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Payment Risks of International Transactions

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For exporters of goods and services, serious consideration must be put into balancing the potential benefits of providing favourable payment terms with the risk of payment default and the costs of international debt recovery.

It is beyond the scope of this article to cover all of the issues surrounding cross border debt recovery and insolvency, however, it is fair to say that this can often be a complicated, time consuming and expensive exercise.

Any exporters that provide payment terms on account should have debt collection procedures in place, which are specific to the type of transaction, type of client and contemplates enforceability of any judgments or awards in the countries in which the customer does business or holds assets.

Additionally or alternatively, exporters may choose to utilise factoring services to ensure cash flow remains positive in the short term.

FACTORING

Factoring typically involves a commercial arrangement between a business and a factor, whereby the factor pays to the business around 80% of the value of the invoices rendered by the business to its clients. The factor pays the 80% upfront and then recovers the amounts outstanding from the clients of the business. The factor's fee and debt recovery costs are taken out of the remaining 20% of the invoice value and the balance is paid to the business.

The above example is for illustrative purposes only and actual structure of the transaction may vary between factoring companies. This arrangement is one way to mitigate against payment risk and maintain high levels of cash flow in the business rather than waiting 30, 60, 90 or 120 plus days for payment.

Obviously, the business incurs the cost of the factor's fees, which would need to be weighed up against the need for immediate cash flow and the acceptable level of payment risk for each particular business.

TERMS OF TRADE

It is essential that importers and exporters select appropriate terms of trade which are congruent with the level of payment risk that each party is satisfied with. It is commonplace for international trade contracts to include incoterms, such as: Ex-works, FOB, FAS, DDP, etc, which incorporate particular contractual conditions relating to:

- timing of payment;
- responsibility for payment of transportation, insurance and duties; and
- the time for passing title to and risk in the goods.

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Parties to international trade contracts must ensure that they fully understand the implications of any terms of trade, including any incoterms, included in their contract and ensure that the contractual terms, particularly payment terms, do not leave them exposed to unacceptable risks.

I recently received an enquiry from a client who had unwittingly become liable for thousands of dollars in port storage charges due to a misunderstanding over the timing of payment. These issues can make the difference between a deal being profitable or unprofitable.

LETTERS OF CREDIT

A letter of credit, issued to the exporter by the importer's bank, substitutes the bank's credit worthiness for that of the importer. The letter of credit constitutes an assurance by the bank that the importer has funds at its disposal up to the limit specified in the letter of credit.

Letters of credit can be conditional and it is of particular importance to appropriately consider all of the conditions prior to entering into any binding agreements or shipping any goods.

As the bank's credit worthiness is the assurance being provided to the exporter, it is also important to consider the status of the bank itself and undertake sufficient due diligence to establish the legitimacy and credit worthiness of the bank.

SECURITY

One of the other common methods of mitigating against payment risk is to take security over the goods supplied or the buyer's interest in some other property. This typically takes the forms of:

1. a retention of title or romalpa clause;

2. a charging clause; and

3. a securitised guarantee.

Where the property in respect of which the security is given is "personal property", strict rules apply in relation to the creation, registration, perfection and enforcement of such security interests under the *Personal Properties and Securities Act 2009* (Cth) ("**PPSA**").

As the PPSA is Australian legislation, it will not apply to items of personal property which are outside the jurisdiction of Australia.

Accordingly, for the international sale of goods, consideration must be given to the points in time where the PPSA will apply to the goods whilst in storage or transit and when the PPSA ceases to apply to the goods.

REGISTRATION OF SECURITY INTERESTS

Retention of title clauses have been common place for many years as a means of securing payment for goods sold on credit terms and these clauses feature in most supply agreements.

One of the lesser discussed benefits of retention of title clauses is the ability to protect the brand value of your products in the event of a distributor or reseller of your product becoming insolvent.

Seeing your brand value diminished through the sale of your stock at a liquidation auction may add unnecessary insult to injury on top of lining up with other unsecured creditors in the hope of receiving some payment (often cents in the dollar, if anything) for the stock supplied.

Properly drafted retention of title clauses and early registration of the security interest created by such clauses could prevent this nightmare outcome for your business.

If you do not want your distributors and retailers to damage the value of your brand in an insolvency event which is outside of your control, you simply cannot afford to ignore the need to have a PPSA registration regime in place for your business, whether internally administered or handled by outsourcers.

We recently acted on behalf of an importer of a patented prefabricated building product with enormous potential application in the residential construction industry. The client was keenly aware of the potential for distributors and installers to damage the brand value of this unique product.

Our client had spent considerable time, money and intellectual resources in developing comprehensive training and operations manuals as well as the design of an internal certification programme for distributors and installers.

The client appeared deeply concerned by the prospect of seeing their products liquidated for cents in the dollar in the event of insolvency of any distributor or installer, quite aside from the payment risk associated with such an event.

There are some examples of brands losing so much brand value through the insolvency of a distributor that the continued viability of the brand itself was completely eroded.

There are strict deadlines for registration of security interests under the PPSA. Failure to comply with such

registration requirements will result in the essential loss of the right to enforce the security interest, including the recovery of possession of goods under retention of title clauses.

Accordingly, for the minimisation of payment risk and the protection of your brand value, it is paramount that your supply contracts are drafted to optimise the rights available to you (including the creation of security interests under the PPSA) and that you have an appropriate system in place for the timely registration of such interests on the personal property security register.

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