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Avoiding Pitfalls in the Collection of Payment

by Wade M. Gallant, Jr.*

In addition to avoiding pitfalls in the making of transnational contracts, the subject of an earlier discussion, a seller must avoid pitfalls in the collection of payment. My advice to the exporter is that he and his attorney should have a thorough discussion with a representative of an experienced international department of a commercial bank before drafting the transnational sales contract. It has been my experience that sound advice in this area *before* the sales contract is prepared can avoid many of the pitfalls that might otherwise be encountered in the collection of payment. If the seller is totally unfamiliar with the credit standing and reputation of the foreign buyer, the banker will most likely advise him to require by contract that the buyer furnish an irrevocable letter of credit from a foreign bank. In addition, the letter should be confirmed by a local bank and should specify a reasonable number and type of documents to accompany each draft drawn thereunder. The banker can also advise the exporter on how to protect himself on shipping dates, as well as on the expiry date of the letter of credit itself, and can alert him to other important matters. I will discuss only some of the pitfalls to be avoided, time making it impossible to discuss them all.

Protest

Section 501(3) of Article 3 of the Uniform Commercial Code (hereinafter the "Code") provides that unless excused, such as by waiver, protest of any dishonor is necessary to charge the drawer and endorsers of any draft which on its face appears to be drawn *or* payable outside of the states and territories of the United States and the District of Columbia. The official comment to this provision of the Code¹ states that this requirement is applied to such international drafts because it is generally required by foreign law, which the Code cannot affect. With respect to drafts drawn in the situations discussed in the preceding section by Mr. Edwards, instructions are usually given to protest for nonacceptance or nonpayment. In connection with drafts drawn here and presented

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¹ U.C.C. § 3-501; N.C. GEN. STAT. § 25-3-501 (1965) (amended 1967).

abroad, protest would be governed by the law of the country where presented, if collection is to be enforced there. Protest usually consists of a formal statement, prepared by a notary public, that a draft was presented for payment or acceptance (whichever the case may be) and that such payment or acceptance was refused and the draft thereby dishonored.² The notary presents a draft which has been refused to the drawee. If payment or acceptance is then refused, the notary records this fact, prepares a certificate of protest and notifies all interested parties.

The purposes of protest are to establish, through the action of a disinterested party (usually a notary), that the draft actually was dishonored and to notify interested parties so that they may take such action as they wish.

If a lawsuit becomes necessary, protest may give a summary right of action to execute against property in some countries.³ This would permit the plaintiff to attach personal property of the defendant at the beginning of legal action or at least to obtain a judgment much more rapidly than might otherwise be possible. In such countries, the advantage of protest is obvious.

Some exporters, however, feel that protest is usually not worthwhile, both because it gives them little practical benefit (notice of nonacceptance or nonpayment can be obtained without protest) and/or because it creates ill will. Whether possible ill will is a significant consideration depends, of course, upon the situation. Customers who are slow in payment may often be worth keeping as customers in spite of the delay.

A foreign collecting bank may sometimes automatically protest drafts which are dishonored. One reason for such action is that a bank must protest drafts which are dishonored in order to protect its right of recourse to the drawer.⁴ If the foreign collecting bank does not know whether the bank sending the draft for collection has purchased or discounted the draft or whether the draft is merely being handled as a collection item, the foreign bank may automatically protest any dishonor to protect the possible interest of the forwarding bank.

In import situations where the draft is drawn abroad and is presented for payment or acceptance here, the Uniform Commercial Code governs protest. As stated earlier, the Code requires protest of such a draft to charge the drawer and endorsers, unless protest is excused by the provisions of Section 511 of Article 3 of the Code.⁵ Those provisions

² U.C.C. § 3-509; N.C. GEN. STAT. § 25-3-509 (1965); see 3 ANDERSON, UNIFORM COMMERCIAL CODE § 3-509 (2d ed. 1971) for general discussion of protest. See also 18 AM. JUR. LEGAL FORMS 2D §§ 253: 2141-43 (1974) for samples of a formal protest certificate.

³ There are constitutional limitations on summary actions such as attachment and garnishment in the U.S. See, e.g., *Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969); *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974). North Carolina has codified these procedural safeguards. See N.C. GEN. STAT. §§ 1-440.1-.46 (Supp. 1975).

⁴ U.C.C. §§ 3-502(2), -509; N.C. GEN. STAT. §§ 25-3-502(2), -509 (1965).

⁵ U.C.C. § 3-511; N.C. GEN. STAT. § 25-3-511 (1965).

excuse protest in several situations: when the party to be charged has waived it expressly or by implication; when such party has himself dishonored the draft or has countermanded payment or otherwise has no reason to expect or right to require that the draft be accepted or paid; or when by reasonable diligence the protest cannot be made or the notice given.

Section 509 of Article 3 of the Code sets forth the requirements of a protest:

(1) A protest is a certificate of dishonor made under the hand and seal of a United States consul or vice consul or a notary public or other person authorized to certify dishonor by the law of the place where dishonor occurs. It may be upon information satisfactory to such person.

(2) The protest must identify the instrument and certify either that due presentment has been made or the reason why it is excused and that the instrument has been dishonored by nonacceptance or nonpayment.

(3) The protest may also certify that notice of dishonor has been given to all parties or to specified parties.⁶

Although most promissory notes used in the United States contain a waiver of protest as a standard provision,⁷ drafts used in international payments usually do not contain any such waiver. The protest need not be in any particular form, so long as it certifies the matters stated in (2) immediately above. It need not be annexed to the instrument and may be forwarded separately, but annexation would satisfy the requirement that the protest identify the instrument.⁸ For the reasons outlined above, a seller of merchandise and his banker, if he has purchased the draft from the seller, should always instruct the collecting bank to protest for nonpayment or nonacceptance. By so doing, the seller will remain in the strongest legal position to seek recourse against the buyer for dishonor.

Letters of Credit

Mr. Edwards has already described various forms of letters of credit and stated that in the United States, Article 5 of the Code sets forth certain definitions and rules applicable to letters of credit. It was pointed out that Article 5 is extremely important with respect to the rights of the various parties involved in letters of credit issued by local banks. Article 5, however, does not apply to letters of credit issued by foreign banks unless such letters are confirmed by local banks. Therefore, an exporter

⁶ U.C.C. § 3-509; N.C. GEN. STAT. § 25-3-509 (1965). Paragraph six of the official comment to this section of the Code states that this provision recognizes the practice of including in the protest a certification that notice of dishonor has been given to all parties or to specified parties, and section 510 of Article 3 makes such a certification presumptive evidence that the notice has been given.

⁷ See 18 AM. JUR. LEGAL FORMS 2D § 253:1913, sec. 16. "Maker waives presentment, protest, and notice of dishonor, and maker waives his right to all other notices or demands that might otherwise be required by law." See also *id.* § 253:1914.

⁸ *Courtaulds N. America, Inc. v. North Carolina Nat'l Bank*, 528 F.2d 802 (4th Cir. 1975).

should require that the letter of credit to be issued by the buyer's foreign bank make itself expressly subject to the Uniform Customs and Practice for Commercial Documentary Credits⁹ simply because there is no uniform international law governing letters of credit similar to the Uniform Commercial Code in this country.

Mr. Edwards has pointed out the wisdom of not attempting to have the letter of credit substitute for a well negotiated sales contract, and he correctly pointed out that banks pay on the basis of apparent compliance of the required documents rather than on whether or not the documents state the truth. It is never intended that a bank issuing a letter of credit involve itself in the underlying commercial transaction. It pays or does not pay on the basis of its examination of documents alone and a bank has no right to question the truth or falsity of the documents if they appear on their face to be in order.¹⁰

Banks issuing letters of credit have only a reasonable length of time to examine documents which are presented with a draft drawn under a letter of credit (in this country, until the close of the third banking day following receipt of the documents unless the presenter has expressly or impliedly consented to a longer period of time).¹¹ Failure to honor the draft within the specified time limits constitutes dishonor of the draft.¹² For this reason, knowledgeable banks will not issue letters of credit containing documentation requirements which are so complicated that the banks cannot accurately determine within the allowed time period whether the documents do in fact comply with the requirements of the letters of credit. Such overly complicated and burdensome letters of credit serve no useful purpose to either the buyer or seller and certainly not to the bank issuing them.

At this point it might be beneficial to give some examples of pitfalls associated with letter of credit transactions. Assume, for example, that a New England T-shirt manufacturer receives an order from an English seller for 100 dozen T-shirts stamped with the slogan "Yankee Go Home." He goes to his attorney, Mr. Diputs, tells him that he does not know the buyer and asks how he can assure himself that in shipping the T-shirts to England he will receive payment. Attorney Diputs advises him that he should require that the shipment be covered by a letter of credit. Shortly thereafter the manufacturer receives from Barclay's Bank a formal-looking statement along the following lines: "Dear Sir: We are informed by XYZ T-Shirt Sales Corporation, London, England, that they have opened their irrevocable letter of credit No. A006 in your favor for sum or sums not exceeding a total of \$20,000 available by your drafts

⁹ INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 290, UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS (rev. ed. 1974) [hereinafter cited as U.C.P.].

¹⁰ U.C.P. art. 8(b); U.C.C. § 5-106(4); N.C. GEN. STAT. § 25-5-106(4) (1965).

¹¹ U.C.C. § 5-112; N.C. GEN. STAT. § 25-5-112 (1965).

¹² U.C.C. § 5-112(1); N.C. GEN. STAT. § 25-5-112(1) (1965).

drawn on XYZ T-Shirt Sales Corporation accompanied by the following documents. . . .”

In due course, shipment is made and the drafts are presented drawn as required by the credit and forwarded to Barclay’s Bank. Barclay’s Bank writes back and states that XYZ T-Shirt Sales Corporation, upon due presentment, has failed to pay the draft because of impending bankruptcy. When Attorney Diputs is requested to enforce payment against Barclay’s Bank, he finds by reading Article 3b of the Uniform Customs and Practice¹³ that an irrevocable credit may be advised to a beneficiary through a bank without engagement on the part of that bank. Before the goods were manufactured, Attorney Diputs should have required Barclay’s Bank to *confirm* the irrevocable credit of XYZ T-Shirt Sales Corporation and not merely to *advise* the opening of the credit. In that case, such confirmation would have constituted a definite undertaking of Barclay’s Bank in addition to the undertaking of the XYZ T-Shirt Sales Corporation. As a result, the New England T-shirt manufacturer remains the owner of 100 dozen T-shirts stamped with a slogan that will not make them readily salable in New England, although they might be more salable in this part of the country.

The next time the manufacturer received an order from another T-shirt sales company in England for a similar supply of T-shirts, he returned to Attorney Diputs who advised him that he should receive an irrevocable authority to purchase from an English bank. The manufacturer included that requirement in his contract with the English company, and, in due course, he received from Barclay’s Bank a formal document stating: “Gentlemen: We have been authorized by John Bull T-Shirts Limited to purchase your drafts drawn at sight on John Bull T-Shirts Limited for any sum or sums not exceeding in total U.S. \$20,000 accompanied by the following documents. . . .” He manufactures and ships the goods, and the draft is purchased by Barclay’s and the money forwarded to the New England manufacturer. Shortly thereafter he receives a letter from Barclay’s requesting reimbursement on the ground that John Bull T-Shirts Limited has gone into bankruptcy and Barclay’s is holding the New England manufacturer responsible because the drafts were not drawn without recourse. Here again, Attorney Diputs failed to secure payment for his client because an authority to purchase is simply that. It means that the bank has been authorized to purchase the draft but it has recourse against the drawer if the draft is not paid by the drawee.¹⁴ An authority to purchase can authorize drafts to be drawn

¹³ U.C.P. art. 3(b). “An irrevocable credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of that bank, but when an issuing bank authorizes or requests another bank to confirm its irrevocable credit and the latter does so, such confirmation constitutes a definite undertaking of the confirming bank in addition to the undertaking of the issuing bank. . . .”

¹⁴ U.C.P. art. 3(a); U.C.C. § 5-109(1); N.C. GEN. STAT. § 25-5-109(1) (1965).

without recourse, but the authority must so state.¹⁵

Finally, in the next transaction, Attorney Diputs apparently has learned from his mistakes. He gets a form letter of credit from his local bank and tells the New England manufacturer that he needs an English bank to issue a letter of credit that resembles it. The letter of credit arrives and does resemble the form letter, except that it does not state whether it is irrevocable or revocable. The New England manufacturer promptly manufactures the goods requested and immediately prior to shipment, receives a cable from the English bank. The cable states that the bank has been instructed by the T-shirt sales corporation to revoke the letter of credit. The manufacturer immediately consults Attorney Diputs and finds that Article 1 of the Uniform Customs and Practice provides the following: Credits may either be revocable or irrevocable; all credits, therefore, should clearly indicate whether they are revocable or irrevocable; but in the absence of such indication, the credit shall be deemed to be revocable. Here, again, Attorney Diputs has stubbed his toe and the reason is obvious when you spell his name backwards. The above examples illustrate that in the world of letters of credit, everything may not be what it seems to be.

Fortunately, the authority to purchase with recourse is seldom used in foreign trade. At one time, however, it was used extensively in trade with the Far East, not because it added any engagement by the bank but because it indicated that the bank thought that the buyer's credit standing was good enough initially to negotiate or purchase the draft on its behalf. Nevertheless, if the buyer in the Far East failed to honor the draft, the seller had to reimburse the purchasing bank. An unscrupulous buyer may use an authority to purchase with recourse if he thinks he can deceive an unsuspecting seller.

Before closing, some mention should be made of the guaranty or stand-by letter of credit, which is the form most frequently used where services rather than goods are involved.¹⁶ In general, the law states that it is ultra vires and unenforceable for a bank to issue its guaranty unless it has a direct financial interest in the transaction.¹⁷ In what might be characterized as a triumph of form over substance, stand-by letters of credit have become established and are not subject to challenge as a guaranty in disguise. In *New Jersey Bank v. Palladino*,¹⁸ the letter said that the bank would "assume obligations" arising from, in and out of a note made by Palladino. This was not deemed a letter of credit and was not enforceable against the bank as a guaranty.¹⁹

The usual form of a stand-by letter of credit is an engagement by

¹⁵ U.C.P. art. 1(a).

¹⁶ See generally H. HARFIELD, *BANK CREDITS AND ACCEPTANCES* (5th ed. 1974); VERKUIL, *Bank Solvency and Guaranty Letters of Credit*, 25 STAN. L. REV. 716 (1973).

¹⁷ 4 A. MICHIE, *BANKS AND BANKING* § 43, at 75 (1971).

¹⁸ 146 N.J. Super. 6, 368 A.2d 943 (1976).

¹⁹ *Id.* at 12, 368 A.2d at 946.

the bank to honor drafts drawn up to a given amount, accompanied by the beneficiary's certificate that the party for whom the letter of credit was opened has failed to perform the services required in some specific manner. Such a letter of credit is proper although a guaranty of performance by the bank would not be proper or enforceable. Since this is a conference on exporting, it would not be advisable to spend more time discussing stand-by or guaranty letters of credit since documentary credits are the type that will be used in the great majority of export payment transactions.

Financial Terms vs. Delivery Terms

Financial terms of sale are not to be confused with delivery terms, such as c.i.f., f.o.b. or f.a.s. Delivery terms are intended to indicate what is included in the unit price quoted and any additional separate charges. Furthermore, they determine the obligations of the seller and of the buyer, respectively, in the delivery of goods. Financial terms of sale are the terms of payment—the manner in which and the time within which payment must be made. Delivery terms, or so called “foreign trade definitions,” have in the past created great confusion because the courts of various countries have interpreted these definitions in different ways.

A useful publication in this respect is the Revised American Foreign Trade Definitions—1941,²⁰ adopted July 30, 1941 by a joint committee representing the Chamber of Commerce of the United States of America, National Council of American Importers, Inc. and the National Foreign Trade Council, Inc. From talking with the National Foreign Trade Council, Inc., I have learned that these definitions are in the process of being rewritten, but the 1941 publication is the version still in use. These definitions give a precise meaning to many delivery terms which are often abbreviated. These definitions have been disseminated worldwide and most foreign importers have copies. Since these definitions have no status at law in most countries, it is imperative that sellers and buyers agree to their acceptance as part of the contract of sale. Inclusion in the contract of sale is the only sure way to make them legally binding upon all parties. It would be well to heed the “general notes of caution”²¹

²⁰ NATIONAL FOREIGN TRADE COUNCIL, REVISED AMERICAN FOREIGN TRADE DEFINITIONS—1941 (1941).

²¹ The notes recommend several precautions to be taken in drafting the contract. They recommend that buyers and sellers agree that their contract be subject to the REVISED AMERICAN FOREIGN TRADE DEFINITIONS—1941. Foreign trade terms not listed there should be avoided unless the parties first reach a definite understanding as to their definition. Abbreviations are susceptible to misunderstanding and should be avoided. All terms referring to quantity, weight, volume, length or surface should be clearly defined and agreed upon. The party to bear the cost of any inspection or certificate of inspection should be determined in advance. Unless otherwise agreed upon, all expenses are for the account of the seller up to the point at which buyer must handle subsequent movement of goods. All elements of the contract should be specifically agreed upon, and particular attention should be given to customary practices, which might be the source of differing assumptions by the parties.

appearing immediately before the "definition of quotations" in the Revised American Trade Definitions.