CISG states that a gap should be filled "in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."

4. It is not clear what body of law a court would apply if a company is doing business with a debtor that is located in a country outside of the United States and is *not* a signatory to the CISG.

5. It is likely that the UCC's definition of "receive" would apply to a domestic sale of goods.

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