BUSINESS LAW

Financing of international business transaction

Dr. Zoltan Vig

BME
Gazdaság- és
Társadalomtudományi Kar

Wire transfer, collection

wire transfer

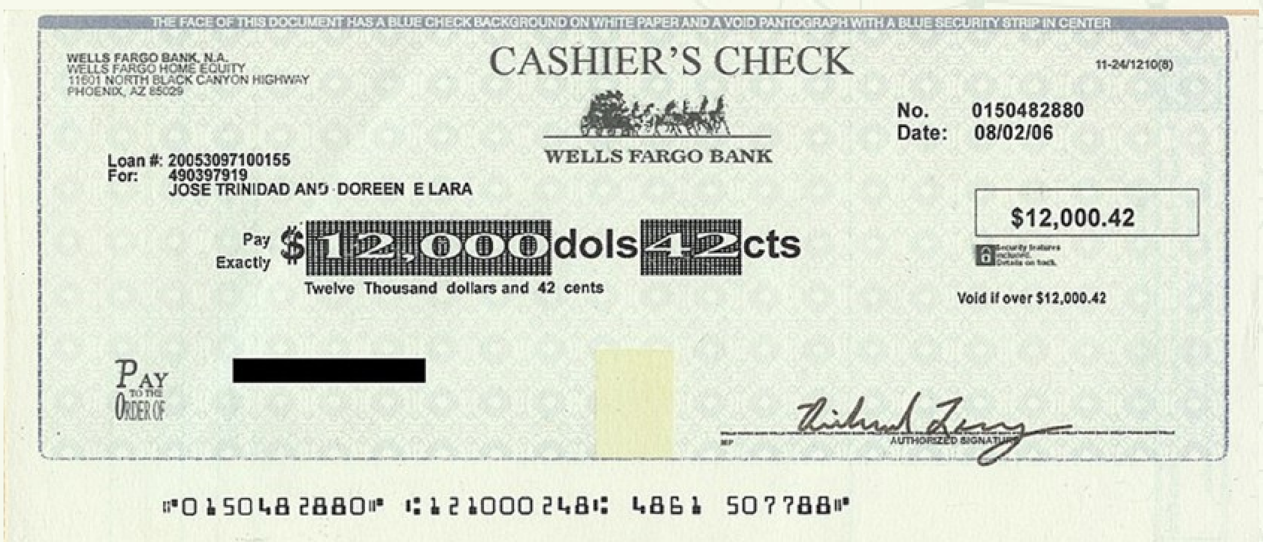
- relatively inexpensive way of payment
- risky for the seller (trust needed)
- not going to solve the liquidity problems of the buyer
- buyer orders its bank to transfer a certain amount of money to the seller

collection

- safer method of payment, seller 'collects' the money from the buyer's bank account
- seller will have to present certain documents to the bank proving that it dispatched or delivered the goods
- International Chamber of Commerce has issued its Uniform Rules for Collections which apply only if the parties agreed to apply it (otherwise, national law applies)

Check

Check is a negotiable instrument, a written order directing a bank to pay money as instructed. It is a **credit instrument**, as you cannot cash it before the date on it. This instrument is used less frequently nowadays in international trade.



Bill of exchange, promissory note

With a **bill of exchange** the

- issuer orders the addressee to pay on a certain date or after, a certain sum to a third party
- a written order by the *drawer* (buyer) to the *drawee* (bank) to pay money to the *payee* (seller)
- negotiable instrument, represents money debt, without condition (there is no requirement to show legal title), therefore no objection can be invoked related to the underlying business (*e.g.* deficient performance, *set-off*)
- has a credit function, because until the expiry you do not have to have the money on your account, so in some sense it is very similar to the check.

Promissory note functions similarly to the bill of exchange, however, here the issuer promises that he or she will (instead of the bank) pay at a certain future date

Letter of credit, bill of lading

letter of credit

- solves:
  - trust between the seller and the buyer
  - need for credit by the buyer

security used for this transaction: **bill of lading** (B/L) a negotiable instrument representing goods

- issued by the carrier to the shipper (who is the seller) when the carrier takes over the goods
- functions:

  (1) proves that the goods were handed over to the carrier (how much and in what condition was taken over by the carrier for transport to the destination port) 'clean', meaning that the carrier took over the goods 'in apparent good order and condition'

  (2) proves the conclusion of the freight contract between the shipper and the carrier

  (3) proves the legal title to the goods

Letter of credit

There are several legal relationships (**contracts**) related to a letter of credit transaction, which are independent in legal sense

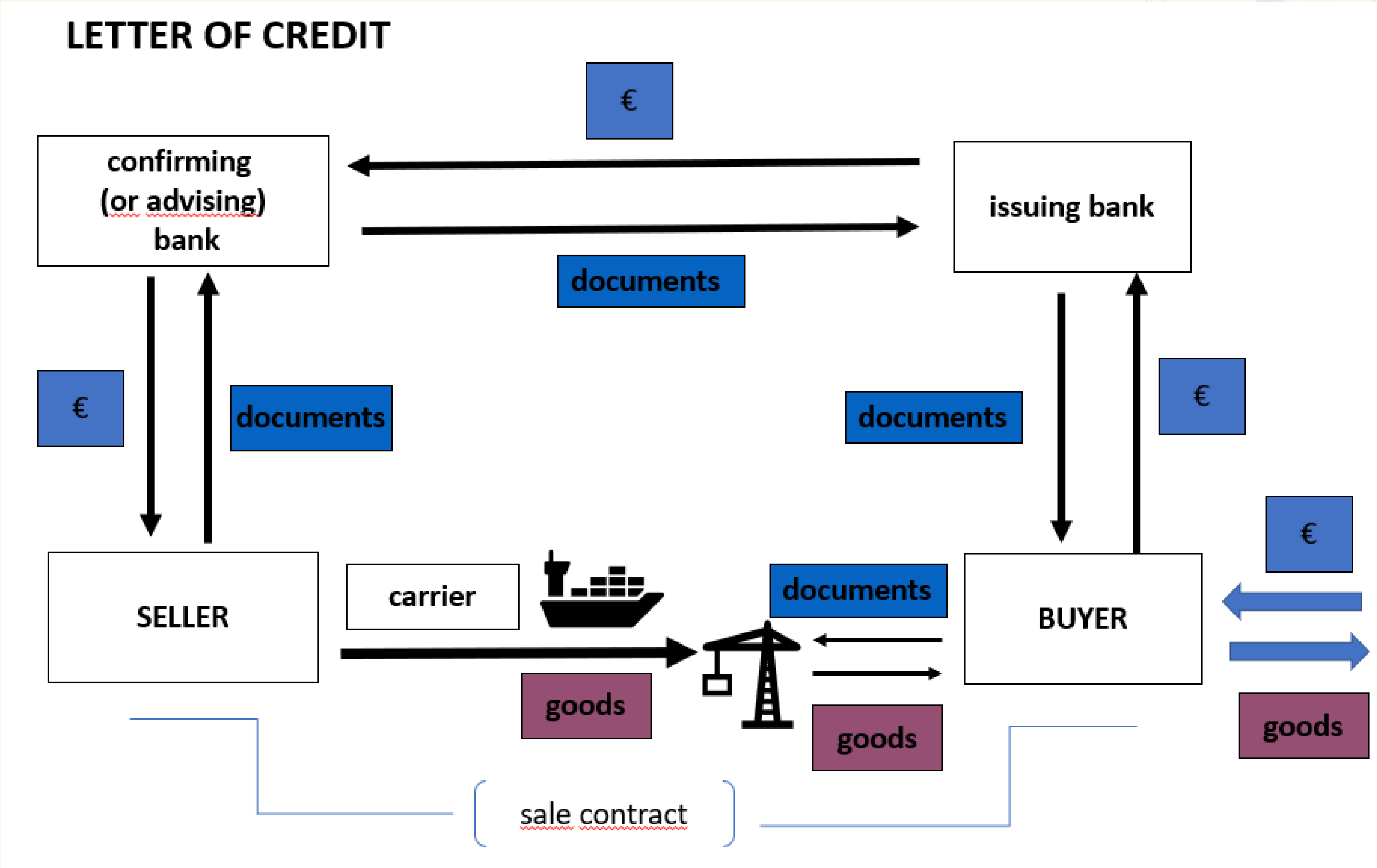
(1) <u>sale contract</u> which is the basic agreement, and which is concluded between the seller and the buyer >> this agreement will indicate letter of credit as payment method between the parties,

(2) order of the buyer to his bank (the issuing bank) to open a letter of credit for the seller (<u>banking services contract</u>),

(3) irrevocable <u>promise of the issuing bank to the seller</u> that it will pay for the documents (contractual obligation in common law systems),

(4) <u>irrevocable promise of the *confirming bank* to the seller</u> that it will pay for the documents,

(5) between the issuing bank and the confirming bank also a <u>banking service contract</u>



LETTER OF CREDIT
€
confirming (or advising) bank
issuing bank
documents
€
documents
documents
€
€
SELLER
carrier
documents
BUYER
goods
goods
goods
sale contract

Letter of credit

some international principles related to this transaction:

- the basic contract, the sale contract, is a <u>separate legal relationship</u> from the letter of credit transaction, this was established in the Power Curber case: ”The bank is in no way concerned with any dispute that the buyer may have with the seller.” so, the bank will have to pay if all the required documents are presented, even if there is some dispute regarding the sale contract. Also, if there is a problem with the letter of credit, it will not affect the validity of the sale contract
- principle of ‘<u>strict compliance</u>’: the bank will very strictly examine all the documents in formal sense, and it has the right to refuse them if there is any mistake

law applicable to the letter of credit issues:

the parties can agree that they will apply the International Chamber of Commerce’s Uniform Customs and Practice for Documentary Credits (UCP 600)

if not >> conflict of laws rules and based on that apply a national law

Warehouse warrant

similarly to the bill of lading, represents right of disposal over the goods, however, in this case, stored in a warehouse. It is also a negotiable (transferable) instrument

it has two parts: warrant for the goods and a pawn ticket (you can borrow money on the goods)

Bank guarantee

- primarily not a payment method, but a guarantee by the bank that it will pay instead of the buyer if the buyer fails to pay until the agreed date for some reason
- used for large projects
- practically, there is an **agency contract** between the buyer and the bank, in which the buyer orders its bank to issue a bank guarantee, what is in legal sense a <u>one-sided promise to the seller</u> that it will pay irrespectively to any dispute between the parties regarding the sale agreement
- bank can refuse to pay if the payee acts obviously in <u>bad faith</u>, or the payment would be <u>contrary to international public order</u>
- in any case, the bank can dispute the payment only following it happened
- **applicable law**: the bank performs the characteristic performance, thus, it will be the law of the country where the seat of the bank is
- however, the parties are free to choose a law, or to agree on the ICC Uniform Rules for Demand Guarantees

Factoring, forfeiting

international factoring

- special financing technique
- the seller assigns its receivables (money it is owed by the buyer) to the factoring company (factor), the factoring company makes advance payments to the seller before the date of maturity
- usually a complex service, the factor also does bookkeeping, analyses, collection
- if the parties agree on a so-called <u>genuine factoring</u> agreement, then the <u>seller is not liable for the debts of the buyer</u>, except in the case of bad faith of the seller, that is to say, when it knew in advance that the buyer is insolvent
- usually regulated by different national laws

forfeiting is another special financing technique >> basically the same as factoring, the difference is that the receivable is incorporated in a bill of exchange or in a promissory note, and the assignment takes place by discounting

Leasing

technological development

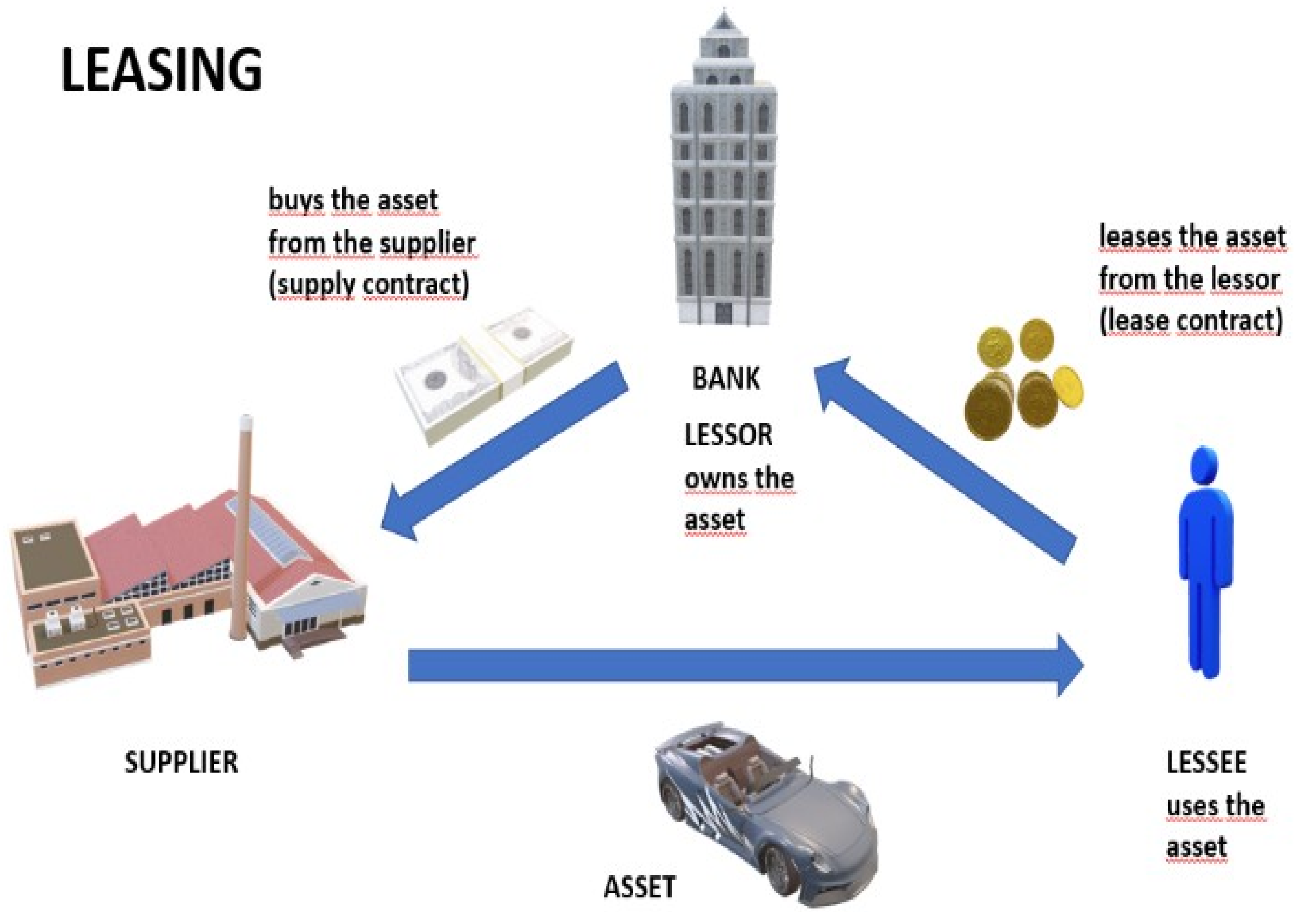
two types of leasing:

(1) operating leasing (the producer leases the asset directly to the lessee, who pays the fee to the producer), and

(2) **financial leasing** (there are three parties and two contracts)

- latter is more common and regulated by the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988)
- there are two contracts related to international financial leasing:
  - first transaction is when the lessor (a leasing company, who finances the purchase of the asset and who owns it) on the specifications of the lessee (who uses the asset and pays periodically for the asset to the lessor), enters into a contract (the supply agreement) with the supplier (manufacturer), under which the lessor acquires equipment on terms approved by the lessee
  - second, the lessor enters into a contract (the leasing agreement) with the lessee, granting to the lessee the right to use the equipment in return for the payment of rentals, and at the end of the term, the lessee usually has the right to purchase the asset at residual value (however, this is optional).

LEASING


buys the asset
from the supplier
(supply contract)
BANK
LESSOR
owns the
asset
leases the asset
from the lessor
(lease contract)
SUPPLIER
LESSEE
uses the
asset
ASSET

Leasing

UNIDROIT Convention applies when the lessor and the lessee have their places of business in different states and (a) those states and the state in which the supplier has its place of business are contracting states; or (b) both the supply agreement and the leasing agreement are governed by the law of a contracting state. However, the parties (all of them) are free to exclude the Convention. Financial leasing is typically regulated in national laws worldwide.

In legal sense, there is division between **legal** and **economic ownership** of the leased asset: legal ownership stays with the lessor, while the risk, maintenance and rewards related to the asset are with the lessee, but he or she is obliged to proper use of the asset

- lessee will detect the asset in its financial statement
- duties of the supplier under the supply agreement are also owed to the lessee as if the asset was supplied to him or her.

Thank you!

BME
Gazdaság- és
Társadalomtudományi Kar