Financing agricultural exports: Legal and other considerations

by Steven E. Hendrix*

The U.S. Department of Agriculture established the Commodity Credit Corporation (CCC) to help promote the sale of U.S. agricultural products. The CCC offers two programs specifically created to assist exporters: the Export Credit Guarantee Program and the Intermediate Export Credit Guarantee Program. Of the two, the Export Credit Guarantee Program is much more popular, and will be the focus of this article.

The CCC Export Credit Guarantee Program

The goal of the Export Credit Guarantee program is to transfer the risk of loss due to nonpayments by foreign banks from U.S. exporters (or U.S. financing institutions) to the CCC. Under the program, the U.S. exporter pays a fee and receives a payment guarantee from the CCC. Usually, the exporter will assign the proceeds that may become due under the payment guarantee to a U.S. bank (or other financial institution) which in turn extends credit to finance the export sale.

The U.S. exporter, U.S. bank or other financing institution is then protected by the CCC's guarantee in the event of nonpayment by the ultimate buyers and/or their banks. If the U.S. exporter assigns the proceeds payable under the payment guarantee, the U.S. exporter can usually sell U.S. agricultural commodities to foreign buyers on deferred payment terms and nevertheless receive payment immediately after export.

The CCC's program is designed to expand U.S. agricultural exports by stimulating U.S. bank financing of foreign purchases on credit terms of up to 3 years. In every transaction, the foreign buyer's bank must issue an irrevocable letter of credit covering the port value of the commodity exported. The CCC's guarantee will cover most of the amount owed to the U.S. bank in case the foreign bank defaults.

Objectives

The Export Guarantee Program was created to:

- facilitate exportation;
- forestall or limit reductions in exports;
- permit exporters to meet competition from other countries; and
- increase commercial exports of U.S. agricultural commodities.

The Export Guarantee program is especially useful in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where private financial institutions would be unwilling to provide financing without the CCC's guarantee. The CCC does not wish to provide guarantees where commodities could otherwise be purchased for cash in the absence of the CCC's program.

An additional objective is to permit some countries with improved financial conditions to purchase on fully commercial terms. This would be particularly appropriate for countries that no longer meet P.L. 480 per capita gross national product limitations.

Eligible Countries and Commodities

Generally, the CCC's program targets countries where the guarantees are necessary to secure financing of the exports and where the destination countries have the financial strength to provide a reasonable expectation that foreign exchange will be available to make payments as scheduled.

In the past, the CCC's export programs were geared principally to bulk agricultural commodities. However, the CCC will now study requests on a case-by-case basis, rather than publish an eligible commodity list. Any agricultural commodity whose export furthers the CCC's long-range market

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development objectives may be considered.

A few countries are barred legally from participating in the program. These include countries barred by the Trade Act of 1974 and certain countries barred by executive order or U.S. Department of Commerce regulations.

Coverage

The CCC's guarantee covers most of the port value (f.o.b. value) of the commodity, plus a portion of the accrued interest. Following CCC approval of a request for guarantees from a foreign buyer or U.S. exporter, the precise percentages of coverage will be specified in a press release announcing the availability of the guarantees. (These percentages are also specified in each individual payment guarantee.) The CCC's guarantees may not cover maritime freight or other charges arising after export.

Procedures to Obtain Guarantees

The CCC will consider requests for guarantees submitted by private foreign buyers, foreign-government buying agencies, or U.S. exporters. The request may be submitted through the U.S. agricultural counselor or attache in the country of destination or may be submitted directly to the Assistant General Sales Manager, U.S. Department of Agriculture. The request should specify the commodity desired, quantity, estimated value, approximate shipping period, the credit period desired, and if available, the name of the foreign bank that will issue the letter of credit.

If the CCC decides that the request meets its market development objectives and other considerations and should be granted, it will issue a press release specifying the commodity, country, amount of coverage available, shipping deadline, guarantee rates charged by the CCC, and other pertinent information. The CCC must approve the foreign bank that will issue the letter of credit. The CCC leaves to the foreign buyer the responsibility to arrange financing with a U.S. bank. On request, the CCC will provide the names of U.S. banks that have participated in the program.

"The goal of [the Commodity Credit Corporation (CCC) Export Guarantee Program] is to insure that the risk of loss due to nonpayments by foreign banks may be transferred from U.S. exporters (or U.S. financing institutions) to the CCC."

U.S. Bank Financing

Often, a foreign buyer may arrange for financing with a financial institution in the United States prior to purchasing commodities from U.S. exporters. U.S. exporters must register these sales with the CCC and pay a guarantee fee at the time of registrations. The exporter must know the credit period in order to calculate the guarantee fee and must submit an estimated payment schedule for principal at the time of the sale registration. The guarantee rates used to calculate the guarantee fee will be listed in the CCC's press release.

Summary of Operation

Normally, after receiving approval from the CCC, the foreign buyer will arrange financing through a U.S. bank, purchase commodities from a U.S. exporter, and arrange for a letter of credit issued in favor of the exporter by a CCC-approved bank in the destination country. The exporter will register the sale with the CCC, pay the guarantee fee, and receive a payment guarantee. The exporter may immediately assign the proceeds payable by the CCC under the payment guarantee to the U.S. bank financing the transaction. The bank will notify the CCC of the assignment and the CCC will then acknowledge the assignment.

After shipment of the commodities, the exporter presents documents to the U.S. bank, assigns the account receivable to the bank, and receives payment for the port value of the commodities. The exporter will send the CCC a report of export and a payment schedule, including both principal and interest.

The U.S. bank will collect from the foreign bank according to the agreed schedule, as shown in the exporter's report of export. If the foreign bank fails to pay as scheduled, the U.S. bank may make a claim on the CCC, and assign the account receivable and obligation from the foreign bank to the CCC, and then the CCC will pay the U.S. assignee bank the amount covered by the payment guarantee. The CCC will attempt to recover amounts in default from the foreign bank and will allocate any collections to itself and to the U.S. bank on a **pro rata** basis, as the respective interests indicate.

Alternatives to the CCC

There two primary alternatives to the CCC. The first, using no insurance at all, avoids governmental limitations and fees. However, due to the risks involved in many countries, especially in the letter

Continued on page 18

foreign establishments can be used to perform a variety of functions, ranging from simple sales and marketing activities to full-scale manufacturing operations.

Legal issues frequently determine the appropriate vehicle for foreign investment. Foreign branches may be inadvisable since they could subject the entire company to the jurisdiction of the country where the foreign branch is located. While a subsidiary is often a desirable form of organization, local laws forbidding majority foreign ownership or offering tax or other incentives to locally-controlled companies may require or encourage using a joint venture. Joint ventures may also be an appealing form of direct investment from a commercial standpoint, allowing the foreign and local companies to combine their strengths and at the same time to share the initial capital commitments and risks.

Foreign investments pose a number of political and economic risks. Political risks arise from the submission of one's capital to the sovereignty of a foreign government. Expropriation is the most extreme of political risks. Actions such as imposition of price controls which limit the foreign operation's profitability, and exchange controls or other regulations which limit its ability to acquire foreign materials or to expatriate capital or profits, are more common. Economic risks include a downturn in the local economy, high inflation, exchange rate fluctuations, sharp changes in interest rates, etc.

One of the most common means of alleviating the special risks associated with foreign investments is to share such risks with another investor by means of a joint venture. Because the joint venture must cede certain control over the enterprise, it is crucial to document the relationship. Joint venture agreements should address the following:

- The purposes for which the joint venture is organized and restrictions on any expansion of such purposes

- The respective capital contributions, loans and other commitment required of the participants

- Appropriate control provisions and minority protection, including requirements for major transactions to be approved by both parties

- Restrictions on the transfer of interests in the joint venture and appropriate provisions for financial supervision of the joint venture

- Procedures under which the joint venture would be terminated and its assets liquidated

Direct foreign investment also requires consideration of local company laws, foreign investment laws, taxes, and antitrust laws. Because of its complexity, companies should seek appropriate advice before engaging in a foreign investment transaction.

All of the foregoing call for appropriate legal advice. A list of international lawyers in Wisconsin is in Appendix K of the *Handbook.*

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Ag exports cont. from page 15

of credit market, exporters should carefully consider the use of an insurance as well as their ability to absorb nonpayment.

The second alternative is the Foreign Credit Insurance Association (FCIA). FCIA has two programs to assist exporters and financial institutions in financing exports of bulk agricultural commodities: the Bank Letter of Credit Policy and its various short-term policies. These policies are open for all markets for which short-term insurance coverage is available according to the FCIA Country Limitations Schedule, and can only be used for bulk agricultural commodities of 100% U.S. origin.

There is one decided advantage to the FCIA programs: the CCC programs have a product limit,- an annual allocation established by the Foreign Agricultural Service. FCIA programs generally have no product limit.

Before deciding which program to use, a user should be familiar with differences between FCIA and the CCC in the terms of their policies, including: value covered, commencement of coverage, eligible buyers, form of payment, maximum principal and interest coverage, country limits, credit limits, repayment terms, uninsured portions, fees and claim waiting periods. Each of these factors may influence which program is more desirable.

According to the Foreign Agricultural Service, CCC funds are often fully utilized, especially in certain markets. Therefore, it is advisable to apply as early as possible to assure the availability of CCC funds. FCIA, on the other hand, has exposure limits set by its board of directors. The limits are a function of how FCIA views the country and foreign bank creditworthiness. Thus, while FCIA does not have a "country limit," it is also advisable to apply for coverage early so that your transaction will be included within FCIA's exposure limits.

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