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# EXPORT-IMPORT BANKING

THE INSTRUMENTS AND OPERATIONS UTILIZED  
BY AMERICAN EXPORTERS AND IMPORTERS  
AND THEIR BANKS IN FINANCING  
FOREIGN TRADE

By

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OVERSEAS DIVISION

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LOVINGLY DEDICATED  
TO MY LATE WIFE  
HARRIOT SHATERIAN  
WHO HELPED SO DEVOTEDLY  
IN THE PREPARATION OF THIS WORK



## PREFACE

Two World Wars have definitely placed American manufacturers in the roles of exporters and importers. At the same time, American banks have expanded their facilities to meet the increasing demands of their clients for export-import services. Co-operation between the two groups can only be obtained when they understand and appreciate their respective requirements. The bank must offer and must explain to the merchant the various methods of financing foreign trade. The merchant must select intelligently the method best suited for a given operation. Both must understand the instruments to be used and the rights and liabilities created by the various forms of these instruments.

In 1917, when I first entered the Overseas Division of The National City Bank, the old foreign trade procedures were just beginning to change to those which are now followed. My twenty-eight years of service with the Bank thus gave me the privilege of taking an active part in the development of export-import banking in the United States. I believe that upon those of us who took part in this development devolves the duty of placing their experiences at the disposal of all persons interested in foreign trade and its proper financing. This belief has prompted me to prepare this book, in the hope that it will be of value to the exporter, importer, banker, and student. Since 1925 I have conducted classes at the American Institute of Banking, New York Chapter, on the subject of Foreign Department Operations, which covers all phases of the instruments and procedures utilized in financing foreign trade. This teaching experience has enabled me to determine which details require the fullest explanation.

The book is divided into three parts. Part I is intended to acquaint the reader with the development of our foreign trade as we know it today and the corresponding development of American banking facilities. Part II covers fully the instru-

ments used in export-import banking. Part III covers the operations of the three principal sections of a bank's foreign department in which the American foreign trader is particularly interested: buying and selling foreign exchange; discounting and making advances against dollar bills and attending to the collection of foreign bills of all types; and commercial credits.

Monetary, exchange, and shipping regulations of a temporary character which were imposed upon us by the necessities of war have been deliberately ignored. The fundamentals of export-import banking practices and procedures which were used before World War II, and which were used during the War (subject to war restrictions and controls), will be freely used in peacetime. These fundamentals are the things which I have endeavored to clarify.

My sincere thanks are given to the following gentlemen for their interest and helpful suggestions: Mr. Leo N. Shaw, Vice President and Manager, Mr. Wilbert Ward, Vice President and Mr. John L. Hogeboom, Assistant Vice President, all three of the Overseas Division of The National City Bank of New York; Mr. Joseph C. Rovensky, former Vice President and Manager of the Foreign Department of The Chase National Bank of the City of New York; Mr. James F. Brennan, Vice President, and Mr. A. E. Smith, of Rollins Burdick Hunter Co., Incorporated; and Mr. Charles S. Elder, of Chubb & Son.

W. S. SHATERIAN

Rutherford, N. J.

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PART I  
THE FOREIGN DEPARTMENT



# CHAPTER 1

## THE EVOLUTION OF FOREIGN BANKING IN AMERICA

Prior to World War I, almost the entire general export trade of the United States was handled by a dozen concerns, domiciled in New York, with ample credit structures, and with branches and representatives at the more important trading centers throughout the world. They had no goods of their own to sell but represented American manufacturers who, by contract, had given to these concerns exclusive export sales rights in designated foreign territories. Some of us will remember these concerns—Henry W. Peabody & Co., William E. Peck & Co., Arkell & Douglass, etc. The American manufacturer was quite satisfied to make his export sales to these exporting concerns and receive payment from them. His export sales differed from his domestic sales only in price and in packing. As a rule, export prices were lower than domestic prices and packing cases intended for overseas were of heavier boards, lined with waterproof paper and steel strapped. The packing specifications were given to the manufacturer by the exporting concern.

There were sound reasons for this system. Foreign buyers did not wish to send cash with their orders, nor were they satisfied that they would receive the exact goods ordered, if their order were accompanied by a bank draft payable in New York (cash), addressed to the manufacturer direct. On the other hand, the manufacturer was unwilling to extend terms to foreign buyers because, at that time, it was quite difficult to obtain in New York dependable credit information on foreign buyers. It was quite difficult, if not impossible, for American sellers and foreign buyers to become acquainted sufficiently well to enable them to do business with each other according to the patterns now generally followed.

At the turn of the century, therefore, our general export business was conducted along the following lines. The export house would make a contract with manufacturers for all export rights in a given territory, say, South Africa. The export house, which maintained a branch at Capetown, would send samples and catalogs of the manufacturers to its branch which, in turn, would obtain orders and address these orders to its home office in New York, indicating the identity of the buyers and the terms of sale, based upon the branch's knowledge of the standing of the buyers. The export house in New York would then prepare orders addressed to the interested manufacturers, indicating at the same time the required labels, packing, and other such details. The merchandise was then shipped to New York, with notice to the export house.

Upon its arrival in New York, trucks of the export house would take delivery from the railroad and deliver the cases to the dock. The manufacturers would immediately invoice the merchandise to the export house, allowing the usual discounts from the list prices as stipulated in the contracts between the export house and the interested factories, and the usual cash discount of 2 per cent for payment within 10 days of invoice. The export house would pay the factories in due course and the factories would consider the operations quite completed. Under this procedure, the factories were not interested in the credit standing of the ultimate buyers in Capetown or in the terms extended to such buyers by the export house. They were not concerned with the ocean shipping details, or with consular requirements or with marine insurance. The export house in New York did the real exporting. It obtained the ocean bills of lading, the consular papers, arranged for the marine insurance and did the billing as against the ultimate buyers. The export house also drew the drafts (orders for the payment of money), on the ultimate buyers and negotiated (sold or discounted) such drafts with banks in New York. If the particular lot of goods intended for a particular concern in Capetown were refused, the Capetown branch of the New York export house could sell the goods readily enough to another concern in that city.

What was the banking situation in these pre-World War I days? In the first place, American banks had very little credit information on foreign names. Very few persons were interested in such a service. The group of export houses depended almost exclusively upon the credit judgment of their foreign branches or representatives. The American banks, with very few exceptions, carried no accounts with foreign banks. They had no foreign branches and no foreign departments as we know them today. The National City Bank of New York was the first American bank to open a foreign branch (in 1914 in Buenos Aires) and was also operating in 1914 at a few other foreign points through International Banking Corporation, an affiliate. The majority of the larger New York banks would shy away from all foreign banking operations.

The situation would have been intolerable were it not for the fact that a group of British banks maintained agencies in New York and these agencies, having the facilities, obtained almost all of the foreign banking business then available in New York. These agencies had offices in London and at all other important commercial points to assist them. Moreover, much of the American export business was done in sterling rather than in dollars. Indeed, most sales to buyers even in South America were made in sterling and it was very common in those days to have the American export house draw 90 days sight sterling drafts on their buyers in Buenos Aires, payable by means of 90 days sight bankers' drafts on London, thus giving the buyers unusually long and attractive terms. The American manufacturer was not concerned with these long terms. He sold his merchandise to the exporting concern in New York and received payment from the exporting concern within 10 to 30 days of invoice.

World War I changed this situation at one stroke instead of permitting the change to take place gradually and in keeping with the growth of our export trade. Then, as now (following World War II), a scarcity of goods developed and the United States was about the only country in a position partially to supply the world-wide demand. The merchant in Buenos Aires was not satisfied to place his orders through the local branch of the American exporting concern, for the branch was not in a posi-

tion to make definite commitments as to quality, quantity, price or date of delivery. He came to New York, sought out factories which could supply him, called on such factories in person, deposited the required cash with the order, and agreed to be responsible for making the shipments from New York to Buenos Aires. The factories manufactured the merchandise, packed it for export, and delivered it to a warehouse in New York for account of the buyer.

In a picture of this character, there was no room for the exporting concerns in New York. The problem of the manufacturer was not one of finding foreign buyers; rather, it was one of trying to fill stacks of orders accompanied by cash or covered by commercial letters of credit addressed to him by good American banks which assured the manufacturer of payment against railroad bills of lading, or warehouse receipts, or ocean bills of lading. The manufacturer realized that, by dealing with the foreign buyers direct, he could obtain more profits and at the same time reduce the cost of the merchandise to the buyers. The larger manufacturers established their own export departments and began extending credit to their foreign buyers as the supply of goods caught up with and exceeded the demand for goods. The regularly established exporting concerns began to liquidate. They had largely outlived their usefulness.

This change was also reflected in the American banks in New York. The manufacturers expected their own banks to take care of the banking end of their foreign business instead of the New York agencies of foreign banks. The American banks met the challenge by establishing their own branches in important foreign trade centers, by strengthening their foreign correspondent relationships, by building up their credit information on foreign names, and by streamlining their own foreign departments, in order to take care of the foreign banking needs of their own clients. The growth of the foreign departments of the larger New York banks during 1917-20 was phenomenal. In a large measure these banks unconsciously took over the principal functions of the exporting concerns—the elimination of credit risks and the obtaining of prompt payment. The credit risk to the manufacturer was eliminated by dependable credit informa-

tion available at the American banks and by the facilities of commercial credits, while prompt payment was obtained by him through the discounting facilities of these banks. Moreover, the American dollar became the leading currency of the world and the foreign trade of the United States began being conducted in terms of dollars instead of largely in sterling as it was in the years prior to World War I.

It will be noted from the foregoing brief discussion that our foreign trade as being conducted today is comparatively new to thousands of manufacturers and bankers. Consequently, we still have a great deal to learn. Upon those of us who entered the field some twenty-five years ago and who have become enriched by our experiences since that time, devolves the duty of clarifying the operations in which all persons connected with foreign trade are interested.

At the close of World War II America is again the leading actual and potential supplier of goods to a world with empty shelves. Our foreign trade has revived tremendously. To export and to import successfully, it is necessary for us to have a good knowledge of the various forms of financing such business. The future may bring about changes, but we shall be in a better position to operate when we have a clear understanding of the fundamental practices of the immediate past. Fundamentals change very slowly.

## CHAPTER 2

### THE ORGANIZATION OF THE FOREIGN DEPARTMENT

The foreign department is only a part of the bank. It may be an important part of the organization, but there could be no foreign department unless there is first a successful bank, organized under our Federal or State laws and authorized to conduct a general banking business within the limitations imposed by law. The foreign department is organized and supervised by the general management of the bank—the board of directors, the president, and the cashier or secretary. As a rule, however, the directors and management officers of the bank are not in a position to give all of their time to the foreign department but delegate authority to a vice president or to a manager who, with the knowledge and approval of the management, organizes the department and makes it function.

The organization of the foreign departments of banks materially differs because of conditions inherently peculiar to each, and it becomes necessary to place them in separate classifications. First, let us consider the foreign department of a bank which carries no accounts abroad and which has no foreign branches. Such a bank may have accounts in dollars on its books in the names of foreign correspondent banks and in the names of foreign merchants. Not having foreign currency accounts abroad, it will not be in a position to buy and sell foreign exchange for its own account. It may, however, sell foreign currency drafts drawn by it under the protection of the fully equipped foreign department of another bank and it may also execute the other foreign department operations of its clients through such other bank. If the foreign department of a bank in this first category is favored with a large volume of foreign collections, it can forward them to banks abroad for collection.

In time, perhaps, it can induce some of the foreign banks enjoying this collection business to open dollar accounts on the books of the remitting American bank. Commercial credits covering exports are not apt to be advised to the American beneficiaries through such a bank, and it will not be in a position to issue its own commercial credits in cover of import operations because neither the foreign shippers nor their local bankers may have sufficient knowledge of, or confidence in, an American bank of this class.

What classes of operations, then, may such a foreign department conduct? Hardly any for its own account, but it can make arrangements with another bank which has a complete foreign department and put through this other bank all operations of such character. For instance, it can endorse to and enter for collection with the larger bank all bills, drawn in U. S. dollars, payable in foreign countries. It may discount or make advances against such bills. It may request the larger bank to establish import commercial credits for account of its importing clients, and the larger bank may utilize the facilities of the smaller bank to advise the beneficiaries of export credits when such beneficiaries are located nearer to the smaller bank. It may obtain credit reports on foreign merchants and reports on conditions abroad from the larger bank for the benefit of its clients.

It is quite obvious, however, that the smaller bank cannot continue to give such second-hand service to its clients unless they are concerns too small to maintain direct contacts with the larger banks and are willing to pay the smaller bank an extra commission here and there in order to be able to obtain such indirect but good service. To handle operations in this manner the foreign department of the small bank, which is made up of from one to three persons, must be staffed by men who have a good knowledge of documents and of foreign banking technique so that they can be helpful to their own clients and clearly understand the requirements of the larger banks which consummate the operations. It is highly dangerous for such a small foreign department to attempt to bluff its way and a candid appreciation of the respective positions of all concerned will be most conducive to its successful operation. Such a foreign department

does not make money for the bank, but operates more in the nature of a service department.

Let us now consider the organization of the foreign department which is equipped to handle all classes of operations but has no branches in foreign countries. We have such banks in all of the principal cities in the United States. Such a department is again under the supervision of the general management of the bank. It is usually in direct charge of a vice president or manager who, in turn, is assisted by a number of other vice presidents and junior officers.

The operations are actually consummated by a number of sections or sub-departments, each in charge of a trained man who may or may not be a junior officer. As a rule one man, with one or more assistants, is in charge of the section buying and selling foreign exchange. This is perhaps the most important section of the department because in normal times it has almost unlimited possibilities for profits—and losses, too—and requires management well steeped in the intricacies of foreign-exchange trading. This section is sometimes called the Foreign Exchange Department or the Traders Department and the men in charge are called traders—they trade in foreign exchange which consists of orders for the payment of monies foreign to us.

To buy and sell foreign exchange, the trader must have abroad accounts in the currencies of the respective foreign countries. As the trader purchases sterling exchange, it is credited to his sterling account in London, and that same account is debited by his London correspondent whenever the trader sells sterling and the exchange sold is presented to the correspondent for payment. The balance in the account represents the trader's stock in trade.

When the trader opens an account abroad, it is only natural that the foreign bank should reciprocate by opening a dollar account on the books of the trader's bank. This reciprocal arrangement is made, however, only with countries whose currencies are bought and sold in volume in the American market. The trader will not wish to open a foreign currency account unless he can use it by frequent purchases and sales. Otherwise, he may be caught with an amount of a particular exchange for

which there is no good demand and which can be sold only at a loss.

The department will also have a number of senior officers who are in charge of certain geographical segments of the world, who keep in touch with all conditions in their respective territories, and who supervise the business of the department in and from such territories. These are the men who solicit dollar accounts from foreign bankers and merchants. These are the men who confer with the domestic clients of the bank interested in foreign trade. These are the men who, with the co-operation of the domestic officers of the bank, solicit business for the department.

The actual operating units of the department, as a rule, are in charge of a junior officer or chief clerk whose job is to supply the necessary personnel and tools to the operating sections. The number of sections will depend upon the volume handled, but the following units are generally found:

- Commercial credits, import and export
- Collections payable abroad; discounting or making advances against such collections
- Tellers' work,—issuing drafts sold by the trader; making transfers to points abroad; making domestic payments for account of foreign clients; receiving deposits for the credit of foreign accounts, etc.
- Foreign collections payable within the United States and covering American imports
- Telegraph and cable
- Translators

There may be other units which serve both the domestic and foreign sides of the bank, such as:

- Credit information
- Bookkeeping
- Travelers' checks and travelers' letters of credit
- Incoming mail
- Outgoing mail

Custody of securities  
Signature control  
Test words  
etc. etc.

Each bank will set up its operating units in a manner best suiting its requirements, taking into consideration the volume of business and the availability of personnel and space.

The third type of organization of the foreign department is the one similar to the preceding type except that it also takes into consideration a number of branches in foreign countries and their supervision. Obviously the more foreign branches an institution has, the larger must be its officers and staff who are charged with the duty of controlling and supervising the many and varying activities of such branches. Suitable buildings must be purchased, leased, or constructed in foreign countries. The branch officials must be selected at Head Office and sent out from Head Office. Members of the staff to occupy key positions at the branches are similarly supplied. The capital of each branch must be determined, taking into consideration local taxes and the probable needs of each branch. While the branch management is given discretion to engage in operations involving the extension of a limited amount of credit without obtaining the prior approval of Head Office, such operations must be reported to Head Office as well as all applications for credit involving amounts in excess of the discretionary limits set for the branch management.

While each branch is a complete and separate banking unit, the branches look to the foreign department at Head Office for instructions and guidance exactly in the same manner as the foreign department is controlled by the general management of Head Office—the board of directors, the president, and the cashier. As a rule, the Head Office officer who has charge of the bank's business say, in and with Brazil, will also be in charge of the branches which may operate in Brazil. At times, however, the supervision of branches is placed in still other hands, especially when the branches are large in number and consequently have many problems to submit to Head Office.

As there is no uniformity in the organization of foreign departments, and as the larger departments are made up of many people, the American merchant dealing with them should become well acquainted with two or three key men in the foreign departments of the larger banks so that he may contact them as occasion arises, to ascertain the correct section and the identity of the right man in such section with whom he may wish to take up a given problem. While the telephone operators of a bank are trained to know the functions of every department and section of the bank and of their key men, they are primarily telephone operators and much annoyance and loss of time will be avoided were the merchant in a position to contact an officer or senior employee who knows the bank thoroughly, one who can promptly put the merchant in touch with the right man to hear the merchant's story and to offer the required solution. This procedure brings the big foreign department and the merchant much closer together and gives the merchant a proper introduction to and knowledge of every section of the foreign department. It is also welcomed by the banks themselves which are anxious to take care of the requirements of their clients both quickly and properly.

## CHAPTER 3

### THE RELATION OF THE FOREIGN DEPARTMENT TO THE BANK AS A WHOLE

In almost every city and town in the United States we find manufacturing concerns which are actively interested in foreign trade. These concerns maintain relations with their local banks and the larger among them also carry accounts with the banks in our larger cities which maintain foreign departments. An American business now expects its bank to extend to it not only the usual facilities incident to domestic banking but also the special facilities required in the conduct of foreign operations. This dual service cannot always be rendered by one and the same bank and the sooner this situation is admitted the more harmoniously all interested parties can operate. A factory in Piqua, Ohio, requires the services of a local bank for payroll purposes, for its deposit facilities, and for the payment of its ordinary current bills. It would not wish, for instance, to make payment to a local plumber by means of a check drawn on a New York bank. On the other hand, the same factory may require the facilities of a New York bank which specializes in foreign banking, and will carry an account with such a New York bank to collect its foreign bills, to open commercial credits covering import operations, and to keep in touch with conditions abroad.

If the cash position of the factory does not entitle it to the services of two banks, the one for its domestic needs and the other for its foreign needs, it may as well admit that fact and make the best possible arrangements with its local bank for obtaining the facilities of a bank in a large trade center with a good foreign department. The local bank, in all probability, carries an account with the larger bank and can obtain its special

foreign department facilities for the local factory. It would be well, also, for the local bank frankly to admit its own lack of facilities for foreign business but impress upon the local factory that these special services are available through the bank's larger correspondent bank in New York, Chicago, or Boston. There is enough glory for all. The big bank in New York cannot possibly extend to the Piqua factory the services which that factory receives from its local bank. The local bank is equipped to extend to it the foreign facilities of the New York bank.

The export manager of one of our largest concerns manufacturing grinding wheels told the author some years ago that it was the grinding wheel which made the automobile possible. So it is with our foreign trade. Without the local bank, the Piqua factory would find it difficult to operate. Without the factory, there would be no foreign business for the New York bank. Those who work in the foreign departments of these institutions should be proud of the part they play in the development of our foreign trade. The foreign department, when properly organized and operated, becomes the best asset of the large city bank. Here are some of the reasons for this broad statement:

The bank with a good foreign department is in a position to obtain new desirable depositors who need such special facilities. X Company in Piqua is interested in foreign trade. The representatives of Bank A located in Chicago and of Bank B located in New York, periodically call on X Company and solicit accounts for their respective institutions. Both banks are very highly regarded in the domestic field of banking. Assuming Bank A maintains a well-established foreign department while Bank B does not but takes care of its foreign operations through the facilities of another and larger bank, it is quite evident that when X Company is ready to establish an out-of-town account, it will be established with Bank A—the bank equipped to give directly both domestic and foreign banking facilities.

The foreign department holds customers already on the books of the bank. We have in New York, for instance, many banks which conduct a purely domestic business. They may have

among their depositors a number of concerns interested in foreign trade. It will only be natural for such concerns to transfer their accounts to another bank with a foreign department when their standing becomes sufficiently large to make their accounts attractive to the larger bank. This situation will not arise if the first bank maintains a good foreign department.

The foreign department is a wonderful training ground for bankers. The personnel of the foreign department must not only know all the details of the business on the domestic side, including a good knowledge of commodities, but also must be expert in economic, social, and political conditions in all foreign countries, must have knowledge of all the foreign exchanges, and must understand thoroughly the unusual technical services offered by the foreign department. While a man trained in the foreign department can readily enough be transferred to the domestic side of the bank, the reverse is not always true.

The earnings of the foreign department need not be negligible. While the buying and selling of foreign exchange is not child's play, it may be done without risk if the trader operates conservatively. The foreign exchange trader may have \$40,000. with which to operate. If he buys £10,000. at \$4.00 to the pound, and sells it out immediately at \$4.00½, he has made ½ cent on each pound, or \$50. on the £10,000. Now, if he can repeat this operation ten times during the business day, selling out his last purchase of £10,000. at 4:00 P.M. he will finish the day with his \$40,000. in hand and with a gross profit of \$500. for the day. Profits without risk may be made in collection commissions and in commissions incident to some forms of commercial credits. Loans made in the foreign department, in the form of discounting or of advances against foreign bills, usually command higher rates of interest than the loans made on the domestic side. If the bank with a foreign department also operates branches in foreign countries, such branches are supervised by the foreign department and their profits are reflected in the earnings of the foreign department.

All this leads to the conclusion that the foreign department can be made a very important part of a bank. But this is true

only if it is properly organized and staffed by officers and clerks who thoroughly understand its many problems and ramifications. A poorly organized and staffed foreign department is a liability to the bank and a nuisance to its clients who require foreign banking services.



PART II

INSTRUMENTS AND TERMS USED IN THE  
FOREIGN DEPARTMENT



## CHAPTER 4

### THE BILL OF EXCHANGE

**Definition.**—The Negotiable Instruments Law defines a bill of exchange as follows:

A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time, a sum certain in money, to order or to bearer.

**Typical Form of the Bill of Exchange.**—Examine closely Form 1, which is a typical form of bill as drawn on a blank furnished by Guaranty Trust Company of New York to its clients who draw bills on persons residing or doing business

10-11-1936	100 William Street, New York, N. Y., May 1, 1947	FORM T-1117
\$ 5084.16 U.S. Currency		
Ninety (90) days after eight of this FIRST OF EXCHANGE		
(Second unpaid) pay to the order of Guaranty Trust Company of New York		
Five thousand eighty four and 15/100 Dollars, U. S. Currency		
payable for face amount by prime Banker's sight draft on New York, New York		
Value received and charge to account of		
To Butler Import Co., Ltda.,		
Calle Gomez 15, Buenos Aires, Argentina		
No. 184	American Export Corporation	John J. Trout, Treasurer

Form 1. Typical Bill of Exchange Drawn on Form Supplied by Guaranty Trust Company of New York to Its Clients

in foreign countries. In examining Form 1, be sure to note carefully how each and every requirement of the legal definition has been met. The phrases not required by the definition are discussed later.

**The Parties to the Bill of Exchange.**—The word “person” as used in the foregoing definition applies to corporations, partnerships, and trade names, as well as to natural persons.

The drawer or maker of the bill is the person who has issued it. The drawer of our typical bill is American Export Corporation.

The drawee is the person to whom the bill is addressed, such as Butler Import Company, Ltda. He is the one who is to pay it and, in the case of a time bill (a bill payable at a determinable future time) to formally accept the bill when it is presented to him for acceptance and ultimately pay it at maturity.

The payee is the person to whose order the bill is drawn payable—Guaranty Trust Company. The payee is the person to whom the drawee is to pay the funds mentioned in the bill.

The endorser of the bill is any person who has placed his name on the back of the bill, thus indicating that he has acquired title to the bill and is to receive the payment either for his own account or for account of the original payee or for account of another person from whom he, himself, has obtained title. For instance, should Guaranty Trust Company desire to forward our typical bill to X Bank of Buenos Aires for collection, Guaranty would endorse on the back of the bill:

Pay to the order of  
X Bank of Buenos Aires  
Guaranty Trust Company of New York  
John Jones  
Assistant Secretary

The X Bank of Buenos Aires becomes the endorsee of the bill. Guaranty Trust Company, which is the payee of the bill, is now an endorser also. Every endorsee becomes an endorser when he, in turn, places his name on the back of the bill, for the purpose of passing title.

**The Usance or Tenor of the Bill.**—The phrase indicating the time of payment is called the usance or tenor of the bill. In our typical bill the usance is “Ninety (90) days after sight.” The number of days involved is usually indicated both in numerals and words.

**Drawing the Bill in Duplicate.**—Bills issued in connection with foreign trade are usually drawn in duplicate, the original being known as the “First of Exchange” and the duplicate copy as the “Second of Exchange.” Appropriate mention is made in both copies that the copy at hand is good only if the other copy has not been utilized. The purpose in drawing such bills in duplicate is that the shipping and insurance documents which are also drawn in duplicate or triplicate may be split up into sets with a copy of the relative bill attached to each set, after which the two sets of bills and documents are forwarded for collection by separate mails. If one set is lost or delayed in transit, the second set should arrive at the foreign point soon thereafter, thus reducing delays in clearing the merchandise and in collecting the corresponding bill. The law does not require, however, that bills be drawn in duplicate and the custom has come about by commercial usage.

**The Form of the Bill—Conflict of Laws.**—While the Negotiable Instruments Law does not give us a sample of the words to be used in drawing bills, our typical bill is the form uniformly accepted by our courts, banks, and merchants as being quite adequate. All the requirements and conditions contained in the legal definition of a bill of exchange must be in the form of the bill and they are in our typical bill. Any omission is fatal. Any addition may make the instrument worthless as a bill of exchange. If the prescribed conditions are not fully met, we have on our hands not a bill of exchange but something nameless which only resembles a bill.

Bills drawn in international trade generally involve two sets of laws which may or may not be similar—the relevant laws of the drawer’s country and the relevant laws of the drawee’s country. There is a marked similarity between the Uniform Negotiable Instruments Law of the United States and the Bills of Exchange Act of Great Britain. Many of our American laws are patterned after the corresponding British laws. The British law is also followed by the British Commonwealth of Nations and by the British colonies. This similarity, unfortunately, does not extend to the other countries of the world which, in

general, follow civil codes based upon French laws promulgated in the days of Napoleon and popularly called the Code Napoleon. This conflict, happily, is not such a serious matter for the reason that the form of the instrument will be questioned only when the bill is dishonored and becomes the object of a lawsuit.

A bill payable at sight or on demand seldom can become the object of a lawsuit between the drawer and the drawee. You may, out of sheer devilry, draw a sight bill on Butler Import Co., Ltda., of Buenos Aires and Butler will properly decline to pay it. You may carry your devilry further and wish to sue Mr. Butler's company for the value of the bill but no lawyer would take your case unless you can allege facts and circumstances which made the company your debtor and the desired lawsuit must be based upon such facts and circumstances and not upon the unpaid bill. If you have sold some merchandise to Jose Garcia of Buenos Aires and have covered the sale by a sight bill, should Garcia refuse to pay the bill, you must sue him on the contract of sale and not on the dishonored sight bill. It follows, therefore, that the form of a sight bill drawn in the United States on a foreign drawee may properly follow the requirements of American law and the possible conflicting requirements of the drawee's country may be ignored.

The same reasoning and conclusion may be applied to a bill payable so many days after sight or after date, if the bill has been dishonored by non-acceptance. We may draw time bills on any one whose name we may fancy, but our unwarranted action cannot possibly create any liability upon the part of the drawee whose name we have fancied. If a time bill is dishonored by non-acceptance and we wish to recover the value of it by a lawsuit, our action, just as in the case of a dishonored sight bill, must be based upon the facts and circumstances in cover of which the time bill has been drawn. The bill and its form will not be reviewed by the courts of the foreign drawee because the suit is not on the time bill which has been dishonored by non-acceptance.

Should the time bill be duly accepted by the foreign drawee but dishonored by non-payment at maturity, the lawsuit against

the defaulting drawee is based upon the dishonored acceptance and not upon the facts and circumstances in cover of which the bill was created by the drawer. When the time bill was presented to the drawee for acceptance, he was privileged either to accept or refuse to accept it. By placing his formal acceptance on the bill, he has served notice on all interested parties that he approved the underlying facts and circumstances, that he considered himself indebted to the drawer for the amount of the bill and that, at maturity, he would pay the bill. This is the only time when foreign courts are called upon to pass upon the sufficiency of the form of the bill.

Of course, if it were possible for American drawers to have full knowledge of the requirements of all the different countries upon which they may have occasion to draw time bills, and also to have assurances that the legal requirements once learned have not been changed, it would be advisable to draw such bills within the requirements of the foreign jurisdictions involved. But if a bill is drawn within the legal requirements of the drawee's country, it may not be within the requirements of the drawer's country. It is absolutely essential, therefore, that the bill be drawn strictly within the current requirements of the drawer's country to avoid having on our hands an instrument which is not a true bill of exchange as defined by either American law or by the law of the drawee's country.

To avoid such a contingency, it is well established in international law that if an act prescribed by law has been properly consummated in the country of origin, it will receive judicial recognition in the courts of other countries. For instance, if an American drawer has drawn his export bill strictly within the requirements of American law, the instrument should be considered as sufficient in the courts of the drawee's country, even though it may be slightly insufficient within the requirements of that foreign jurisdiction. It is possible, of course, that some foreign courts of inferior jurisdiction may not follow this rule, thus necessitating the carrying of the case by appeals to higher courts. But this danger seems to be less important than the danger of creating an instrument which may be defective in the

jurisdictions of both the drawer and the drawee, and it becomes indispensable that American exporters use extreme care in drawing bills payable abroad to make sure that such bills meet our own legal requirements and are not made insufficient or valueless by the careless addition of phrases or instructions which tend to violate the simple conditions prescribed for bills of exchange by our Negotiable Instruments Law.

**Negotiation.**—A bill of exchange properly drawn within the requirements of the Negotiable Instruments Law is a negotiable instrument. We negotiate such an instrument when we sell it to someone or discount it with someone. If the payee of a bill endorses it to the order of a bank so that bank may collect the bill as his agent and for his account, the bill is not negotiated but merely endorsed to the bank for the specific purpose of collection. However, should the drawer discount the bill with the payee (Guaranty Trust Company in our typical bill) we say that the drawer has negotiated the bill to the payee. Similarly, should the payee wish to rediscount the bill, we say that the payee has negotiated it to the institution making the rediscount. Properly speaking, only negotiable instruments can be negotiated.

**The Advantages of a Negotiable Instrument.**—When a bill of exchange, which is one of several instruments defined by law as being negotiable, is negotiated, the party to whom it is negotiated takes the paper free from any counter-claims which the drawee may have as against the drawer. When a bank discounts an accepted bill before its maturity and gives the proceeds thereof to the negotiator, usually the drawer, and has no knowledge of any fact which may justify the drawee to dishonor it, the bank becomes a “holder in due course” or “an innocent holder for value” and may collect from the drawee even though the drawee may have at the time of maturity a valid reason for not paying the bill or may have a greater claim against the drawer. A negotiable note, which is also a negotiable instrument, will perhaps best illustrate this point.

Assume John Smith, a carpenter, owes Benjamin Brown, a grocer, some \$100. for groceries. Carpenter Smith cannot pay

grocer Brown immediately but he does give the grocer his own negotiable note for \$100. payable sixty days after its date of issue. The grocer, needing cash, discounts the note with his bank. Some thirty days later, the carpenter does some work for the grocer to the value of \$75. But grocer Brown fails before carpenter Smith can collect this amount from him. When the note matures the bank presents the note to Smith for payment, but Smith says Brown owes him \$75. and offers to pay the bank \$25. only, representing the difference between what he owed Brown and what the now bankrupt Brown owes him. The bank states that it is "an innocent holder for value," and is not concerned with any claims which carpenter Smith may have against grocer Brown. The courts will sustain the position of the bank. Now, were the note non-negotiable the bank would have been obliged to settle for the \$25. difference because the principle of the "innocent holder for value" applies to negotiable instruments only, as the assignee of a non-negotiable instrument (a claim, for instance) takes the claim subject to all rights which the debtor may have against the assignor.

It may be well to mention here, moreover, that the principle could not apply if the note had not been discounted but held by the grocer. He, the grocer, would not have been "an innocent holder for value" but an actual party to the transaction, and the carpenter would have been permitted to deduct from the value of the note the \$75. which the grocer owed him. Of course, were the note not in negotiable form, the bank would not have knowingly discounted it. As a matter of fact, bills and notes could not be freely negotiated were it not for this principle of "innocent holder for value" as no one would wish to discount a note or a bill of exchange unless he were assured that the debtor could not defeat its collection by counter-claims which the debtor may have or may acquire before the maturity of the obligation, as against his original creditor.

The second advantage of negotiable instruments is that the same laws which create and define such instruments also provide special provisions which simplify all problems which arise in connection with them. The rights of the parties are clearly defined. The claim of the holder is in the best possible form for

legal prosecution against the drawee or any endorser who may be liable for the payment to the holder. In suing, the plaintiff merely offers the dishonored note or accepted bill to the court as his evidence and rests his side of the case. It is incumbent upon the defendant to justify his refusal to pay. The burden of proof is thus shifted from the plaintiff to the defendant. It is quite important, therefore, to use utmost care in drawing, negotiating, and endorsing instruments intended to be negotiable so that they may not lose their negotiable character in the eyes of the law and deprive the holder of these advantages.

The title to a non-negotiable instrument cannot pass by mere endorsement but must be assigned either by the use of a short form of assignment placed on the instrument or by the use of a separate instrument. The assignor gives to the assignee the exact title which he has, subject to all counter-claims which the debtor of the instrument has against the assignor. If the assignee sues the debtor, he stands in the shoes of the assignor and must justify the existence of the claim against the debtor exactly in the same manner as the assignor would have been obliged to do were he, himself, conducting the lawsuit against the debtor. The assignee acquires no rights against the debtor which are superior to or different from the rights which the assignor has against the debtor and, under these circumstances, the debtor may defeat the assignee's suit by proving that he owes nothing to the assignor or, perhaps, has a greater counter-claim against him. Because of all this, banks do not purchase or discount non-negotiable instruments.

### **Legal Requirements of the Bill of Exchange**

We are now prepared to examine the bill of exchange more closely and especially its legal requirements, as indicated in the legal definition quoted at the commencement of this chapter. These requirements must be fully met if the instrument is to be a valid bill. While the average debtor will readily enough pay the bill drawn against him by his creditor irrespective of its form, should the instrument become the object of a lawsuit, the

courts must decide if it is, in fact, a bill of exchange, subject to the special laws applicable to bills.

**The Bill of Exchange Must Be an *Unconditional* Order.**—The bill of exchange is an order—a command—and not a request. While we oftentimes lean backwards in our endeavor to be polite and courteous in our business correspondence, when drawing bills we never use the word “please.” The check which you draw against your bank reads “Pay to the order of \_\_\_\_\_” and not “Please pay to the order of \_\_\_\_\_.” This idea of an order is further strengthened by the fact that it must be unconditional. Were the payment of a bill to be made contingent upon the happening of an event or the fulfillment of a specified prerequisite, it could not be negotiated as the holder for value must first be satisfied that the indicated condition has been fulfilled before he could collect the value of the bill from the drawee.

This requirement is usually violated by the drawer when he innocently makes the payment of the bill conditional by inserting in the space intended for the usance, phrases such as “On arrival” or “On arrival SS Baltic” or “After clearance.” Obviously, the drawee of such a bill could not possibly be compelled to pay the bill unless the merchandise had arrived, or the ship carrying it had arrived or unless the drawee had, in fact, cleared the merchandise.

Again, a bill may be made conditional, and therefore worthless as a bill of exchange, by indicating thereon the particulars of the shipment or of the merchandise. A notation may be on a bill reading “100 bales cotton ex steamer Mary Jane.” It is hard to determine the intention of the drawer who has placed such a notation on the bill unless it be that the drawee need not accept or pay it unless he has, in fact, received the 100 bales of cotton ex steamer Mary Jane. But this is the interpretation farthest removed from the mind of the drawer, who in all probability would wish to negotiate the bill; he could not negotiate it if its honoring were to depend upon any such contingency or prerequisite. It is highly important, therefore, that no

notations appear on a bill which may possibly make the order conditional.

**The Bill of Exchange Must Be in Writing.**—It is easy to understand why an oral order could not be a bill. The law does not stipulate, however, the form of the writing. It may be typed, in handwriting, or printed. Neither does it stipulate any particular language or languages to be used in drawing bills. While the Negotiable Instruments Law of New York State presumes that the English language, the official language of the State, is to be used, a bill drawn in New York State in a foreign language will be deemed to be a true and sufficient bill of exchange providing it otherwise meets all the specified requirements of the legal definition. May a true bill of exchange be drawn in pencil? Yes, because the definition does not prohibit it. But the courts have properly held that no prudent man would attempt to create a bill by drawing it in pencil and if he does elect to act so imprudently he must not complain of adverse consequences resulting from unauthorized changes made in the terms and parties of the instrument as originally issued, drawn in pencil. Again, the negotiability of such a bill is made almost impossible, since no purchaser could be reasonably certain that the instrument has not been and may not be wrongfully altered.

**The Bill of Exchange Must Be Addressed by One Person to Another.**—We have already indicated that the word "person" as used in the definition of a bill of exchange applies to corporations, partnerships, and trade names, as well as to natural persons. Moreover, a bill may be drawn *jointly* against two or more persons, but cannot be drawn against two or more persons in the alternative or in succession. For instance, while a bill may be drawn against A *and* B, it cannot be drawn against A *or* B, as the latter form would create uncertainty as to the identity of the drawee and the holder of the bill would not know if he is to present it to A or to B.

The identity of the drawer and drawee is made more certain, moreover, by indicating their addresses. If the drawer utilizes a bill form printed specially for him, in all probability his name and address (his business card) are printed on the form.

If not, the drawer's full address should be indicated in the date line. The full address of the drawee, including his street address, should be indicated on the bill, and particularly so in the event the drawee has a common name or conducts his business in a large city. The drawee must be clearly identified. The documents, including commercial invoices, which may be attached to a time bill are usually surrendered to the drawee when he has formally accepted the bill while the accepted bill, without the benefit of the required addresses which appear in the invoices, may pass through several hands until its maturity date and these intermediaries may be required to get in touch with the drawer or drawee before the bill matures. If the bill is dishonored and is to be protested, the notary also requires the full addresses of the parties to the bill for the purpose of mailing out his notices of protest.

**The Bill of Exchange Must Be Signed by the Person Giving the Order.**—Actual signatures, made in pen and ink, are required. No difficulty arises if the drawer of the bill is an individual. He just signs it. When bills are drawn by corporations, however, the corporate signature must correctly appear at the bottom of the bill. Who may or who may not properly make the corporate signature depends upon the board of directors of the corporation. The board may, by suitable resolution, limit the signing authority to the officers of the corporation, to be exercised individually or jointly, or the board may grant authority to certain employees, such as the cashier, the export manager and his assistant, or to the bookkeeper or other senior clerk, to issue bills in the name of the corporation.

A bank will not usually question the validity of the corporate signature appearing on a bill unless it is called upon to discount the bill or to make advances thereagainst. Under these circumstances the bank will wish to be assured that the corporate signature has been made pursuant to corporate authority (duly adopted resolutions of the board of directors) so that the corporation cannot question the binding force of the instrument upon it. While the name of the corporation may be printed or typed, the person making the corporate signature must sign in

pen and ink, and designate his title or authority immediately after or under his personal signature, as follows :

Corporate signature as made by an officer.

American Export Corporation	(printed or typed)
John Sullivan, Treasurer	(name in handwriting)

Corporate signature as made by an authorized employee.

American Export Corporation	(printed or typed)
per pro Henry Smith	(name in handwriting)

or

American Export Corporation	(printed or typed)
Henry Smith, Attorney-in-fact	(name in handwriting)

or

American Export Corporation	(printed or typed)
Henry Smith, Export Manager	(name in handwriting)

If the bill has been signed by Henry Smith as export manager or other similar titles, such as credit manager, cashier, etc., the bank handling the bill must be satisfied that he has been authorized, in fact, by the board of directors, to issue bills in the name of the corporation, especially if the bank acquires a financial interest in the bill by purchase, discount, or advances.

When bills of exchange are issued by partnerships, the partnership signature may be made by any of the several partners and the personal signature of the signing partner need not appear in the firm signature. Because of this, the partnership signature is not usually typed or printed but is made in the handwriting of each partner who, under the partnership agreement, is authorized to make the partnership signature and lawfully bind the partnership. Assuming we have under consideration a partnership designated as John Adam & Sons, and composed of three partners, John, Henry, and Louis Adam, any of the three may make the partnership signature in his own handwriting by merely signing as John Adam & Sons. At times, however, partnerships supply the firm name in the same manner as a corporation, that is to say, the name of the partnership is printed or typed and followed by the actual signature of the particular partner making the firm signature, either with or

without the notations "General Partner," or "Special Partner," or "Partner." It is also possible for a partnership to grant authority to non-partners to make the partnership signature under specified conditions and this phase is handled and utilized exactly in the same manner as the authorized agents of the corporations, except that the authority is granted to the agent by a member of the firm instead of by the board of directors.

Partnership signature as made by a partner :

John Adam & Sons	(in handwriting)
or	
John Adam & Sons	(printed or typed)
Louis Adam, General Partner	(name in handwriting)

Partnership signatures as made by an authorized employee :

John Adam & Sons	(printed or typed)
per pro Henry Smith	(name in handwriting)
or	
John Adam & Sons	(printed or typed)
Henry Smith, Attorney-in-fact	(name in handwriting)
John Adam & Sons	(printed or typed)
Henry Smith, Export Manager	(name in handwriting)

If the bill has been signed by Henry Smith as export manager or other similar title, the banks handling the bill must be satisfied that he has been duly authorized by the firm to use the firm signature, especially if they have acquired a financial interest in the bill.

**The Bill of Exchange Must Be Payable on Demand or at a Fixed or Determinable Future Time.**—This is one of the more important requirements. Without a definite time element, such instruments could not be negotiated because the banks which purchase or discount bills would not know when they are to receive reimbursement by collecting the bills from the drawees. If a bill is drawn payable on a certain future date, say, December 1, 1947, the time of payment is definite. If drawn payable "at sight" or "on demand," it is still definite because payment is to be made as soon as the instrument can be presented to the drawee. The payment date is also certain when a bill is drawn payable "——— days after date." If a bill is drawn

payable "——— days after sight," its payment date is determinable, the understanding being that the drawee will accept the bill as soon as it can be presented to him for acceptance and the stipulated time will commence to run from the date of such acceptance. When a bill drawn payable "——— days after sight" is accepted, the date of acceptance is the date when the bill is "sighted."

The validity of a bill of exchange is entirely lost, however, when the date of payment is made uncertain or indefinite by the addition of problematic instructions or contingencies. This is often done when the usance is indicated by such phrases as "on arrival" or "on arrival of merchandise" or "on arrival of steamer 'America,'" etc. It may be the intention of the drawer that the presentment of the bill to the drawee is to be deferred until the corresponding merchandise has arrived at the home port of the drawee-buyer. But suppose the steamer is considerably delayed in transit or perhaps never arrives at its intended destination? What will be the status of the bill in the hands of a bank which has bought or discounted it? Obviously, a formal presentment cannot be made because the stipulated condition, "on arrival of the steamer 'America,'" has not been fulfilled. In most instances the safe arrival of the merchandise has nothing to do with the bill and its prompt honoring. The goods belong to the buyer. The goods have been insured for account of the buyer (usually for the value of the corresponding draft plus 10 per cent to cover the contemplated profit on the transaction) and it is incumbent upon the drawee to honor the bill and to collect the value of the lost merchandise from the insurance company.

A bill of exchange is not a letter of instructions but the drawer may, if he so elects, instruct the collecting bank by a separate letter to defer the presentment of the bill until the arrival of the carrying vessel or until the happening of a similar event. Bills accompanied by such instructions cannot be freely sold or discounted but, if negotiated, the element of time for interest purposes may be reviewed when payment is received by the negotiating bank and the necessary adjustment made with the drawer.

**The Bill of Exchange Must Call for the Payment of a Sum Certain, in Money.**—Under this requirement the amount to be paid by the drawee must be, in the first place, an amount certain, meaning a definite amount. This is one of the conditions which is most abused or overlooked by drawers of bills. While the amount of the bill may be indicated both in numerals and spelled out, the requirement of definiteness is violated when, in addition to the principal amount, the instrument calls for the payment of unspecified collection charges and/or interest without indicating the length of time for which interest is to be collected or the rate per annum. Oftentimes bills are issued which bear notations reading, “plus collection charges” or “plus interest” or “plus interest at 6 per cent” without specifying the length of time, or “plus interest for 60 days,” without specifying the rate.

Notations of this character not only destroy the validity of a bill but also they are not well received by the drawee, who may wonder if the notations were placed on the instrument by the drawer or perhaps by an intervening party such as a collecting bank. Again, assuming the drawee is satisfied that the notations were placed on the bill by the drawer, he may wish to pay a part of the collection charges, whereas it was the intention of the drawer that the drawee pay *all* collection charges. For instance, a bill drawn in New York City on a merchant in La Paz, Bolivia, will be subject to two collection charges. The first, usually  $\frac{1}{8}$  per cent, is for account of the services of the New York bank, and the second, currently 1 per cent, for account of the bank in La Paz. The drawee may be willing to pay the collection charges of the La Paz bank but not the charges of the New York bank, unless he is satisfied that the drawer has stipulated that the drawee is to pay both charges, in which event he may pay and take up the matter with the drawer direct.

The same difficulties and misunderstandings may arise as to the payment of interest and if the amount of the instrument is made uncertain because of such notations as to collection charges and/or interest, the instrument is not a true bill of exchange either in law or in fact. All charges to be paid by drawees should be itemized in the relevant invoices and the corresponding

bill drawn for the exact total amount to be collected from the drawee.

The currency of the bill must be clearly indicated and shown both in numerals and spelled out, the same as we do when issuing domestic checks. While a check is usually payable in the currency of the country in which the drawee bank is located, a bill may be drawn and made payable either in the currency of the drawer's or of the drawee's country. For instance, a check drawn in "dollars" on Bank of Montreal, in Montreal, is presumably payable in Canadian dollars. But a bill drawn in "dollars" by an American exporter against his customer in Canada may be drawn and payable either in United States or in Canadian dollars. This ambiguity becomes very important to avoid, especially when Canadian dollars may be quoted at a discount. The currency involved should be indicated in such a clear manner so that no one may be misled.

Bills may be drawn in "U. S. dollars" on foreign countries, wherein our dollar is in general circulation and/or is legal tender, such as Cuba, Dominican Republic, Panama, Bermuda, etc., but the description "U. S. dollars" is not enough. The drawees in these countries are entirely justified in offering to the collecting bank locally obtainable U. S. dollars as payment for dollar bills drawn on them by American exporters. The foreign collecting banks will be obliged to remit the locally obtainable dollars to the New York exporters and the expense involved will be chargeable to the exporters. Under the current Cuban Public Works Tax Law, all remittances to outside points are subject to the tax and this tax will also be chargeable to the exporters.

To avoid this uncertainty and expense, the exporters must clearly indicate, on their bills payable in foreign dollar countries, whether payment is to be made in New York funds or in locally obtainable U. S. dollars. If New York funds are required, the exporters must indicate that fact by placing under the amount a notation such as "New York Funds," or "Payable in New York Funds" or "Payable by an Approved Banker's Check on New York," or "Payable at the Collecting Bank's Selling Rate on Date of Payment for Sight Drafts on New York." In our

typical bill of exchange form (Form 1) the phrase used to obtain this result reads "Payable for face amount by Prime Banker's Sight Draft on New York, New York." Informed exporters have suitable rubber stamps which they use on their bills payable in these countries in order to make the currency more certain. This difficulty does not arise in foreign countries wherein our dollar is not in general use and is not legal tender.

**The Bill of Exchange Must Be Made Payable "to Order" or "to Bearer."**—We are all familiar with checks extended to "Bearer." We call them "Bearer Checks." They are quite similar to checks payable to "Cash." The dollar bill in your pocket is negotiable because it is payable to "Bearer." In England, the same result is obtained by extending such checks "To John Smith or Bearer." The word "Bearer" is intended to make the check negotiable by mere transfer and need not be endorsed by the transferrers.

When, however, the proceeds of a bill are to be paid to a designated person or to his nominee, it must contain the words "to order" in order to be regarded as a bill of exchange, negotiable by mere endorsement. If these words of negotiability—"to order"—are omitted from such a bill, we cannot have a true bill of exchange. Some may elect to name such an instrument as a non-negotiable bill of exchange but that is merely their own name for it because if it does not meet the requirements of the Negotiable Instruments Law definition, it is not a bill of exchange and the law has no real name for it.

**"Value Received and Charge to the Account of."**—You will also note the above phrase in our typical bill. No mention of this phrase is made in the legal definition of a bill of exchange and it is hard to determine just when or why it crept into the printed bill forms. It follows, therefore, that an instrument without this phrase but with all the other requirements mentioned in the definition must be a good and valid bill of exchange. The phrase has two parts, "value received" and "charge to the account of." As the bill, when paid, becomes the property of and may be retained by the drawee, the words "value received" take on the form of a receipt issued by the drawer to the drawee

covering the funds mentioned in the bill. But no such receipt is required as the paid draft itself will clearly indicate that the drawee has paid the funds involved to the payee designated by the drawer. These words "value received" are intended also to be the recital of "consideration" for the contractual relationships created by the bill. While it is true that every legal contract must have a "consideration" and that this "consideration" is usually cited in formal contracts, the recital is not required in bills of exchange because bills are special contracts created and defined by the law and the law does not require such recital. The "consideration" is presumed.

The words "charge to the account of" are in the nature of instructions addressed by the drawer to the drawee. What these words mean, in effect, is this: The drawer tells the drawee, "You have on your books an account in my name (the drawer's name) which shows a credit balance in my favor. As soon as you pay this draft, you may charge the amount of the draft to that account." But a bill was never intended to be used as a letter of instructions; yet it is difficult to find a printed bill form without these unnecessary notations.

The inclusion of these words in a bill form does not affect the validity of the instrument but many merchants, not fully appreciating the intention of the phrase, endeavor to complete it by writing after the word "of" such remarks as "100 Bales Cotton" or "Shipment by Steamer X" or some such other notation which *may* affect the validity of the draft, as we shall see later. If a merchant does not have courage enough to omit the phrase entirely from his printed bill forms, he should remember that the word "of" should not be followed by any notations whatsoever, as it is usually just above the signature of the drawer and, in effect, the last part of the phrase is intended to be read "and charge to the account of American Export Corporation," the corporation being the drawer of the bill.

**Accepting Time Bills.**—The maturities of bills payable at sight or at fixed future times or at so many days after date are definite enough but when a time bill is drawn payable "——"

days after sight," we cannot ascertain the date of its maturity until it has been "sighted." This "sighting" is established by the formal acceptance of the bill by the drawee. If the drawees of our typical bill wish to accept the ninety days sight bill drawn on them, they indicate their acceptance thereof by writing across the face of the bill :

Accepted  
Butler Import Co. Ltda.  
John Butler, Treasurer  
May 21, 1947

The date in the acceptance is indispensable as it will indicate that the maturity of the draft is to be some ninety days later, i.e., August 19, 1947.

Although bills payable at fixed future dates or at so many days after date do not require formal acceptances by the drawees to fix their respective maturity dates, it is customary in business practice to have all time bills accepted, irrespective of the form of their usances. There are two practical reasons for this. In the first place, the holder of the bill, be he the drawer, or his agent, or a third party to whom the bill has been sold, will acquire better security for the ultimate payment of the bill as the drawee has, by his acceptance, become a real party to the bill and may be compelled to redeem his formal acceptance by paying it at maturity. In the second place, there are usually shipping documents attached to the bill, documents which represent and often control the merchandise in cover of which the bill is drawn. These documents may be surrenderable to the drawee only when the drawee has formally accepted the bill and thus has made himself liable for its payment at maturity. The drawee of a time bill has no liability with respect to the bill unless and until he accepts it. You and I, if we choose to do so, may draw time bills on any first class bank or commercial house in the country but such unwarranted action upon our part does not create any liability upon the part of the drawees. The liability upon the part of drawees is created only if and when they accept bills drawn on them.

## The Legal Rights and Liabilities of Parties

**The Legal Rights and Liabilities of the Drawer.**—The drawer creates the bill. If he negotiates it for value to another, he agrees with the purchaser and with those to whom the purchaser may negotiate it that he, the drawer, will redeem and pay it in the event the drawee dishonors it by non-acceptance or by non-payment, as the case may be, unless he is relieved of this liability by any act or omission upon the part of the holder and the then owner of the bill, as provided by the Negotiable Instruments Law. Anyone who becomes the owner of the bill either by purchase or by a discounting operation has this right of recourse to the drawer, providing the right has not been impaired or voided altogether by the failure of the owner to respect certain obligations imposed upon him by the law. We shall discuss these obligations in the sections covering the protesting of bills. (See pages 225-242.)

**The Legal Rights and Liabilities of the Drawee.**—The drawee is the addressee of the bill. He is the person who must honor it by acceptance and subsequent payment if a time bill is involved, or by immediate payment if the bill is payable at sight or on demand. If the bill is in the form of a check or one payable at sight or on demand, its purchaser acquires no rights against the drawee. The drawer of the check may have no account at the drawee bank. In the case of a demand draft drawn by Smith on Jones, drawee Jones cannot be compelled to pay the draft. If he is indebted to Smith in the amount of the demand draft, Smith may sue him on the debt itself, showing how the debt arose, etc., but neither Smith nor anyone else holding the draft from Smith can sue Jones on the unpaid demand draft but must allege and prove the circumstances which created the indebtedness of Jones to Smith. Similarly, neither the drawer nor an endorser of a time bill of exchange can acquire legal rights against the drawee of such a time bill, when the bill has become dishonored by non-acceptance. The drawee cannot prevent people from drawing on him and the mere issuance or existence of a time bill cannot and will not impose upon the drawee the legal obligation to accept the bill.

The situation is quite different, however, if the drawee has accepted the bill but has dishonored it by non-payment. By his acceptance, the drawee served notice upon all interested parties that the drawer was authorized to draw on him and that he would pay the bill at maturity. Assuming the bill has been properly drawn and its negotiability has not been impaired by the addition of phrases, the drawee also undertakes to honor his acceptance free from any counter-claims which he may then or on the day of maturity, have against the drawer.

**The Legal Rights and Liabilities of the Payee.**—The payee of a bill, when a person other than the drawer, continues to have recourse to the drawer until the bill has been discharged by the drawee's payment, providing always that no act or omission of the payee has destroyed this right of recourse. As against the drawee he has no rights unless the bill is a time bill, has been duly accepted by the drawee but has been dishonored by non-payment. If the bill has been dishonored by non-acceptance or, as in the case of a check or sight bill, dishonored by non-payment, the payee cannot proceed against the drawee but must recover the value of the bill from the drawer. If the time bill has been duly accepted and then dishonored by non-payment, the payee may sue and recover either from the drawee or from the drawer, providing he has not lost this right by some act or omission, as indicated by law.

Whenever the bill is drawn payable to the order of the drawer, the drawer, himself, becomes the payee and his rights and liabilities as payee become merged with his rights and liabilities as drawer. When a bill is drawn payable to the order of the drawer by the use of the phrase "Pay to the order of Ourselves," and is then endorsed by the drawer in blank by merely writing his name on the back of the bill, the drawer has in his hands a bill which is in negotiable form, and title to which may be passed by mere delivery. He may sell the bill, thus endorsed, to his bank or enter it with his bank for collection. If his own bank will not take the bill for either purpose, he may offer it to another bank without drawing a new bill as the name of his own bank does not appear on the bill. Many drawers, however, utilize bill forms supplied by banks in which the supplying banks are

designated as the payees. It is quite proper to use these forms, providing the drawer is assured that the bank supplying the forms will handle his bills.

**When the Payee Is "Bearer" or "Cash."**—Checks, which are bills of exchange, are often drawn to the order of cash. The Negotiable Instruments Law states that a bill must be drawn either to the order of a person (individuals, partnerships, trade names, or corporations) or to bearer. It also states that a bill is payable to bearer "when the name of the payee does not purport to be the name of any person." As the word "Cash" is not the name of any person, a check so drawn is regarded as one payable "to bearer."

Under the British Bills of Exchange Act, a check must be drawn payable "to or to the order of a specified person, or to bearer." Although the British law also provides that "where the payee is a fictitious or non-existing person, the check may be treated as payable to bearer," this does not help the situation as a check made payable to cash is not made payable to any *person*, fictitious or otherwise. If the British rule is violated, therefore, the check cannot be regarded as a negotiable instrument in Great Britain. Consequently our British friends do not draw checks to "Cash" but to "Bearer."

### Endorsing Bills of Exchange

**The Blank Endorsement.**—When the endorser merely writes his name on the back of a bill, he is said to have endorsed it in blank. He may, thereafter, pass title to the instrument by mere delivery to someone else. A bill endorsed in blank becomes bearer paper but the holder may make it payable to his own order by writing immediately above the blank endorsement the phrase "Pay to the order of (the holder's name)."

**The Special Endorsement.**—When the endorsement specifies the person to whom or to whose order the bill is to be payable, we have a special endorsement. The subsequent endorsement of such an endorsee is necessary to the further negotiation of the bill. Most endorsements are of this type. They not

only give the full chain of persons who may have had an interest in the bill but also give the holder full recourse against all endorsers preceding him. Moreover, a person to whom a bill has been specially endorsed and who has not as yet endorsed it himself, is protected against the loss of the bill as the casual finder could not negotiate it without the missing endorsement of the holder. If the finder supplies the missing endorsement, he commits forgery.

**The Restrictive Endorsement.**—An endorsement is restrictive, which either (1) prohibits the further negotiation of the bill, (2) constitutes the endorsee the agent of the endorser, or (3) vests the title in the endorsee, in trust for or to the use of some other person. But the mere absence of words implying power to negotiate does not make an endorsement restrictive. While a restrictive endorsee has power to receive payment, to bring any action on the bill which his endorser could bring, and to transfer his rights as such endorsee when the wording of the endorsement does not prohibit such transfer, all subsequent endorsees acquire only the title of the first endorsee under the restrictive endorsement.

The commonest form of restrictive endorsement is that in which the payee or subsequent endorser places on the back of the instrument a phrase reading "Pay to the order of X Bank, for collection." X Bank cannot pass full title to such a bill and the form of the endorsement places all subsequent holders on notice that X Bank is the agent of the person who has restrictively endorsed the bill to X Bank. This form of endorsement may appear on checks drawn in foreign currencies offered to country banks for sale and sent by the country banks to their large city correspondents with the request that they be purchased at the then going rates of exchange. In purchasing a check so endorsed, the correspondent bank in the big city is placed on notice that the country bank is acting as the agent of its disclosed principal (the person who endorsed the instrument to the country bank) and that, in the event the check is not paid by the drawee bank, the city bank must seek reimbursement from the principal of the country bank and not from the country bank, which is only the collecting agent of a disclosed principal. To be sure,

the country bank may have used the endorsement stamp intended for domestic collections and without any idea of disclaiming responsibility and may even be willing to reimburse the city bank but it is within the power of the country bank to disclaim responsibility whenever the city bank buys from the country bank a check endorsed restrictively.

The bill must be drawn payable "to order" or "to bearer." The words "to order" cannot be omitted unless the bill is drawn payable "to bearer." But the omission of "to order" from an endorsement does not affect the negotiability of the bill and an endorsement reading "Pay to John Jones" is just as effective as an endorsement reading "Pay to the order of John Jones."

**The Qualified Endorsement.**—When the endorser, by the use of words, intends to pass title to a bill made payable to his order without assuming the usual responsibilities of an endorser, he qualifies his endorsement by adding to it words to that effect. The commonest form is the endorsement to which have been added the words "without recourse." We obviously cannot purchase a bill so endorsed, since the endorser says, in effect, "Here is a bill. I will give you title to it but do not look to me in the event it is dishonored." The qualified endorsee, however, may look to all other parties prior to the qualified endorser.

### The Legal Rights and Liabilities of Endorsers

The endorser of a bill who has paid value for it is in the same legal position as the payee who has purchased or discounted the bill, with this addition: upon the dishonor of the bill either by non-acceptance or for non-payment, he can always seek and obtain reimbursement from the party who negotiated the bill to him, be that party the original payee or another intervening endorser. He also has recourse against the drawer but he has no rights against the drawee except in the case of a time bill which has been duly accepted but dishonored by non-payment.

**As to the Endorser in Blank and Special Endorser.**—By his endorsement, an endorser in blank, as well as a special endorser, warrants:

1. That the instrument is genuine and in all respects what it purports to be.
2. That he has a good title to it.
3. That all prior parties have capacity to contract.
4. That the instrument is, at the time of his endorsement, valid and subsisting.
5. That on due presentment it shall be accepted or paid, or both, as the case may be according to its tenor, and if it be dishonored, and the necessary proceedings on dishonor be taken, he will pay the amount thereof to the holder, or to any subsequent endorser who may be compelled to pay it.

**As to the Restrictive Endorser.**—The restrictive endorser (endorsing "For Collection," for instance) makes the same warranties as the blank and special endorsers, but the warranties do not run in favor of the immediate restrictive endorsee who becomes the agent of the endorser. By his restrictive endorsement, the endorser either (a) prohibits the further negotiation of the instrument, (b) constitutes the endorsee as his agent, or (c) vests the title of the instrument in the endorsee in trust for or to the use of some other person.

If, in furthering one of these purposes, the endorsee himself is obliged to endorse the instrument restrictively endorsed to his order, the warranties are made by his disclosed principal, the restrictive endorser. The restrictive endorser confers upon his endorsee the right to receive payment of the instrument, to bring any action thereon which his endorser could take, and to transfer his rights when the form of the endorsement authorizes him to do so. However, all endorsers subsequent to the first restrictive endorsee acquire only the restricted title of the first endorsee. In other words, the first restricted endorsee cannot pass full title and both he and his subsequent endorsee hold the instrument as agents of the restrictive endorser and subject to the restrictions placed thereon by the restrictive endorser. Consequently, instruments endorsed restrictively are not usually sold or discounted.

**As to the Qualified Endorser.**—A qualified endorser ("Without Recourse," for instance), makes the above indicated

warranties of a special endorser numbered 1, 2, 3, and 4, but not the warranty numbered 5. If a bank or other "person" has no financial interest in a bill and does not wish to assume any responsibility whatsoever in connection therewith or even make the warranties 1, 2, 3, and 4, the qualified endorsement reads "Without Recourse or Warranties."

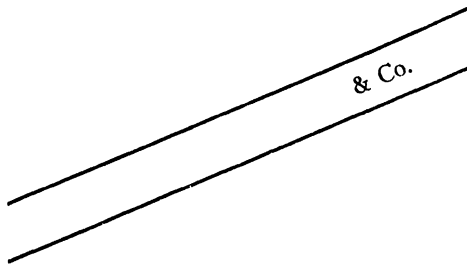
**Guaranty of Endorsements.**—Whenever a bank presents a check for payment through the established banking channels or offers the check for negotiation, and the check bears irregular or restrictive endorsements, it may elect to guarantee such endorsements. This is accomplished when the endorsement stamp of the bank contains a phrase reading "Prior Endorsements Guaranteed." Under such circumstances, the guarantor bank becomes and assumes the liabilities of a regular endorser and will be considered as making the usual warranties of a regular endorser.

### The Various Forms of the Bill of Exchange

**Checks.**—Checks are bills of exchange. Checks are instruments drawn against funds presently held by the drawee, usually a bank, for account of the drawer, these funds being in the form of a credit balance on the books of the drawee bank in the name and in favor of the drawer. The usance of checks is not usually indicated but all checks are payable upon presentation.

**Bankers' Checks.**—Bankers' checks are bills of exchange. A bankers' check is one drawn by a bank. It is usually drawn on another bank. The fact that a check is drawn on a bank—and most checks are drawn on banks—does not make it a bankers' check, but the drawer of the check must be a bank or banker. A bankers' check is the equivalent of a commercial check certified for payment by a bank. If the holder of a bankers' check cannot obtain its payment from the drawee bank, he can and will be reimbursed by the drawer bank. Bankers' checks are also known as Bankers' Bills or Bankers' Drafts, although these two terms are generally applied when the bills or drafts are payable at usances longer than sight or demand.

**Crossed Checks on Great Britain.**—When the face of a check on Great Britain bears the marking



we say the check has been “crossed” and we have a “crossed check.” The holder of a crossed check cannot cash it at the drawee bank but must either deposit it with the drawee bank for the credit of his account or have the drawee bank pay its proceeds to another bank for the credit of the account which the holder has with such other bank. Some American banks obtain the same result by placing on their own Cashier’s or Treasurer’s checks a notation reading “Payable through —— Clearing House only.” The payee or other holder of a check so marked cannot obtain payment from the paying teller of the drawee bank but must have it collected through banking channels.

**Drafts.**—Drafts are bills of exchange. Drafts may or may not be drawn against funds presently held by the drawee for account of the drawer but it is assumed that the drawee is indebted to the drawer for the amount of the draft or may be willing to accommodate the drawer with the funds or credit facility contemplated by the draft. The words “draft” and “bill” may be used interchangeably to mean the same thing.

**Clean Bills of Exchange.**—Clean bills are bills of exchange to which documents of title are not attached to be delivered to the persons against whom the bills are drawn when such drawees either accept or pay the bills. By documents of title we mean negotiable documents such as bills of lading, warehouse receipts, stock certificates, bonds, etc. The documents usually have the same monetary value as the corresponding bills. They must be

in negotiable form, that is to say, payable "to bearer" or to the order of a designated person, endorsed by such person, so that the owner of the bills may be in a position to reimburse himself partially or wholly by selling the documents or the merchandise represented thereby in the event the bills become dishonored by the drawees. If the documents are not in a form which collateralizes the bills and protects the holder thereof, we still have a clean bill, *from a credit point of view*, no matter how many documents may be attached to the drafts.

**Documentary Bills of Exchange.**—Documentary bills are bills of exchange to which documents of title are attached, as defined in the preceding paragraph, which documents are to be surrendered to the drawees when they accept or pay the corresponding drafts.

**Documents Against Payment Bills.**—Documents against Payment bills—abbreviated D/P bills—are those sight or time bills to which documents are attached which documents are to be surrendered to the drawees when the drawees have paid the corresponding bills. Sight documentary bills are, by their nature, always D/P.

**Documents Against Acceptance Bills.**—Documents against Acceptance bills—abbreviated D/A bills—are those time bills to which documents are attached, which documents are to be surrendered to the drawees when the drawees have accepted the corresponding bills. Time documentary bills may be either D/A or D/P.

**Sight Bills.**—Sight bills are those which are payable upon presentation, or at sight, or on demand. In this category we have all types of checks, drawn by individuals and commercial concerns, as well as all clean and documentary bills which may be payable upon presentation, at sight or on demand.

**Time or Usance Bills.**—Time bills are those which are payable at a fixed future time or at a determinable future time. If, for instance, a bill is drawn on September 5, 1947, and is made payable on November 28, 1947, we have a time bill payable at a fixed future time. Most time bills, however, are drawn pay-

able at determinable future times. They may be drawn payable, say, "30 days after sight" or at "30 days after date," abbreviated as "30 d/s" and "30 d/d." The first type is also known as a time sight bill while the second type is known as a time date bill. Time bills are also known as usance bills, as distinguished from sight or demand bills.

**Short Time Bills and Long Time Bills.**—Short time bills are those which are payable 3 to 15 days after sight or after date. Long time bills or long bills are those which are payable at usances longer than 15 days after sight or 15 days after date.

**Acceptances.**—Acceptances are bills of exchange. They are time bills which have been duly accepted by the drawees but which have not as yet matured. Bankers' Acceptances are those time bills which are drawn on and have been accepted by banks or bankers. When the accepting drawee is an individual or commercial concern, we have a Commercial Acceptance.

## CHAPTER 5

### BILLS OF LADING

**Definition and Purposes.**—Bills of lading are the documents which common carriers, principally railroads, steamship companies, and trucking concerns give to shippers in connection with property delivered to them for transportation from one point to another. The bill of lading has a threefold purpose:

1. It is a receipt. It is the written acknowledgment of the receipt of personal property for transportation.

2. It is a contract. It is the contract between the shipper and carrier covering the transportation and delivery of the personal property at a certain point to a designated person or to his order.

3. It is a document of title, acceptable for credit, providing it is in a form which gives the holder title to the property covered by it.

**Common Carriers Defined.**—A common carrier, as defined by the New York courts, is a person (individual, co-partnership, or corporation) who, by virtue of his calling and as a regular business, undertakes for hire to transport persons or commodities from place to place, offering his services to all such as may choose to employ him and pay his charges. The activities of the common carriers are controlled by special laws. They cannot pick and choose but must accept all business offered them within their regulations, applicable to all alike.

**Common Carriers Who Are Insurers Also.**—Railroads and trucking concerns operating as common carriers are insurers of the goods placed in their custody for transportation. This is not a hardship for the reason that the carriers' charges are placed high enough to cover this additional service. As a matter of fact, such carriers are in two lines of business at one and the

same time—carriers and insurers—and a part of the freight charges is intended for the insurance premium. Carriers are absolved from responsibility if the loss is the direct result of some unforeseen catastrophe such as earthquake, lightning, sudden washouts, etc. The test seems to be that the carrier has no liability if the direct cause of the damage is of a nature which prudent men cannot guard against. The carrier is also absolved if the loss is due in whole or in part to an act or omission upon the part of the shipper, as when the shipper has wrongfully described the property or packed it improperly. Carriers never open up packages to make sure that the goods are, in fact, as described by the shipper or have been sufficiently well packed to withstand the contemplated carriage to the desired destination. The carrier is also absolved if the loss is the result of natural consequences such as evaporation, fermentation, or other similar losses due to the inherent nature of the goods.

**Common Carriers Who Are Not Insurers Also.**—Steamship companies are not insurers. The law obligates them to utilize seaworthy vessels, properly equipped and manned. When making an ocean shipment, the shipper must protect himself against losses by adequate insurance purchased from an insurance company. It would be entirely feasible, of course, to compel steamship companies to become insurers also, but this would involve the increasing of ocean freight rates and taking the business from the insurance companies and giving it to the ocean carriers, without any particularly worthwhile advantage to the shipper.

**Common Carriers May Not Waive by Contract Their Liability for Negligence.**—No common carrier is permitted to waive by contract his liability for his own negligence or for the negligence of his agents. In other words, the carrier company cannot have in the bill of lading a clause to the effect that the shipper or other holders of the bill of lading shall not maintain an action at law against the company based upon the alleged negligence of the company or of its agents. As a matter of fact, the courts have ruled quite fully as to the conditions which may appear in a bill of lading. If the carrier has unreasonable



		(To be filled in by Carrier)			
CODE	FREIGHT	RATE	FREIGHT	RATE	FREIGHT
				Surcharge	
				45-2	
				45-	
				45-	
				47-3 Insurance Premium	
				47-25 Wharf Demurrage	
				55-3 Mexican Tax	
				55-4 Tolls & Wharfage	
				55-5 Handling Charge	
				55-11 Canal Transfer	
TOTAL (of both columns)					

RECEIVED by Grace Line Inc., herein referred to as "the Carrier", from the above named shipper, goods, or packages said to contain goods, or both, hereinabove described, in apparent good order and condition unless otherwise indicated herein, consigned to the above named consignee and to be held and transported, subject to all of the written, typed, printed and stamped provisions of this bill of lading, including expressly those set forth on the reverse side hereof, which shall govern the relations between all parties concerned herewith, from the above named Port of Loading to the above named Port of Discharge or so near thereto as the ship can get safely and leave conditions safely afloat at all stages of water and conditions of weather and there, on payment of any amount then due and owing hereunder to the Carrier, to be delivered to consignee or on-carrier, as the case may be, when all responsibility of the Carrier shall terminate.

IN WITNESS WHEREOF, bills of lading have been signed, one of which being accomplished the other to stand void.

NEW YORK

(Place and date of issue)

GRACE LINE INC.

By \_\_\_\_\_ Agent

(See provisions on reverse side hereof)

B/L No. \_\_\_\_\_

GRACE LINE INC.  
PRINTED IN U.S.A.

Form 2. Typical Bill of Lading as Issued by Grace Line, Inc.

self-serving conditions in the bill of lading, as when an attempt is made to mitigate the carrier's negligence, the courts will promptly nullify them. This is the reason we seldom take the trouble to read the finely printed conditions of a bill of lading and properly assume that the same are both reasonable and within the law.

**The Lien of Common Carriers.**—The law gives common carriers a lien upon the goods which they transport and they need not release the property until their charges have been paid. The lien becomes the first claim against the goods and all holders of the bill of lading acquire the document subject to the prior satisfaction of the carrier's lien representing the carrier's charges.

**The Lading May Be in Sola Form or in Sets of Two or Three Copies.**—While railroad bills of lading are generally issued in sola form (one original copy), steamship bills of lading are generally issued in sets of three. Some steamship companies issue them in sets of two, while a few issue them in sola form. Toward the end of the document (see Form 2, page 52) it is clearly indicated how many original copies have been issued and if issued in sets, it is provided that upon the utilization of one original copy, the other original copies making up the set are to become void and of no value. Each and every signed original copy of the set is of equal force and effect. Steamship ladings are issued in sets in order that the shipper and intervening banks may be able to forward to the buyer of the merchandise two sets of all the shipping papers, including the corresponding draft, if any, by two separate mails, thus making sure that another set of these papers is available in the event the set mailed by the steamer carrying the merchandise is lost or delayed in transit.

**The Dock Receipt.**—Steamship bills of lading are invariably prepared by the shipper on forms furnished by the steamship companies. Upon being advised that the steamer to carry the merchandise is accepting cargo, the merchandise, properly packed and marked, is delivered to the dock at which the vessel

is berthed and the shipper is given a Dock Receipt. He tenders this dock receipt with the bill of lading forms prepared by himself to the office of the steamship company. The company exchanges the dock receipt for the bill of lading, now properly signed by the master of the carrying vessel or by his agent. Bills of lading may also be signed by the company owning or operating the vessel instead of by the vessel's master.

**Clean and Foul Bills of Lading.**—While carriers do not examine and verify the contents of cases, bags, and packages, they do examine the outside packing in order to make sure that it is sufficient for the requirements of the alleged contents and will withstand the necessary handling until the goods are delivered to the consignee. If the packages are not put up properly or some have been damaged between the shipper's warehouse and the dock, this fact is noted on the dock receipt and subsequently on the lading and must be taken into consideration if losses result or are aggravated due to the faulty condition of one or more packages. As the bill of lading recites the receipt of the goods "in apparent good order," the exceptions are indicated by notations on the dock receipt and lading, reading such as :

100 bags rice—ten bags torn  
15 cases cotton piece goods—two cases broken  
1,000 bundles iron bars—sixty-eight bundles rusty

When such notations appear on a bill of lading, we have what is known as a Foul Bill of Lading. If the carrier is satisfied that the packages received are "in apparent good order," notations of this character are not placed on the dock receipt or subsequently on the bill of lading and we then have a Clean Bill of Lading as distinguished from a Foul Bill of Lading. It must be realized that these notations not only protect the carrier against losses attributable to poor packaging but also protect everyone else who may give value for the lading. While the lading may call for 100 bags of rice, everyone is on notice that only 90 bags may be delivered as the rice in the 10 torn bags may have entirely run out during the voyage.

**The Three Purposes or Functions of Bills of Lading.**—Under the heading "Definition and Purposes," we have indicated that bills of lading may have three separate functions, to wit:

1. They serve as receipts for the goods delivered to the carrier for transportation.

2. They serve as the contract for the services to be rendered by the carrier.

3. They serve as documents of title, acceptable for credit operations, providing they are in a form which gives the holder of the lading's title to the merchandise mentioned therein.

Functions 1 and 2 are inherent parts of every bill of lading, while function 3 may or may not be present, depending upon the form of the bill of lading.

**The Bill of Lading as a Receipt.**—As a receipt, it is of no force or value if the property mentioned in the lading has not been, in fact, delivered to the carrier. While the carrier cannot be compelled to deliver something which he has not received, if the lading has been signed for the carrier by the agent of the carrier charged with the duty of signing ladings on behalf of his principal, the carrier may be liable in damages to those third parties who have been misled by the wrongful act of the agent in signing a receipt (the bill of lading) when no goods have been received. If the lading has not been signed by an authorized or unauthorized agent of the carrier, no one can hold the carrier responsible. The signature of the carrier appearing on such a lading is just another form of forgery and the document is a fraud. Bill of lading forms, like check forms are freely obtainable and the mere fact someone has forged a bill of lading cannot make the carrier liable any more than you are liable if a person fraudulently issues a check in your name. And so it is quite possible for a bill of lading to be a fraud and forgery from beginning to end.

We have already stated that the carrier may not waive liability for his negligence or for the negligence of his agents. It follows, therefore, that if the lading has been fraudulently issued and signed by the agent of the carrier, the carrier may be liable to innocent third parties who suffer loss because of the

negligent and criminal act of the agent. Who is the agent of the carrier with respect to bills of lading? He is the man who has been authorized by the carrier to sign bills of lading. He cannot be any employee of the carrier, such as office boys or typists. To make the act of signing binding upon the principal, it must be an act within the agent's scope of employment and authority. If an unauthorized person in the employ of the carrier signs a bill of lading for and in the name of the carrier, his action is not different from the action of any other person not in the employ of the carrier who deliberately forges the carrier's name to the document. And this situation gives us a bill of lading which may have the earmarks of genuineness and which, nevertheless, is not binding upon the carrier.

**Accommodation Bills of Lading.**—The situation becomes really involved, however, when the bill of lading is signed by an authorized agent of the carrier although the goods mentioned therein have not been delivered to the carrier. The shipper may be a friend of the agent. He induces the friendly agent to issue a bill of lading for ten cases of hardware although he has not delivered any of the cases to the carrier. He tells the agent that he has sold the hardware to X & Co., but the factory from which he intends to buy it will not give him credit and he is thus unable to fill the order of X & Co. The agent, because of his friendship for the shipper or perhaps for a share of the profit to be made by the shipper, issues and delivers to the shipper a lading covering ten cases of hardware. The shipper then attaches the bill of lading to a sight draft on X & Co. and discounts the draft at a bank. He thereupon purchases the hardware from the factory and actually delivers the ten cases to the carrier, thus legitimatizing the bill of lading conceived in fraud and iniquity. In the meantime, the discounting bank will collect the shipper's sight draft on X & Co attached to the bill of lading and surrender the lading to X & Co. upon the payment of the sight draft. If for any reason whatsoever the shipper fails to make the lading good by delivering 10 cases of hardware to the carrier, X & Co. will have a cause of action against the carrier. While most jurisdictions hold that the carrier is liable for the wrongful acts of his agent, other jurisdictions hold that such an

act of the agent was outside of the powers and authority delegated to him by his principal, the carrier, and hence the principal is not responsible for the agent's fraud. A bill of lading issued under such circumstances is known as an Accommodation Bill of Lading.

**Fictitious Bills of Lading.**—The lading may be signed by the agent authorized to sign bills of lading and still be what is known as a Fictitious Bill of Lading. This setup is quite similar to the setup of the Accommodation Bill of Lading, except that in the case of the fictitious lading neither the alleged shipper nor the crooked agent intends to have the required merchandise supplied to the carrier at a later date. Here the shipper and the agent have formed a partnership for the purpose of raising some money fraudulently. The bank which discounts or advances funds against a draft to which such a lading is attached as collateral, may be able to hold the carrier liable for the wrongful act of his agent. The courts of some states will hold, as in the case of the accommodation lading, that the agent acted outside of the scope of the authority delegated to him by his principal and hence the principal should not be held responsible for the criminally wrongful acts of his agent. Then again, assuming the carrier is liable, the amount of damages is problematic for the reason that bills of lading do not always give the real value of the merchandise shipped and it would be quite difficult to determine a value for "ten cases of hardware," described only in such general terms and which, in fact, do not exist.

The bill of lading may or may not be a valid receipt for property received from the shipper. The shipper mentioned in the lading cannot possibly demand from the carrier property which he has not delivered to the carrier for transportation to the destination indicated in the lading. Moreover, the shipper knows from experience whether the carrier's signature appearing on the lading has been made by a duly authorized agent of the carrier. The honest shipper has no difficulty in being assured that he has received in the bill of lading a receipt for his goods which is binding upon the carrier. If he is dishonest, he must

obtain the fruits of his dishonesty through a third party who knows nothing of the dishonest scheme. This third party is usually a bank which, in good faith, discounts a draft to which the lading is attached and which serves as the collateral for the discount.

The bank does not verify the genuineness of a bill of lading, or the goods covered thereby. It assumes, and quite properly, that the shipper-borrower has delivered the goods and has seen to it that the lading has been signed by an authorized agent of the carrier. The bank has faith in the borrower and the borrower's draft is discounted largely because of this faith. If the borrower is dishonest, he could have filled the ten cases not with hardware but with scrap iron and the carrier would have discharged his duties completely and properly by the delivery of the same ten cases as received from the shipper, irrespective of their real contents.

We are constantly accepting important documents without verifying the signatures appearing thereon because we trust the persons who have obtained these documents from the original sources of issue. No one takes the trouble to check a life insurance policy to make sure that the company signatures appearing thereon are genuine and binding upon the company. We just have faith in the agent who arranged the details of the coverage. Most people will accept the cashier's check of a bank or a certified check in lieu of cash and do not attempt to verify the bank signatures appearing on such checks. We just assume that the party offering us such checks is honest and has seen to it that the checks are what they purport to be. And so, the intermediary holder of a bill of lading, usually a bank, need have no concern about the genuineness of the carrier's signature as appearing on the lading, if the bank trusts the holder who obtained the lading from the carrier. Without trust and confidence in the shipper or in the person who wishes to utilize the bill of lading as an instrument for raising money, the bank should not take part in the operation. Banks cannot have faith in strangers and it is dangerous to place reliance upon a bill of lading in the hands of a stranger.

**The Position of the Consignee.**—We now come to the consignee mentioned in the bill of lading—the one for whom the goods are intended. Should he have any misgivings about the genuineness of the carrier's signature appearing on the lading and its binding effect upon the carrier? As a rule, the buyer of merchandise makes payment upon receiving the bill of lading and he must await the arrival of the shipment. He has no way of determining the regularity of the lading. Here again, the problem is solved by faith, the faith of the buyer in the integrity of the seller. Without this faith, well founded, the buyer is always at the mercy of the seller.

The dishonest seller can defraud his buyer with a fraudulent bill of lading and in many other ways. Let us suppose the lading is genuine in every respect but that the goods actually in the cases are of a quantity, quality, and nature different from the goods ordered by the buyer. The carrier is not responsible, since he has delivered the exact cases entrusted to him by the shipper for transportation. The carrier does not verify the contents, which may be sawdust and bricks while the bill of lading describes the merchandise as cotton sheetings. Again, the goods may be seriously damaged in transit because of poor packing upon the part of the shipper, or the goods may spoil due to their inherent nature and carelessness upon the shipper's part, as when valuable wine in kegs turns into vinegar. The buyer must not only have faith in the integrity of the seller but also in the ability of the seller to make good losses attributable to his carelessness or ignorance.

It is impossible, of course, to summarize all the possible circumstances which may make a bill of lading worthless as a receipt and at the same time free the carrier from responsibility. It is obvious, however, that a bill of lading in the hands of a questionable person may not be what it purports to be. When dealing with such persons or with strangers who may or may not be of good repute, a bank assumes bill of lading risks which may bring about lawsuits and losses.

**The Bill of Lading as a Contract.**—The bill of lading is a contract between the shipper, the carrier, and the consignee.

Although a contract, its provisions are seldom read by the shippers and by the consignees. Even the carrier companies may not be thoroughly conversant with every condition printed in the body of the document, but their counsel who prepared it does know. The many finely printed clauses in the body of the bill of lading are intended to give the carrier the highest degree of protection obtainable under all foreseeable circumstances. All this, however, is not a serious matter because, in the last analysis, it will be the courts and not the interested individuals which must determine if the printed conditions, or any of them, are to be of full force and effect in a given case. We have previously pointed out that a carrier may not disclaim liability for its negligence. It may limit its liability, however, but the degree of such limitation is again a matter for the courts.

It is gratifying to realize, moreover, that the contractual clauses in a bill of lading are exactly the same for all shippers by the steamers of a given company. There cannot be one form of contract for A & Co. and another for B & Co. when both are shipping the same type of merchandise from the same port to the same port. The law stipulates that all shippers be treated alike. Furthermore, like all written documents, there can be no parole (verbal) understandings or reservations between the carrier and shipper because parole evidence will not be accepted by a court if it has a tendency to change the terms of a written agreement.

The contractual provisions of bills of lading indicating the rights and liabilities of shippers and carriers are largely controlled by statutory laws. When the bill of lading covers the transportation of goods to or from the United States, in foreign trade, the contractual relationship and the rights and liabilities of the interested parties are governed principally by the provisions of the United States Carriage of Goods by Sea Act, passed by Congress in 1936. This act very largely superseded the Harter Act which latter act, however, still remains in force with regard to domestic commerce. The Harter Act also still applies in some respects to overseas shipments such as to the period prior to loading on board or to the period after unloading from an overseas vessel.

The Carriage of Goods by Sea Act adopted the principles of the Hague Rules, which were promulgated at an international convention held at The Hague in September, 1921. It was first intended that these rules should be voluntarily incorporated in bills of lading by reference. Demands arose, however, for the adoption of the rules by legislative action. This resulted in the holding of a number of other international conventions which culminated in the adoption of the so-called Brussels Convention of 1922-1924 and the various statutes known as Carriage of Goods by Sea Acts, such as have been adopted by the United States, by Great Britain, and by practically all maritime nations.

The purpose underlying these rules and conventions, and the various statutes that have given them effect, is the unification and standardization of the principal provisions of ocean bills of lading. The law as it is embodied in these statutes relieves the shipowner of much of the common-law liability under which he would be liable for practically all losses except those due to acts of God and public enemies.

The Carriage of Goods by Sea Act does not apply to live animals or to cargo which, by the contract of carriage, is stated as being carried on deck and is so carried.

Under the Act the carrier is bound, before and at the beginning of the voyage, to exercise due diligence to make the ship seaworthy, to properly man, equip, and supply the ship, to make the holds, refrigerating and cooling chambers, and all other parts of the ship on which goods are carried, fit and safe for their reception, carriage, and preservation. The Act also provides that the carrier shall properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried.

**The Immunities of Shipowners.**—To give a somewhat comprehensive knowledge of the immunities granted to shipowners, we quote from the Act:

#### SECTION 4

(1) Neither the carrier nor the ship shall be liable for loss or damage arising or resulting from unseaworthiness unless caused by want of due diligence on the part of the carrier to make the ship seaworthy, and to secure that the ship is properly manned, equipped, and supplied, and to make the holds, refrigerating and cool chambers,

and all other parts of the ship in which goods are carried fit and safe for their reception, carriage, and preservation in accordance with the provisions of paragraph (1) Section 3. Whenever loss or damage has resulted from unseaworthiness, the burden of proving the exercise of due diligence shall be on the carrier or other persons claiming exemption under this section.

(2) Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from:

- (a) Act, neglect, or default of the master, mariner, pilot or the servants of the carrier in the navigation or in the management of the ship;
- (b) Fire, unless caused by the actual fault or privity of the carrier;
- (c) Perils, dangers, and accidents of the sea or other navigable waters;
- (d) Act of God;
- (e) Act of war;
- (f) Act of public enemies;
- (g) Arrest or restraint of princes, rulers, or people, or seizure under legal process;
- (h) Quarantine restrictions;
- (i) Act or omission of the shipper or owner of the goods, his agent or representative;
- (j) Strikes or lockouts or stoppage or restraint of labor from whatever cause, whether partial or general: Provided, That nothing herein contained shall be construed to relieve a carrier from responsibility for the carrier's own acts;
- (k) Riots and civil commotions;
- (l) Saving or attempting to save life or property at sea;
- (m) Wastage in bulk or weight or any other loss or damage arising from inherent defect, quality, or vice of the goods;
- (n) Insufficiency of packing;
- (o) Insufficiency or inadequacy of marks;
- (p) Latent defects not discoverable by due diligence; and
- (q) Any other cause arising without the actual fault and privity of the carrier and without the fault or neglect of the agents or servants of the carrier, but the burden of proof shall be on the person claiming the benefit of this exception to show that neither the actual fault or privity of the carrier nor the fault or neglect of the agents or servants of the carrier contributed to the loss or damage.

(5) Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connection with the transportation of goods in an amount exceeding \$500. per package, lawful money of the United States, or in case of goods not shipped in packages, per customary freight unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading.

**Both-to-Blame Collision Clause.**—We have already indicated that should the carrier include in the body of the bill of lading self-serving declarations of an unreasonable nature, the courts are apt to decide that such declarations are not binding upon the holder of the bill of lading. The so-called Both-to-Blame Collision clause now included in the bills of ladings of many steamship companies, is a typical self-serving declaration which the courts may hold to be unreasonable and, therefore, not binding upon the holder of the bill of lading. The shipping world is still awaiting a final judgment by a court of last resort on the subject. The clause appearing in bills of lading reads as follows :

If the ship comes into collision with another ship as a result of the negligence of the other ship and any act, neglect or default of the Master, mariner, pilot or the servants of the Carrier in the navigation or in the management of the ship, the owners of the goods carried hereunder will indemnify the Carrier against all loss or liability to the other or non-carrying ship or her owners insofar as such loss or liability represents loss of, or damage to, or any claim whatsoever of the owners of said goods, paid or payable by the other or non-carrying ship or her owners to the owners of said goods and set-off, recouped or recovered by the other or non-carrying ship or her owners as part of their claim against the carrying ship or Carrier.

The foregoing provision shall also apply where the owners, operators or those in charge of any ship or ships or objects other than, or in addition to, the colliding ships or objects are at fault in respect of a collision or contact.

Under American law, in such cases, each ship is liable to pay one half the damages suffered by the other ship or its cargo, and under the principle of cross liability which applies in such cases, the carrying ships are held liable for one half the damage

to their own respective cargoes as well as for one half the damage to cargo in the other ship. Assume a both-to-blame collision in which cargo in A, the carrying vessel, is damaged to the extent of \$50,000. Under American law, the owners of the cargo on A can collect from B, the stranger vessel, 100 per cent of their damage. In settlement of the claim between the two vessels, B can collect back from A one half the damage which B has had to pay for damage to A's cargo or \$25,000.

Thus, although under the Carriage of Goods by Sea Act ship A would not be liable to its own shippers for damage to their cargo caused by the faulty or negligent navigation of A, A is compelled under the law governing liability of ships in cases of mutual fault collisions, to pay vessel B one half of the damages and expenses sustained by vessel B, which includes, of course, the full payment made by vessel B to the owners of the damaged cargo on vessel A. To put it another way, vessel A has paid indirectly and through vessel B, one half of the damage suffered by the cargo owners on vessel A, although such cargo owners could recover no part of their damage from vessel A by direct action.

The purpose of the bill of lading clause is to compel the owner of the cargo in the carrying vessel to reimburse the carrying vessel for amounts which it may have to pay to another vessel for damage to cargo in the carrying vessel caused by both to blame collisions.

**When Provisions of Contract Binding on Consignee.**—The consignee indicated in a bill of lading is not bound by the conditions thereof unless he accepts the shipment covered by the bill of lading.

**The Freight Charges.**—The carrier may agree to collect his charges either from the shipper or from the consignee, providing this is made clear in the bill of lading, but the carrier continues to have his lien on the merchandise until his charges are paid by the indicated party.

**The Bill of Lading as a Document of Title.**—Some writers on this subject state that if the lading is in negotiable form, it becomes an instrument of title and will be acceptable for opera-

tions involving the extension of credit facilities. This is not entirely true. A lading is in negotiable form when the words "to order" appear in the space intended for the name of the consignee. If the words "to order" do not appear in the space, but it is provided that the goods shall be delivered to a designated person direct, we have a non-negotiable or "straight" bill of lading. Thus, should the lading recite that the goods are to be delivered "to order of Jose Garcia y Cia.," the buyer in Havana, we have a negotiable lading while, when the recital is that the goods are to be delivered "unto Jose Garcia y Cia.," we have a non-negotiable or straight bill of lading. But the lading consigning the goods to the order of Jose Garcia y Cia. is neither a document of title nor acceptable for credit to a bank or to any other person in the city of the shipper.

Unless and until a consignee has endorsed the lading it is of no value to anyone else, because the carrier will not deliver the goods except to someone who can produce an original copy of the lading properly endorsed by the consignee mentioned therein. A lading so drawn is a document of title to the consignee only because, after paying the corresponding draft drawn on him by the shipper, he is privileged to endorse the lading and offer it to a bank in his own city as collateral for a loan.

When, however, we speak of a lading as being a document of title, acceptable for credit, we do not have in mind the consignee but rather the shipper or intervening holders of the bill of lading, such as a bank which may make a loan against it or discount a draft attached to it, regarding the lading as the collateral security. The bank obtains complete title to the lading and its underlying merchandise if, by endorsement, the lading becomes bearer paper or if the goods are consigned to the bank direct (straight bill of lading) or to the order of the bank (negotiable bill of lading). Very often the lading provides that the goods are to be delivered "to order of shipper." Obviously, the shipper is not making a shipment to himself, especially when he is in New York while the goods are destined for a foreign port. But by shipping to his own order he is at liberty to endorse it in blank, and thereafter pass title to the lading

and the goods by the mere delivery of the endorsed lading to someone else. He has given the lading the force and effect of bearer paper, insofar as passing a good title is concerned. Banks will readily accept ladings made negotiable in this manner, either for simple loans or as collateral for bills of exchange offered for discount. When the bank acquires a financial interest in such a lading, it does hold a document of title and, of course, the lading has been acceptable to the bank for credit purposes.

### Classifications of Bills of Lading

**Negotiable and Non-Negotiable (also known as Straight or Flat) Bills of Lading.**—We have already indicated that bills of lading may be negotiable or non-negotiable. The difference is determined by the phraseology used in the clause indicating the consignee. If the clause contains the words “to order” we have a negotiable lading, but if the goods are consigned “unto X & Co.,” the words “to order” being omitted, we have a non-negotiable bill of lading, which is popularly called a “straight” bill of lading. Straight bills of lading are also designated as being “flat” bills of lading but this term appears mostly in books.

With few exceptions, it is incumbent upon the shipper to determine if the lading is to be in negotiable or straight form. It is the shipper who prepares the several copies making up the set and, generally speaking, the carrier will sign the original copies without giving any consideration to the phraseology employed by the shipper. The shipper should select the form best suited to his own needs and should not be entirely swayed by the wishes of the foreign buyer, unless the buyer has already paid for the goods, in which event the goods are his and he may have them shipped under a negotiable or straight bill of lading. As a rule, however, the buyer does not pay in advance but agrees to pay as against bills of exchange to be drawn on him by the seller.

Assuming the buyer has expressed no preference as to the form of the lading, should the shipper employ the negotiable

or the straight form of lading? What are the advantages of the one form as against the other? Let us first of all discuss the negotiable form. The carrier will not release the goods covered by a negotiable lading unless and until an original copy, duly endorsed by the indicated consignee party, has been delivered to the carrier. This will not only protect the shipper but will also protect all intermediary parties, such as banks, who may have acquired a financial interest in the lading. This is a very important consideration. In the second place, being a negotiable document, the negotiable lading protects innocent holders for value. Should the negotiable lading be stolen and subsequently negotiated for value to someone else who has no knowledge of the theft, the purchaser is protected. So, also, the innocent holders for value hold the lading and the goods as against all parties which may have claims against the shipper, be they the unpaid sellers of the goods to the shipper or anyone else who may have a valid claim against the shipper. A negotiable bill of lading is negotiated free from existing claims against the goods or against the shipper. Again, being a negotiable document, the negotiable bill of lading can be negotiated and title to it can be passed by special or blank endorsements. Indeed, whenever possible, such a lading is endorsed in blank and thereafter title to it is passed by mere delivery. This becomes important if any of the endorsements are to be made in a foreign country such as Brazil, where each endorsement is subject to a stamp tax.

Now let us consider the straight bill of lading. In the first place, the consignee indicated in the straight bill of lading is permitted to take the delivery of the goods intended for him without the production and surrender of an original copy of the lading. The carrier's agreement is to take the goods from the shipper and to deliver the same goods to the indicated consignee. When the carrier has done that he has fulfilled his agreement and no one else can have an interest in the goods. To be sure, a straight bill of lading may be sold but the carrier will not be responsible to the purchaser unless, before the release of the goods to the indicated consignee, the purchaser of

the lading has brought his purchase to the attention of the carrier and has supplied to the carrier the name of another person to whom the goods may be surrendered.

There can be no innocent holder for value of a non-negotiable document. Consequently, the carrier is not interested in the outstanding straight bill of lading, providing he delivers the merchandise to the consignee mentioned therein and providing, of course, the shipper and possible buyer of the document have not brought its sale to the attention of the carrier and supplied him with new delivery instructions.

At some foreign ports carriers and customs authorities decline to surrender property covered by straight ladings without the surrender of the ladings but such rules are made for the convenience of the carriers and of the customs authorities and do not have the force of law. It is dangerous to rely upon such rules. If the buyer has requested the shipper to consign the property to the buyer direct, using the straight form of lading, the shipper may telephone to the carrier and may receive the information that the property will not be delivered to the designated consignee unless he surrenders the lading. Relying upon this report, the shipper may cover the shipment with a straight form of lading which provides that the carrier is to deliver the property "unto X & Co." (the buyer). He then attaches the straight bill of lading to a sight draft drawn on X & Co. and delivers it to his bank, for collection or for discount, instructing the bank to deliver the lading to the drawee against the payment of the draft.

In due course, the property arrives at the foreign point and the carrier releases it to the designated consignee without insisting upon the surrender of the lading. The collecting bank abroad presents the sight draft but the drawee refuses to pay, stating that he has received the merchandise from the carrier and it is not as ordered. The collecting bank can have no valid claim against the carrier because the foreign agents of the carrier knew nothing about the telephone conversation between the shipper and carrier, and the carrier can readily enough prove that he did deliver the property to the only person who, accord-

ing to the lading, was to receive it—the consignee designated in the lading. The shipper cannot complain, because the law will not give effect to the telephone conversation when it is attempted to vary the intent and meaning of the written lading. The terms of written documents cannot be varied by the introduction of parole evidence. Aside from the technicalities of the law, the shipper cannot have a valid complaint because he could have protected the property by utilizing a negotiable form of lading. By utilizing the straight or non-negotiable lading he, in effect, instructed the carrier to transport the property to the foreign point and there to deliver it to a designated person—the person indicated in the document as the one who is to receive it.

We are all familiar with express receipts, which are usually in non-negotiable form. The express company takes the property to the designated point and there delivers it to the addressee of the package. The receipt is held by the shipper and is not required to release the property to the addressee. It is incumbent upon the carrier, be it an express or steamship company, to make delivery to the party designated as the consignee in the express receipt or in the non-negotiable ocean lading. If correct delivery is made and the carrier can prove it, the carrier has fully and correctly executed his part of the agreement.

It is doubtful whether shippers consider these points when making up their bill of lading forms. Some meet the wishes of their foreign buyers. Others seem to have adopted the one form or the other. Still others bear in mind the wishes of the bank which is to be requested to buy or to discount the drafts to be attached to the ladings. Taking all factors into consideration it would seem that the negotiable lading meets the requirements of the interested parties much more satisfactorily than the straight lading. But, of course, this is a matter of opinion.

### **Negotiable Bills of Lading**

We are now prepared to classify the various forms of negotiable and straight bills of lading. The negotiable bill of lading may be in any one of the following forms. The goods may be consigned :

1. To Order, Notify .....
2. To Order of Shipper
3. To Order of ..... (the buyer)
4. To Order of ..... Bank (the negotiating bank)
5. To Order of ..... Bank (the collecting bank)
6. To Order of ..... (the agent of the shipper)

In discussing these forms, let us test each form by asking

- (a) Has the shipper lost his control over the goods?
- (b) Is the lading required to take delivery from carrier?
- (c) Is the lading good collateral?

1. **"To Order Notify \_\_\_\_\_."**—Whenever this form is used, the shipper merely places in the space intended for the consignee's name the words "To Order." This makes the lading similar to bearer paper. The words "To Order" may be followed by a phrase reading "Notify X & Co.," X & Co. being either the buyer, or his custom house broker, or the local agent of the shipper. X & Co is known as the "Notify Party." It furnishes the carrier and the customs authorities at the foreign point with the name of someone to whom the arrival of the goods can be advised and who will, perhaps, take steps to have the shipment released as against suitable bonds, in order to avoid fines, penalties, and storage charges in the event the ladings are delayed or lost in transit.

The carrier does not insist upon the inclusion of a notify party in this or in any other form of bill of lading, but it is in the shipper's interest to have one. The notify party has no direct interest or rights in the shipment even when the goods are intended for him. He is not the consignee. The consignee is the actual holder of the lading and the carrier or customs will hold the shipment for a reasonable time until someone presents the bill of lading. In a bill of lading of this form, the shipper continues to control the shipment so long as he or his agents hold the bill of lading. The buyer cannot obtain the goods from the carrier until he, himself, has acquired the lading duly endorsed by the shipper, and is able to surrender it to the carrier. This form of bill of lading is, of course, good collateral to the bank which buys or discounts the draft to which it may be

attached, as the lading, endorsed by the shipper, gives the bank title to the merchandise covered by the bill of lading.

2. **"To Order of Shipper."**—This form also may or may not have a notify party. It is very similar to the "To Order" form, and becomes similar to bearer paper when endorsed by the shipper. Consequently, the shipper controls the goods, the lading must be surrendered to obtain the goods from the carrier, and it may serve as collateral. In case of necessity, the lending bank which holds the lading as collateral can obtain the goods from the carrier and can reimburse itself, in whole or in part, by the sale of the goods.

3. **"To Order of \_\_\_\_\_" (Buyer).**—In this form the goods are consigned to the order of the buyer, the buyer being clearly indicated by name. The shipper has lost the control of the shipment because the goods will not be released by the carrier unless and until someone surrenders to the carrier an original copy of the lading, properly endorsed by the buyer. The shipper cannot supply the buyer's endorsement and the carrier will accept no new instructions from the shipper, unless the shipper is in a position to surrender to the carrier at the point of shipment each and every signed original copy of the lading. Being a negotiable bill of lading, the carrier will wish to make sure that no signed original copy is being held by an innocent holder for value. This type of bill of lading is not good as collateral because the interested lending bank may not be able to induce the buyer to endorse the lading and, as we have already indicated, the carrier will not surrender the goods unless and until the person wishing to obtain the goods is in a position to surrender a signed original copy of the lading, duly endorsed by the buyer.

4. **"To Order \_\_\_\_\_ Bank" (Negotiating Bank).**—Here the shipper consigns the merchandise to the order of his American bank which is to be requested to buy or discount the bill of exchange to which the lading is to be attached. Obviously, by utilizing this form, the shipper takes himself out of the picture and loses his control over the shipment. Neither the foreign buyer nor anyone else may obtain the goods from the carrier

without surrender of the lading. The negotiating bank is protected and the lading is good collateral because the bank and only the bank controls the shipment. But the bank would be equally well satisfied and protected had the shipper consigned the goods either to his order or simply "to order" and endorsed the lading in blank. The negotiating bank prefers that its name does not appear on the lading as it dislikes endorsing ladings if the objective can be obtained by the utilization of another form of lading which need not require its endorsement.

5. **"To Order ——— Bank" (Collecting Bank).**—The shipper may consign the goods to the order of his American bank or to the order of the foreign collecting bank in the city of the buyer, with the understanding that neither of these banks is to acquire an interest in the shipment but merely handle the draft to which the lading is attached, as a collection item. In such cases the shipper again loses control of the shipment. The lading must be surrendered to the carrier, properly endorsed by the consignee bank, in order to obtain delivery. It is not good for collateral purposes unless the shipper intends to borrow from the bank to which the goods are consigned. If the consignee bank is a foreign bank or the branch of an American bank in the city of the buyer, its name should not be used as the consignee without its consent. The consignee bank will hesitate to endorse the lading of an unknown or questionable shipper. It may make a charge for its endorsement. The foreign customs authorities will naturally look to the consignee bank for the payment of duties and accrued expenses. The merchants in the buyer's city may wonder if the consignee bank is in the importing business.

6. **"To Order of ———" (Agent of Shipper).**—If the shipper consigns the goods to the order of his own agent in the city of the buyer, he places himself at the mercy of his agent. The shipper loses control of the shipment. As the carrier will not release without the surrender of the lading, the lading must be made available to the agent so that he may endorse it. The agent may then take delivery. This type of lading cannot be used as collateral because it is the consignee-agent, and not the

lending bank, who controls the shipment. The lading will not be accepted by the carrier for the release of the shipment without the endorsement of the agent. He may or may not be willing to endorse it.

While the carrier will not release a shipment without the surrender of an original copy of a negotiable bill of lading in any of these six forms, the shipper can also keep the goods within his own control and offer the lading as collateral, by consigning the goods to his own order or simply "to order." There really is no good reason for utilizing any of the other possible forms discussed above. He is at liberty to use one of these other forms, if he acts advisedly and wishes to accomplish a special purpose.

### Non-Negotiable or Straight Bills of Lading

The straight bill of lading may be in any of the following forms. The goods may be consigned:

1. Unto the shipper
2. Unto the buyer
3. Unto a foreign custom house broker
4. Unto the shipper's foreign agent
5. Unto ..... Bank (the negotiating bank)
6. Unto ..... Bank (the collecting bank)

As we shall see a little later, when shipping to a few specified foreign countries the shipper must utilize the straight bill of lading because the carriers to those countries will not issue ladings in negotiable form. Barring from our present consideration these special cases, the shipper to other countries may use either the negotiable or straight form of bill of lading. Let us test the various forms of straight ladings by the use of the same tests which we utilized in our consideration of the negotiable forms, to wit:

- (a) Has the shipper lost his control over the goods?
- (b) Is the lading required to take delivery from carrier?
- (c) Is the lading good collateral?

1. **Consigning the Goods "Unto Shipper."**—The shipper may indicate himself as the direct consignee or merely use the word "shipper." By this means he retains his control over the goods because the carrier will deliver the goods at the foreign point only to the shipper. In rare instances, the carrier may deliver the goods to the branch of the shipper at the foreign point providing the shipper, John Jones in New York, has consigned the goods "unto John Jones in Buenos Aires," and the branch is operating in the same name as its principal in New York. This, however, is the exceptional case. But if the shipper has no branch office at the foreign point, the carrier will not know to whom to deliver the goods unless and until someone produces an original copy of the lading, properly assigned to him by the shipper. While the shipper may be willing to assign such a lading to a bank for the purpose of selling or discounting the draft to which the lading is attached, it being a non-negotiable document, the bank cannot obtain a title to such a lading which is free from possible claims from third parties. The bank cannot be an innocent holder for value and obtain an absolute title, as it would were the lading a negotiable one. This flaw of title runs with all straight ladings, so we may just as well state right here that the straight lading in any form does not give a negotiating bank as good a title as the negotiable lading.

2. **Consigning the Goods "Unto Buyer."**—If the lading is in this straight form, the shipper has certainly lost his control over the shipment because the carrier will regard the given consignee as the only person to whom the goods may be delivered and the delivery will be made to him either with or without the surrender of the corresponding straight lading. Because of this, no bank will accept such a lading as collateral as the bank cannot control the shipment. This form of lading is generally used whenever the buyer has paid for the goods in advance; if the shipper has thus been prepaid, he is quite satisfied to have the buyer obtain the goods without the lading and the shipper need not offer the lading as collateral. He would not wish to finance the shipment when he has already been paid by the buyer.

**3. Consigning the Goods "Unto a Foreign Custom House Broker."**—The broker may represent either the seller or the buyer. The seller is not satisfied to indicate the buyer as the consignee, so he endeavors to protect himself by using the name of the broker. But in doing this he loses his control of the shipment because the carrier will deliver the goods to the broker either with or without the lading, and, of course, no bank will wish to accept as collateral a useless document of this nature—useless for the purpose of collateral.

Whenever goods have been consigned to a broker representing the seller the ladings may be sent to the broker direct, with the information that there will be attached to the draft drawn on the buyer a delivery order, addressed to the broker, which will be made available to the buyer upon his honoring the draft. A carbon copy of the delivery order may also be sent to the broker, in order that the original delivery order may be more readily identified. If the broker represents the buyer, we have the same situations as when the buyer, himself, is indicated as the consignee. In such cases the shipper loses his control over the shipment, the carrier will make delivery to the buyer's broker without requiring the surrender of the lading and, of course, no bank will wish to consider the document as good collateral when the document does not control the merchandise.

**4. Consigning the Goods "Unto the Shipper's Foreign Agent."**—The situation here is similar to the situation created when the goods are consigned unto a custom house broker representing the seller. However, as the direct agent of the shipper is, in a sense, an employee of the shipper, the shipper's rights and title to the goods are somewhat better protected than when the consignment has been made to an independent broker.

**5. Consigning the Goods "Unto \_\_\_\_\_ Bank" (the Negotiating Bank).**—Whenever the shipper intends to sell or to discount the draft to which the lading will be attached, he may consign the goods to the negotiating bank. The shipper, of course, loses his control of the merchandise the moment the lading has been issued. Moreover, if the negotiating American

bank has a branch operating in the same foreign city as the undisclosed ultimate buyer, it may be said that the goods are consigned unto the branch of the negotiating bank and not to its head office in America. If the bank does not operate such a branch, the carrier will be unable to deliver the goods to anyone unless someone presents the straight bill of lading, duly assigned to him. But this possibility will not make the lading suitable as collateral because it is non-negotiable and cannot be held by the bank as against others who can prove a superior right to the lading and the goods covered by it.

**6. Consigning the Goods "Unto —— Bank" (the Collecting Bank).—**The collecting bank may be a bank in the United States, or its branch in the city of the foreign buyer, or an independent foreign bank in that city. The shipper does not wish to consign the goods to the buyer. He has no agent in the foreign city or has not sufficient confidence in the agent. By consigning to the collecting bank, he is calling upon the bank to act as his agent for the purpose of withholding the shipment from the buyer until the buyer has honored the relevant draft. As a rule, however, the bank has not been previously consulted and it may well be that it dislikes acting as the agent of the shipper, especially when the shipper is not known to the bank. With ladings of this type, the shipper loses his control of the shipment, the lading must be produced to take delivery, unless the consignee bank is actually operating at the foreign point.

Straight bills of lading should be utilized only whenever the carrier refuses to issue negotiable ones to the particular foreign point or whenever the buyer has paid in advance. As the negotiable lading is more desirable from the points of view of all concerned, that form of lading should be utilized whenever possible.

### **Classifications According to Situs of Goods**

Bills of lading, both negotiable and non-negotiable, are also classified with respect to the actual position or situs of the goods at the time when the ladings are issued.

**“On Board” Bills of Lading.**—When shipping space is ample and sailings regular, the lading will recite that the goods have been received on board the vessel which is to carry the goods. This representation in the lading assures the holder of the lading as well as the original shipper that the goods are actually on the steamer mentioned in the document and are not being held on the dock for actual shipment by another steamer. As a rule, goods stowed away in the hold of a vessel are not put back on the dock to make room for other goods. The exception to this rule occurs during war emergencies, when the government may order the discharge of all cargo already stowed away so that the government may use the vessel for the transportation of important war cargo. The “on board” bill of lading also offers some legal advantages which, however, have no great value to the shipper. The shipper and all intervening parties are satisfied when assured that the goods have been placed on the indicated carrying vessel.

**Received-for-Shipment Bill of Lading.**—Whenever the carrier issues and delivers to the shipper the bill of lading before the goods have been placed on the vessel, the lading will recite that the goods have been “Received for shipment by \_\_\_\_\_.” Bills of lading of this form have several degrees, such as :

1. “Received for shipment”—without indicating the name of the vessel, which may carry the goods.
2. “Received for shipment by steamer X, and/or following steamers.”
3. “Received for shipment by steamer X.”

It will be noted that the hoped-for time of shipment becomes progressively more certain. Under Form No. 1, no one can possibly determine when or by what steamer the goods may be shipped. Under Form No. 2, the carrier places us on notice that it is hoped to ship on the steamer X, but if that is not possible, the shipment will go forward, in whole or in partial shipments, by available steamers after steamer X has sailed. Under Form No. 3, we are on notice that the goods are not on board but will be shipped on steamer X. All three forms are predicated on the understanding that the date of shipment may be considerably

deferred. Even when the goods have been "received for shipment by steamer X," we cannot feel certain that the goods will be placed on board of steamer X, which may be sent to dry dock for repairs or may not be available for other reasons which will excuse the carrier. A long delay may occur or another vessel substituted.

Received-for-shipment bills of lading are issued whenever conditions are abnormal and there is not ample shipping space available. The carrier will permit the goods to be placed upon his dock in the hope that a steamer will be available shortly. During wartime the carrier himself may not know the date of the arrival of a steamer, the length of time it may take cargo, or its departure date. The government takes care of all that. Indeed, the government may even prohibit the disclosure of the name of the steamer when the steamer is in port and has actually taken on the cargo. In wartime, it is dangerous to publish maritime news. So long as the availability of ships is less than the demand for ships, we shall have "Received-for-shipment" ladings. But the "on board" lading is obviously the preferable form.

**The "On Board" Endorsement.**—Oftentimes the carrier will issue a Received-for-Shipment lading and a day or two later actually place the goods on board. Under these circumstances, and barring governmental interference in times of extreme emergency, the carrier, upon request, will place an "On Board" endorsement on the Received-for-Shipment lading, thus giving the document the same force and effect as if originally issued as an "On Board" lading. The endorsement, made by a rubber stamp and signed by the carrier, merely reads "On Board SS X."

There are two special forms of ladings in the category of Received-for-Shipment ladings which are in general use in the cotton trade. They are the "Custody Bill of Lading" and the "Port Bill of Lading."

**The Custody Bill of Lading.**—When the bales of cotton have been delivered to the carrier and the steamer which is to carry it has not as yet reached the port where the cotton is held for shipment, the lading issued by the carrier is called a Custody lading.

The cotton is in the custody of the carrier but the steamer indicated in the lading as the carrying vessel is not in port.

**The Port Bill of Lading.**—Under such a lading the cotton is in the custody of the carrier and the carrying vessel is in port but the bales have not as yet been placed on board.

These two forms of ladings are given special significance largely because cotton is shipped in large lots and is very valuable cargo. Many trucks are required to deliver to a pier enough bales to fill the holds of a cargo vessel. It also takes days to load the vessel. The shipper cannot afford to delay the negotiation of the bills of exchange drawn in cover of the cotton until the entire shipment, which may involve thousands of bales, has been delivered to the carrier and the carrier has actually loaded the vessel. The cotton is too valuable and the delay ties up too much money. The shipper is given "Received-for-shipment" ladings as the cotton is delivered to the carrier. Several ladings may be issued to cover parts of the one shipment and the shipper can immediately attach the ladings to drafts drawn on the buyers and sell the drafts to his bankers. The buyers are satisfied that the shipment will come through in due course.

### Other Forms of Bills of Lading

**The Through Bill of Lading.**—Whenever a carrier is obliged to use the facilities of other carriers as well as his own facilities for the purpose of transporting the goods from the city of the seller to the city of the buyer, the carrier issues a "Through" lading and the second and other interested carriers do not issue their own ladings but honor the "Through" lading issued by the first carrier. These ladings may be issued by railroads at interior points or by steamship companies at the seaboard. For instance, the Union Pacific Railroad may issue a lading in Ogden, Utah, covering goods destined for a buyer in Manchester, England. The lading is usually in non-negotiable form. While the name of the steamship company or the name of a particular steamer is not indicated on the lading, it does bear the general routing instruction "via New York." At Council

Bluffs, Iowa, where the Union Pacific has its Eastern terminal, the shipment may be turned over to the Chicago and North-Western R.R. In Chicago, it may be turned over to the Erie R.R. for the trip to New York. In New York, the Traffic Department of the Erie will engage space on a vessel destined for Southampton, England. When the goods arrive in Southampton they are shipped by rail to Manchester, the Southampton office of the steamship company making the arrangements for the rail shipment, Southampton to Manchester.

The one bill of lading issued by the Union Pacific in Ogden will be the only shipping document issued to the shipper and, if negotiable, must be surrendered to the English railroad in Manchester to obtain the shipment. While several carriers are involved, all the connecting carriers are regarded as the agents of the carrier which issued the bill of lading and all of them are jointly and severally liable to the shipper and other holders of the lading. If the goods have been lost or damaged in transit, the holder may sue all of the carriers involved or any particular one, depending upon circumstances. To be sure, should the loss or damage occur while the goods are in the custody of the steamship company, the holder may have a claim against the insurance company which covered the shipment from New York to Southampton and no claim against any of the rail carriers. When engaging steamer space in New York, the New York office of the railroad also covers the shipment with proper insurance. If the freight and other charges are paid by the shipper, the railroad in Ogden bases its charges upon the total charges as made or to be made by each connecting carrier, including insurance premiums and fees for making the transshipment in New York.

Shippers and banks located at interior points of the United States appear to be partial to the use of the "through" bill of lading, and their position may be well taken. The goods are placed with a reliable railroad which agrees to deliver them to the buyer in a foreign country. The railroad will purchase the required cargo space at the seaboard on the first available vessel after the goods arrive at the American port of shipment. It will take care of all the other ocean shipping details. The shipper in

the interior does not require the services of a foreign freight forwarder at the seaboard.

We must remember that the "through" bill of lading is in the nature of a "received-for-shipment" bill of lading, since neither specifies definitely the vessel which is to carry the goods. When shipping space is freely obtainable, the goods will go by the first connecting vessel. When shipping space is not freely obtainable, delays may result, but at such times the shipper at the seaboard is in no better position, because he, too, must hold up his shipment until cargo space is available. Moreover, as a class, railroads are the best customers of the steamship companies and, oftentimes, can secure space more readily than an individual shipper or freight forwarder at the seaboard. The steamship company will wish to cooperate as much as possible in order to prevent congestion in freight yards.

**Shipper's-Load-and-Count Bill of Lading.**—Factories in the interior have their own railroad sidings and are accustomed to load freight cars on these rails in their own establishments. The National Cash Register Co. in Dayton will ship a carload of goods to New York intended for several large buyers in the New York territory. When the car is fully loaded the railroad in Dayton is notified and the carrier will pick up the car and start it on its way to New York. As the carrier did not pack the car, he has no personal knowledge of its contents and must take the word of the shipper as to the number of cases and other details making up the carload shipment. All interested parties are placed on notice as to this situation by an endorsement placed on the lading by the carrier reading "Shipper's Load and Count," thus bringing into being the Shipper's-Load-and-Count lading. If any resulting damage is due to improper packing, the carrier is absolved from responsibility. The carrier will deliver to the consignees whatever there may be in the freight car, irrespective of the count and description of the several shipments which may appear on the ladings.

**Spent and Partially Spent Bills of Lading.**—If the carrier has delivered the merchandise to the consignee of a negotiable bill of lading without the surrender of a signed original copy of

the lading, the outstanding bill of lading is said to be spent, which is another word for "used up." The carrier is, of course, liable but, in all probability, the delivery was made against the guaranty of a bank or against a suitable bond of indemnity. Also, whenever goods are released against one original copy of a set of three copies, the second and third original copies are also popularly regarded as spent bills of ladings.

At times a carrier is required to release a portion of the shipment covered by the bill of lading. The buyer may not be in a position to pay for the entire shipment immediately upon the arrival of the shipment. If he be an importer of 1000 bags of coffee, and the shipper may permit partial deliveries against payment, he may pay for 500 bags and ask the bank holding the documents to obtain the release of 500 bags. As the bill of lading covers 1000 bags, as soon as the 500 bags are released, the lading becomes spent as to these 500 bags, and we have a partially spent lading. It is incumbent upon the carrier to endorse partial deliveries on the lading and if third parties are misled and incur losses because of the neglect to so endorse, the carrier is liable.

**Forwarder's Bills of Lading.**—A bill of lading issued by a freight forwarder in his own name and for his own account is popularly known as a Forwarder's Bill of Lading. (See Form 4, page 87.) A freight forwarder is not a common carrier in the sense of a railroad or steamship company. He may have a fleet of trucks and be regarded as a trucking common carrier by maintaining an established trucking service between two points but that is as near as he can come to being a common carrier. The forwarder sells his services, not transportation. He can sell his services to whomsoever he pleases and withhold his services from whomsoever he pleases. With few exceptions, freight forwarders are not very strong financially. They do not require much capital as their stock in trade is service. Their largest outlay is for the payroll of their employees. They buy shipping space for their principals with funds furnished them by their principals. The forwarder's bill of lading is not a contract between the shipper and the carrier but a contract between the shipper and the forwarder. When the forwarder delivers the

goods covered by his own lading to the carrier, the carrier regards the forwarder as the shipper and the carrier's lading is issued accordingly. It follows, therefore, that in case of loss or other difficulties the shipper or others who hold a forwarder's lading must proceed against the forwarder and not against the carrier employed by the forwarder.

How good is the forwarder's bill of lading? It is as good as the forwarder. It is as good as any other written contract depending upon the financial standing of the parties to the written contract. The ladings of some financially strong forwarders may give the holders even more protection and security than the ladings of some weak steamship companies.

While, generally speaking, the forwarder's lading is not so good as the lading issued by a first class carrier and does not always serve as good collateral, it does have its proper place in the shipping world. A merchant in Valparaiso, Chile, may place small orders with ten different American manufacturers. Assuming the minimum bill of lading charge of the carrier is \$20. for each bill of lading, these ten small orders may involve a total shipping charge of \$200. All steamship lines have minimum charges. If it were possible to combine these ten orders, the probabilities are the same could be packed in one or two cases and the ocean freight on the one or two cases may be only \$40. as compared with the charge of \$200. on ten separate small shipments. In order to combine the ten separate orders into one shipment, the foreign buyer will instruct the individual shippers to ship to X Forwarding Company in New York and that the forwarder thus designated will issue and forward to each shipper a bill of lading which the shipper may utilize as he sees fit. Each shipper is supplied with a bill of lading indicating the shipper by name and indicating the consignee as the shipper may direct.

As soon as all ten orders have been received by X Forwarding Company, the forwarder packs them into one or two cases and ships the cases to the forwarder's branch office or correspondent forwarder in Valparaiso, with the information that he, the forwarder, has issued ten separate bills of lading against the shipment and the individual ten packages are to be released to

the buyer in Valparaiso against the surrender of the corresponding ladings. Each bill of lading bears shipping marks corresponding to the marks appearing on the individual packages so that the branch or correspondent of the New York forwarder has no difficulty in matching the different ladings against the corresponding packages.

Insofar as the steamship company is concerned, the X Forwarding Company is the shipper and the consignee indicated in the lading of the steamship company is the consignee. The contract of the steamship company is with the forwarder and not with the ten individual shippers whose identity is not known to the carrier. To be sure, the forwarder makes a charge for this service but this charge and the freight on the one or two cases make up a total charge considerably less than the \$200. to be paid on ten separate small shipments. This arrangement also enables each individual shipper to control his own shipment because the forwarder gives each shipper a separate document and agrees not to release the goods to the ultimate buyer in Valparaiso unless the forwarder's lading is presented and surrendered to the Valparaiso branch or correspondent of the New York forwarder.

**When Negotiable Bills of Lading Are Not Issued.**—Steamship companies operating to several Latin American countries decline to issue "to order" or negotiable form of bills of lading and insist that all shipments to these countries be covered by "straight" or non-negotiable bills of lading, consigning the property unto the buyer or unto some other person at the foreign port. The reason for this is that the carriers feel that the negotiable bill of lading may not sufficiently protect its holder, thus creating lawsuits for the carrier. As a rule, the steamer unloads the property into the custody of the customs authorities. But the customs authorities, being a branch of government, will follow governmental rules and regulations when releasing merchandise and not necessarily the wishes and instructions of the steamship companies which have placed the property into their custody. Whenever, therefore, the mercantile usages of a consignee country do not accord a negotiable lading the rights


generally accorded such a document, the carrier may be confronted by lawsuits.

A sovereign government cannot be sued in its own courts without its consent and if an aggrieved party wishes to take action he is obliged to confine the action against the carrier. The carrier attempts to avoid this situation by declining to issue negotiable ladings. A waiver freeing the carrier from responsibility, executed by the shipper in favor of the carrier, will not cure the difficulty for the reason that a negotiable bill of lading may be negotiated (sold) to an innocent holder for value and it may be such holder who will allege and prove negligence upon the part of the carrier in releasing the property, for instance, without the surrender of the lading. The identity of holders for value cannot be predetermined.

Without attempting to mention all countries wherein the negotiable bill of lading is not accorded the usual rights, it would appear that shipments going to Colombia, Venezuela, Dominican Republic and Honduras must be handled under non-negotiable straight ladings. In the Dominican Republic it appears that a buyer may obtain the shipment intended for him from the customs against a bond executed by any two other local merchants without surrendering the corresponding bill of lading even though such lading may be in "to order" form.

American exporters shipping to these countries attempt to circumvent the difficulty in several ways whenever they feel they are not in position to consign shipments to certain buyers direct by using "straight" bills of lading. If the local agent of the exporter is responsible, the goods may be consigned to this agent, with the understanding that he will make the shipment available to the buyer just as soon as the buyer has accepted or paid the corresponding draft. But oftentimes the credit standing of the agent is less desirable than the credit standing of the buyer and under such circumstances the exporter will consign the shipment to a bank in the same locality as the buyer, usually selecting the correspondent of the American bank which is to undertake the collection of the covering draft. There is no objection to this procedure, providing the exporter has first obtained the consent of the American bank and also of the foreign bank.

Generally speaking, American banks dislike this procedure because they may be called upon to incur liabilities with respect to shipments which are not contemplated in their ordinary collection service. Because the bank is the direct consignee of the

NO. _____ NON-NEGOTIABLE  REPRESENTATIVES IN ALL PRINCIPAL CITIES OF THE WORLD		CABLE ADDRESS RECEIVED. CODES USED: (A. B. C. 44 & 45 ED. WESTERN UNION BENTLEY'S)	
<p><b>Frederic Henjes Jr., Inc.</b>                  INTERNATIONAL FREIGHT FORWARDERS                  LICENSED CUSTOMS BROKERS                  24 STATE STREET                  NEW YORK</p>			
<p><b>Received</b> on behalf of the shipper and/or owner and/or consignee named herein (hereinafter referred to as the order) bill of lading or receipt of Railroad Company, Steamship Company or other carrier and/or other documents subject to all contracts, clauses, rules regulations and conditions (printed, written or stamped) appearing in the tariffs bills of lading or receipts of the American or Foreign inland and/or ocean carriers said to control the packages described herein for the purposes hereinafter set forth and subject to the terms, provisions and conditions printed, written or stamped on the face and back hereof said packages being in apparent good order and condition except as noted said to contain merchandise the contents value, weight quantity conditions of contents or the marks on said packages not being known to the person firm or corporation named in the heading hereof hereinafter designated as the Company to be forwarded to the port of destination named herein.</p>			
SHIPPED BY _____ PER _____ TO BE FORWARDED FROM _____ PER S/S _____ AND/OR OTHER VESSEL OR VESSELS BOUND FOR _____ FOR DELIVERY UNTO ORDER OF _____ _____ OR ASSIGNS FOR DELIVERY APPLY TO _____			
SENDER'S MARKS AND NUMBERS	SENDER'S DESCRIPTION OF CONTENTS	WEIGHT	MEASUREMENTS

Form 3a. Typical Forwarder's Bill of Lading

shipment, the customs authorities will look to it and not to the real buyer for the payment of the import duties and possible storage charges, fines, etc. Again, when a bank at a foreign point constantly appears as the direct consignee of merchandise, the importing clients of that bank are apt to obtain the erroneous impression that the bank itself is in the importing business and

**SUBJECT ALWAYS TO THE TERMS, CONDITIONS AND EXCEPTIONS OF THIS**

1. The Company assumes no liability as a carrier, and undertakes only to use reasonable care in the selection of carriers, truckmen, forwarders, lightermen, warehousemen, agents and others to whom it may entrust the goods for transportation, handling and/or delivery and/or storage or otherwise.

2. The Company is authorized to select and engage carriers, truckmen, lightermen, forwarders, agents, warehousemen and others, to transport, store, deal with and deliver the goods, all of whom shall be considered the agents of the Sender, and the goods may be entrusted to such agencies subject to all conditions as to limitation of liability for loss or damage, and to all rules, regulations, requirements and conditions, whether printed, written or stamped, appearing in bills of lading, receipts or tariffs issued by such carriers, truckmen, lightermen, forwarders, agents, warehousemen and others.

3. Inasmuch as carriers limit their liability to a nominal sum for loss or damage, unless a freight rate based on valuation is made with said carriers,—the Company must receive at the time when forwarding instructions are given, special written instructions from the Sender to pay such higher freight rate based on valuation; otherwise the valuation placed by the Sender on the goods shall be considered as solely for customs and insurance purposes, and the goods will be delivered to the carriers, subject to all their limitation of liability. Such special written instructions indicating value do not in any manner relate to insurance.

4. The Sender has the option of paying a special compensation to the Company based upon a value in excess of \$50.00 per package, in case of any loss or damage from causes which would make the Company liable, but such option can be exercised only by special written agreement made with the Company, prior to shipment, which agreement shall indicate the limit of the Company's liability and the special compensation for the particular risks by it to be assumed, and be attached hereto or endorsed hereon by a duly authorized officer of the Company;—otherwise the Sender agrees that the Company's liability for any loss or damage to the goods for any cause which would make the Company liable shall not exceed the sum of \$50.00 for each package (or the invoice thereof, if less), and any partial loss or damage for which the Company might be liable, shall be adjusted pro-rata on the basis of the valuation of \$50.00 per package, or the invoice value thereof if less.

5. In no event shall the Company be liable for any act, omission or default in connection with the within shipment, unless a written claim therefor shall be presented to it at its office in New York within six (6) months from date of shipment of the goods to the Company, in a statement to which sworn proof of claim shall be attached. No suit to recover any claim or demand hereunder shall in any event be maintained against the Company unless instituted within three (3) months after presentation of the said claim as above provided. The provisions of any and all Statutes of Limitations are hereby expressly waived.

6. It is agreed that any claim or demand for loss, damage or delay, or any other cause, shall be only against the carriers, truckmen, lightermen, forwarders, agents, warehousemen or others in whose actual custody the goods may be at the time of such loss, damage or delay, and that the Company shall not be liable or responsible for any claim or demand from any cause whatsoever, unless in each case the damages alleged to have been suffered be proved to be caused by the negligence of the Company, its officers or employees, in which event the limitation of liability set forth in paragraph number 4 hereof shall apply.

7. The Company shall not be obliged to incur any expenses or advance any money in connection with the forwarding of the goods, unless the same is previously advanced to the Company by the Sender on demand.

8. The Company shall have a general lien on any property of the Sender in its possession, for all claims for charges and expenses incurred in connection with any shipments of the Sender, and if such claim remains unsatisfied for thirty (30) days after demand for its payment is made, the Company is given the right to sell at public auction or private sale, without notice to the Sender, the goods, or so much thereof as may be necessary to satisfy such lien, and apply the net proceeds less the expenses of such sale, to the payment of its charge.

9. The seizure of the goods by any Government, or by legal process shall not affect the liability of the Sender to the Company in respect to the payment of all charges.

10. If the forwarding of the goods from the seaboard is, or in the opinion of the Company is likely to be prevented or delayed beyond the usual time thereof either directly or indirectly by war, civil commotion, insurrection, blockade or other hostilities, or by strikes, labor disturbances or stoppage of labor of carriers, employees, or others, or by lockout by the carriers or others, the Company may at its discretion but at the risk and expense of the Sender store the goods, and charge all expenses and service incurred thereby to the Sender, and the Company shall be entitled to and have a lien upon the goods for such services and expenses.

11. In the event of the goods being refused at destination or remaining unclaimed at destination or any transshipping point in the course of transit or being returned for any reason, the Sender shall nevertheless pay the Company all charges and expenses in connection therewith, and shall be subject to the provisions of paragraphs 8 and 9 hereof. Nothing herein contained shall obligate the Company to arrange for the return or storage of the goods.

12. The compensation of the company for its services shall be included with and is in addition to the rates and charges of all carriers and other agencies selected by the Company to transport and deal with the goods. The Company's compensation shall also include all brokerages, commissions, and sums received by the Company from carriers, insurers, and others in connection with the shipment.

ISSUED AT NEW YORK IN TRIPLICATE, ONE OF WHICH

For Frederic

DATE .....  
26298—MP

**CONTRACT AND WHICH ARE HEREBY MUTUALLY AGREED AS FOLLOWS:**

13. Charges do not include charges in foreign countries for duties, customs or revenue items, service for customs, clearance, port or terminal charges, or expenses or cartage to consignee's local address, none of which expense are required to be advanced by the Company.

14. The Company shall be under no obligation to arrange for any insurance on the packages herein described on behalf of the Sender or holder hereof and any insurance to be effected by the Company shall be provided by special written agreement; but, insofar as the Company may be responsible to the Shipper, the Company shall be entitled to the benefit of any insurance effected on the goods and to any payments or loans made by the insurer thereon in any manner whatsoever.

15. It is further agreed that, since neither the carriers which will transport and handle this shipment, nor the Company will have any control over the shipment while in custody of government officials, a full and complete delivery shall be deemed to be made when the goods have been delivered to custom house, government or other authorities as required by the law or customs regulations then and there in force.

16. The Company may cause the goods to be stored at the expense and risk of the Shipper, and/or of the goods, if unusual delay occurs enroute, or delivery is prevented by causes beyond the Company's control, and, if acceptance is refused, or the goods unclaimed, at destination, the Company shall not be obligated to arrange for disposition or return of the goods, but the goods shall be at sole risk of Shipper, consignee and/or owner thereof.

17. In the event that this shipment originates at an interior point in the United States or Canada, the Company shall be under no obligation to take any action until a reasonable time after the Company has received a notice from the railroad company, express company or other carrier of the arrival of such shipment at the port of exportation.

18. The Shipper undertakes to mark plainly the contents of all packages containing explosives or other dangerous articles, and assumes all responsibility for failure to do so; also, for not conforming with customs, quarantine or other laws, regulations or requirements, and for undervaluation or misdescription of the goods; and the Shipper agrees to pay and reimburse the Company for all fines and expenses incurred by non-compliance with any of the laws and regulations aforesaid, and to hold the Company harmless therein; and the Company may direct the stoppage, storage, sale, or any other disposition of the goods necessitated by the Shipper's default therein.

19. If specially stated in the place reserved on this contract, the Company will make reasonable effort to select and arrange with forwarders, carriers or other agencies for the reforwarding of the packages hereinafter described beyond the port of arrival of the steamship transporting the same. In selecting such agencies, carriers, truckmen, lightermen, forwarders, warehousemen and others to reforward, transport, store, deal with or deliver the packages, the Company only undertakes to use reasonable care in their selection, and may entrust to the foregoing agencies or any of them the said packages, subject to all conditions as to limitation or liability for loss or damage, and to all rules, regulations, requirements, whether printed, written or stamped, appearing on bills of lading, receipts, or in tariffs issued by such agencies, carriers, truckmen, lightermen, forwarders, warehousemen and others, and subject likewise to local and general customs affecting the same and to the terms of this agreement.

20. The Sender, holder or transferee hereof agrees to accept from the Company, or from carriers, truckmen, lightermen, forwarders, warehousemen and others who may be selected by the Company to transport, store, deal with and deliver the goods at the port of arrival or other places, a bill of lading, delivery order or other document entitling such sender, transferee or holder to receive delivery of the goods from the carrier, truckman, lighterman, forwarder and other agencies to whom the goods may be entrusted, in whose possession the said goods may be at the port of arrival or destination, and the delivery of such bill of lading, delivery order or other document to the sender, transferee or holder hereof, shall be full performance of all of the Company's obligations hereunder with respect to the forwarding and reforwarding of said goods.

21. If the packages herein are consigned to "ORDER" the surrender of this contract duly endorsed shall be required before the delivery of the packages at destination, and if so consigned the Company is hereby authorized by the Sender or holder hereof to effect delivery of said packages to any person presenting this contract so endorsed; and, the effecting of such delivery to any person presenting this contract so endorsed, shall be a full performance of the duty of the Company hereunder. The Company shall not owe any duty to notify the consignee or others of the arrival or disposition of the packages nor be liable for any loss or damage arising from failing so to do. If the packages herein are NOT consigned to "ORDER," then said packages may be delivered without requiring the production of presentation of this contract.

22. All disputes and suits hereunder shall be determined in accordance with the laws of the State of New York.

23. No agent or employee of the Company shall have authority to alter or to waive any of the provisions of this contract.

24. In accepting this contract the Sender and the holder of this contract expressly ratify and agree to be bound by all its stipulations, exceptions and conditions whether written, printed or stamped hereon or affixed hereto, as fully as if they were all signed by such Sender and holder and to expressly waive any right to prior inspection of bill of lading or receipt of any carriers or others to whom the packages are or may be entrusted for transportation, or for any other purpose.

BEING ACCOMPLISHED THE OTHERS STAND VOID.

Henjes Jr. Inc.

PER .....

hence is their direct competitor. If the prior consents of the consignee banks have not been obtained, the banks may decline to protect the shipment when difficulties arise and the goods may be sold by the customs authorities in order to realize, in whole or in part, the duties, storage charges, and fines assessed against the shipment.

Perhaps the best way for the American exporter to protect himself, when being compelled to use "straight" bills of lading, is to consign the shipments to a reputable freight broker and forwarder located in the buyer's port. Banks will gladly supply the names of such brokers and will also give the shippers full credit reports on the names thus suggested. Naturally, the banks must not be held responsible for the acts and omissions of the brokers. Assuming the shipper is satisfied with the standing of the broker, he will consign the goods unto the broker, (straight bill of lading), send the broker the ladings direct, together with a carbon copy of a delivery order addressed to the broker, and advise the broker that when the original delivery order is surrendered to him by the buyer, he may release the goods to the buyer free of payment. The shipper will then attach to the draft drawn on the buyer the original delivery order in lieu of the bill of lading. He will instruct the collecting bank to release the delivery order to the drawee (the buyer) when the drawee honors the draft by accepting it, if it be a time draft, or by paying it, if the draft is payable at sight. Foreign brokers extending this service make a nominal charge, but the procedure does give the shipper the protection which he otherwise will not have when being obliged to utilize "straight" bills of ladings.

The great majority of shippers to these countries prefer to consign their shipments to their buyers direct but, of course, exercise or should exercise greater care in checking the credit standing of the buyers.

### Endorsing Bills of Lading

**Passing Title to Non-negotiable Bills of Lading.**—If the bill of lading is in non-negotiable form, title to it cannot be passed by an endorsement in blank or by a special endorsement

calling upon the carrier to deliver the involved goods to the order of a named third party. Title to a non-negotiable instrument is passed by an assignment which is in the nature of a bill of sale. In other words, the non-negotiable lading is a chattel and may be sold in the same manner as any other chattel. If the purchaser of a non-negotiable lading wishes to have standing with the carrier, he must be in a position to submit a document from the consignee indicated in the lading evidencing the sale of the bill of lading to the purchaser. The assignment serves this purpose and may be evidenced either by a short form of assignment indicated on the back of the bill of lading or by a separate assignment form attached to the lading. Whenever the assignment is noted on the bill of lading itself, its wording is about as follows:

For value received, we hereby assign and set over to and unto  
—(the assignee)—all our right, title, and interest in the within  
document and the property covered thereby.

---

(Signature of assignor)

The purchaser of a non-negotiable bill of lading, however, holds the lading subject to the prior rights—equities—of third parties in the lading and the goods covered by it. An instrument or document which is non-negotiable per se cannot be made negotiable by endorsements in negotiable form. This rule is oftentimes overlooked and non-negotiable ladings are endorsed in the same manner as are negotiable instruments—by blank and by special endorsements—instead of being assigned. This practice is dangerous since the courts are apt to hold that there was no legal transfer of title.

**Passing Title to Negotiable Bills of Lading.**—A negotiable bill of lading may be endorsed in blank or to the order of a third party in the same manner as a check, but with somewhat different effect. The bill of exchange calls for the payment of a fixed amount of money and every endorser of a bill agrees, in effect, that if the person primarily liable for its payment does not pay, he, the endorser, will pay the money involved to the holder of the bill.

This rule could not possibly be extended to the endorsers of bills of lading because such documents cover property of varying grades and values and it would be impossible for such an endorser to complete an operation by tendering other property. The endorser of a bill of lading, however, does make the following four warranties, unless a contrary intention appears in the endorsement itself. These are:

1. That the bill is genuine. Obviously, the endorser does not intend to pass title to a worthless piece of paper, especially when he is to obtain value for it.

2. That he has the legal right to transfer it. This warranty means that the endorser has not obtained possession of the document through fraud but is the actual party at interest with respect to the underlying property.

3. That he has knowledge of no fact which would impair the validity or worth of the bill of lading. This warranty may cover a number of situations. Let us assume that the lading has been stolen and purchased by the endorser at a much lower price than the actual value of the property. Under such circumstances he would be transferring a lawsuit instead of the property mentioned in the lading. Again, let us assume that the property has been destroyed by fire while in the custody of the carrier, and that he has knowledge of that fact. He would, again, be transferring a lawsuit to the endorsee.

4. That the property is merchantable and fit for its given purpose. If this warranty were not made, the lading may again turn out to be a piece of worthless paper. If, for instance, the goods are perishable and have suffered damage in transit not chargeable to the carrier, the endorser will be selling "unmerchantable" goods instead of the sound and saleable property mentioned in the document. The property may be of such a nature which cannot be sold to the public prior to the obtaining of a governmental inspection certificate. Such certificate may be withheld on the ground that the commodity is not fit for human consumption, although it had been intended for such use. There must be an exact similarity between the property as described in the lading and the property itself. The bill of lading is the property, and in view of the fact that the property described

cannot be personally inspected, the endorser warrants that it is merchantable and fit for its given purpose.

These warranties apply, however, only when the bill of lading itself has been endorsed and delivered to someone, for value. In such cases it is the lading which is actually sold or negotiated. For instance, let us assume that the Ottoman Bank in Ankara, Turkey, has shipped ten bales of tobacco to New York, consigned to the order of The National City Bank of New York, with instructions to sell the tobacco at best obtainable prices. The consignee bank promptly makes the sale to X & Co., receives payment, and endorses the bill of lading either in blank or to the order of X & Co., and delivers it to the buyers. In a case of this character the bank necessarily makes the four implied warranties mentioned above, as, otherwise, the bank would be selling a piece of paper—the bill of lading—for a fancy price.

More often, however, banks are not in this position when required to endorse bills of lading consigning merchandise to their order. For instance, if the Turkish bank had previously sold the tobacco to X & Co. and had drawn a sight draft on the buyers and had attached to it the bill of lading, consigning the property to the order of the New York bank, with instructions to deliver the lading to X & Co. against the payment of the sight draft, it would be incumbent upon the consignee bank to endorse the document before delivering it to X & Co. but in such a case the bank would not be considered as making the above four warranties but merely passing title to a document extended to its order. The bill of lading is the collateral for the draft. It may be good collateral or bad collateral; the bank is collecting the draft only and not necessarily the value of the tobacco.

It follows, therefore, that the endorser of a bill of lading makes these warranties when he negotiates or sells the lading itself. But if the lading is attached to a draft or note which must receive attention before the lading is to be surrendered to the endorsee, the endorser does not make the warranties. This rule is followed in all foreign and inter-state operations governed by our Federal laws but may not be the settled rule of law in all the states when intra-state operations are involved. Be-

cause of these difficulties and more particularly because it is difficult at times to determine if the lading itself is the thing negotiated or merely serves as the collateral for another document such as a bill or note, banks invariably waive the warranties when being obliged to endorse bills of lading by the use of an endorsement which reads substantially as follows:

The X Bank of New York hereby gives notice to all parties concerned that it does not warrant and will not be responsible for the genuineness of this document or any document hereto attached nor for the existence, quantity, condition, or delivery of goods purporting to be covered thereby.

DELIVER TO THE ORDER OF

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THE X BANK OF NEW YORK

Assistant Cashier

Difficulty arises, however, when a bank is negotiating the bill of lading itself and the endorsee will properly object to the waiver-endorsement which the bank uses and insists that the endorsement be made unconditionally. In such cases the bank must rely upon its principal, be the principal a client or correspondent bank, and may call upon the principal to defend any suit brought against the endorser bank based upon the warranties implied in the endorsement. If the endorser bank, through a chain of circumstances, can rely absolutely upon the standing of the principal, it should not hesitate to supply an unconditional endorsement.

## CHAPTER 6

### MARINE INSURANCE ON CARGO

Of all the different types of insurance, the most interesting is marine insurance. No one appears to know just where the practice of insuring sea shipments first began but some scholars have discovered certain principles of marine insurance in use some twenty-five hundred years ago. Suffice it to say that marine insurance is as old as ships. It is said, moreover, that the earliest English policy of marine insurance is dated in the year 1680 and the probabilities are that that policy is the earliest of any throughout the world in the form of the policy as we know it today.

**Lloyd's.**—Were we able to go back some 250 years to Edward Lloyd's coffee house in London, we would meet a number of English gentlemen of means who frequented that social center and who were in the habit of insuring hulls and cargoes on the high seas. Taking into consideration the condition of the ship and the particular voyage which it was about to take, a number of these gentlemen fixed the premium to be charged and jointly insured the ship and its cargo against the so-called perils of the sea, each one being responsible for a specified percentage of any loss in exact proportion to the premium received by him. If Mr. A received 5 per cent of the total premium charged, he would be responsible for 5 per cent of the losses sustained in the voyage. This was the beginning of Lloyd's which has developed into one of the great insurance organizations of the world and is now writing a large volume of business not only marine but also fire, casualty, and other forms of non-marine insurance.

While the coffee house of Edward Lloyd has been succeeded by pretentious quarters and the present members of Lloyd's write every type of insurance, the procedure is much the same as





in its earliest days. Some four hundred concerns and individuals are members and each member has deposited with the management a certain amount of cash and securities as a guaranty fund and is permitted to take on business in proportion to the size of his deposit. This rule is intended to prevent an ambitious member from overextending himself as it would be a severe reflection upon the entire organization were any of its members unable to pay losses chargeable to him. As risks are offered, the member initiating the business notes the details of it on a slip and indicates what percentage he, himself, will take and then the slip is passed to a number of other members until the entire risk is covered.

Some members are represented at Lloyd's directly while one man or one concern may be the participating representative for a number of members and the percentage of a given risk as taken by the representative may be apportioned among all the members of the group in accordance with a prearranged schedule. The policy is then issued by the organization and in it are indicated the names or the identification numbers of the participating members and their respective percentage of responsibility in the risk covered by the policy. At first, the insurers actually signed such policies, writing their names and percentages immediately under the body of the document. They thus became the "underwriters" of the insurance. At present, the policy is signed by Lloyd's Secretariat only but the policy still contains the numbers and the percentages of the participants.

Early in the eighteenth century, the first two corporations authorized to carry on the business of marine insurance in England were organized under Royal charter, which gave them a monopoly in conducting the business as corporations. In June 1824 the charter creating the monopoly was repealed and the way opened for the formation of other corporations to engage in the business. Since then many British insurance companies have been organized to carry on the business of marine insurance, some of which have been underwriting successfully for many years and now conduct a very substantial share of the business that is written by British underwriters.

**The Development of Marine Underwriting in the United States.**—A large number of British insurance companies have entered the United States by complying with the laws of the several states governing the admittance of foreign companies to carry on business in the states and these companies have for years transacted business in the United States, together with American marine and fire insurance companies which are authorized by our insurance laws to transact marine insurance.

Although a few American insurance companies have written a substantial amount of ocean cargo insurance for many years, the amount of capital invested in the business by such companies, compared to the capital of foreign companies which were operating in the American market, was small until the emergency created by World War I induced many of the large fire insurance companies, which previously had not engaged in marine insurance, to enter the field. The number soon increased to over one hundred and, with the large American Merchant Marine that had been developed, most of these companies continued in the business following World War I.

World War II created an increased demand for marine insurance facilities covering hull and cargo business. Fortunately, due to the experience gained during World War I, American underwriters were better prepared to meet this emergency, which called for a tremendous expansion of marine insurance facilities. At the present time an American merchant would probably be able to cover in the American market any amount that he could have at risk.

The war years demonstrated the importance of having a strong and sound marine insurance market in this country to protect our commerce in times of national emergency. Marine insurance, like banking, is essential to the development and maintenance of our export and import trade and it is in the interest of those engaged in foreign trade to support the national market in every way possible in order that it may continue to serve our commerce in times of peace as well as in the uncertain and perilous times that, perhaps unexpectedly, may arise in the future.

**The Necessity for Marine Insurance.**—Insurance is not obligatory. If you do not insure, you take your loss and make the best of it. It is hoped, of course, that the insurance premiums that you have saved by not carrying insurance make up an amount of reserve sufficient to take care of probable losses. By not insuring, you have become your own insurance company and you have operated profitably if your losses are less than the premiums which you have saved. You, the owner of the goods, must decide whether or not you can afford to carry your own risk and hope that the law of average, which is the principle on which all insurance is based, will work out in your favor.

When ocean shipments are involved, however, you must bear in mind a type of loss which does not affect your own goods but for which loss, nevertheless, you may be called upon to contribute in "general average." This is an ancient doctrine of maritime law and is definitely recognized by all maritime nations. If, under certain circumstances, the goods of A, carried on the same vessel on which you also have a shipment, are lost or destroyed, you may be required to contribute toward A's loss even though your own goods have not been damaged in any manner whatsoever. This is as it should be. When a vessel leaves its pier and heads for the open seas it is in fact entering upon a venture, a venture with the elements, and both the vessel and its cargo become subject to the perils of the sea.

Let us assume that A owns a boat and that he is in the habit of renting (chartering) it to B and C, two potato growers in Maine. B stows away in the hold of the vessel 5000 bags of potatoes belonging to himself and, thereupon, C stows away 5000 other bags of potatoes belonging to himself. B and C decide to run the boat, thus loaded with their respective lots of potatoes, down to Boston. On the way down to Boston, they run into a storm and it becomes clear to B and C that the boat must be made lighter if they and the boat and the cargo are to ride out the storm. B says to C, "Charlie, you had better throw some of your bags overboard or we will be swamped." C says to B, "Ben, how can you suggest such a thing? Why don't you throw overboard your own potatoes?" Luckily, this danger-

PLEASE READ YOUR POLICY
INSURANCE COMPANY OF NORTH AMERICA
PHILADELPHIA, PA.,
FOUNDED 1732

C. A. R. G. O.

ON ACCOUNT OF

1 In case of loss to be paid in funds current in the United States, to
2 Do make Insurance, and cause..... to be insured, lost or not lost, at and from

3 4 board the good
5 whereof is master for this present voyage
6 or whoever else shall go as master in the
7 said vessel, or by whatever other name or names the said vessel, or the master thereof, is or shall be named or called.

7 Beginning the adventure upon the said goods and merchandises, from and immediately following the loading thereof on board of the
8 said vessel, as aforesaid, and so shall continue and endure until the said goods and merchandises shall be safely landed as aforesaid,
9 AND, in case of any loss or misfortune, in her voyage, to proceed and sail to, touch and stay at, any ports or places, if
10 thereunto obliged by stress of weather, or any other accident, without prejudice to this insurance. The said goods and merchandises,
11 dice, hereby insured, are valued (premium included) at

12 Touching the adventures and perils which the said INSURANCE COMPANY OF NORTH AMERICA is contented to bear,
13 and bearing the adventure voyage, they are of the sea, fire, casting thence, jettisons, barratry of the master and mariners,
14 and all such coming to the said goods and merchandises, and all such misfortunes (licit or contraband trade
15 excepted in all cases), that have or shall come to the hurt, detriment or damage of the said goods and merchandises, as aforesaid,
16 AND in case of any loss or misfortune, it shall be lawful and necessary to and for the assured, his or their factors, servants or part thereof,
17 to sue, labor and travel for, in and about the defence, safeguard and recovery of the said goods and merchandises, or any part thereof,
18 without prejudice to this insurance; nor shall the acts of the assured or insurers, in recovering, saving and preserving the property in
19 question, be considered a waiver or an acceptance of abandonment; to the charges whereof, the said Insurance Company
20 will contribute according to the amount herein insured; having been paid the consideration for this insurance by the
21 assured, or his or their assigns, at and after the rate of

22 And in case of loss, such loss to be paid in thirty days after proof of loss, proof of interest, and adjustment thereof (the amount of the
23 Note and all sums coming due to be paid, first all sums due to the Company from the assured when such loss becomes due being first de-
24 ducted, and all sums coming due to the assured from the Company, first all sums due to the assured when such loss becomes due being first de-
25 duced), and all sums coming due to the assured from the Company, first all sums due to the assured when such loss becomes due being first de-
26 duced, shall in any case be paid, unless amounting to five per cent. PROVIDED ALWAYS, that no partial loss or particular average
27 shall be made any other insurance upon the property aforesaid, prior in day of date to this Policy, then the said INSURANCE
28 COMPANY OF NORTH AMERICA shall be answerable only for so much as the amount of such prior insurance may be deficient
29 towards fully covering the property hereby insured. And the said INSURANCE COMPANY OF NORTH AMERICA shall return the
30 insurance upon the said goods and merchandises, from and immediately following the loading thereof on board of the
31 said vessel, as aforesaid, and so shall continue and endure until the said goods and merchandises shall be safely landed as aforesaid,
32 AND, in case of any loss or misfortune, in her voyage, to proceed and sail to, touch and stay at, any ports or places, if
33 thereunto obliged by stress of weather, or any other accident, without prejudice to this insurance. The said goods and merchandises,
34 dice, hereby insured, are valued (premium included) at
35 contribution in the proportion of the sum by them insured to the aggregate of such simultaneous insurance.

This Company, if there be one where such proof are taken,
or Underwriters of New York, if there be one where such proof are taken,
shall be deemed to be authorized by the Board of Directors.

Form 5a. Typical American Marine Policy Covering Cargo

36 Notwithstanding anything herein contained to the contrary, this insurance is warranted free from capture, seizure, arrest, re-
37 strain, detainment, confiscation, preemption, requisition or nationalization, and the consequences thereof or any attempt thereof,
38 whether in time of peace or war and whether lawful or otherwise; also warranted free from all consequences of hostilities or warfare
39 operations (whether there be a declaration of war or not); but this warranty shall not extend to collision, contact with fixed or
40 floating objects, or any other cause of loss or damage, which may be caused by the negligence or default of the crew of the vessel,
41 of the voyage or services which the vessel concerned or, in the case of a collision, any other vessel involved therein, is performing) a
42 hostile act by or against a belligerent power; and for the purpose of this warranty "power" includes any authority maintaining naval,
43 military or air forces in association with a power.
44 Further warranted free from the consequences of civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or
45 piracy.

46 Warranted free of loss or damage caused by or resulting from strikes, lockouts, labor disturbances, riots, civil commotions or the
47 acts of any person or persons taking part in any such occurrence or disorder.
48 MEMORANDUM. It is also agreed, that bar, bundle, rod, hoop and sheet iron, wire of all kinds, tin plates, steel, madder, sumac, broom,
49 wicker-ware and willow (manufactured or otherwise), straw goods, sack, grain of all kinds, rice, tobacco, Indian meal, fruits (whether pre-
50 served or otherwise), cheese, dry fish, hay, vegetables and roots, paper, rags, hempen yarn, bags, cotton bagging, and other articles used
51 for bags or bagging, pleasure carriages, household furniture, stoves and kettles, musical instruments, looking-glasses and other articles used
52 in travelling, and all such goods and merchandises, when packed in boxes, barrels, kegs, casks, and other articles, shall be insured
53 and carried, except in boxes, from from average under twenty per cent., unless general; and sugar, fax, flax-seed and bread, are warranted
54 by the assured free from average under seven per cent., unless general; and coffee, in bags or bulk, pepper, in bags or bulk, free from
55 average under ten per cent., unless general. Profits warranted free from claim for general average, but subject to the same per centum
56 of partial loss as if the insurance were on goods. In case a total loss of profits be claimed, the Company to be entitled to a credit of the
57 same per centum of salvage as if the insurances were on goods, and in case of contribution in General Average for any portion of the
58 goods insured, the Company to be free from claim for loss on such portion. Not liable for loss of or damage to
59 any goods shipped on deck.

60 Warranted by the assured free from damage or injury from dampness, change of flavor, or being spotted, discolored, rusty or
61 moldy, unless caused by actual contact of water with the articles insured, and by the action of insects, and by the action and sale of the portion only
62 of the contents of the packages so damaged, and not otherwise; and the same practices shall obtain as to all other merchandise as far as
63 practicable. Not liable for loss or damage to any merchandise resulting from breakage or leakage unless occasioned by stranding,
64 sinking, fire, or collision with another vessel.

65 Warranted by the assured that this insurance shall not extend directly or indirectly to the benefit of the carrier or other bailee, by
66 stipulation in bill of lading or otherwise, and any breach of this warranty, and any act or agreement by the assured, prior or subsequent
67 hereto, whereby any carrier or party liable for or on account of loss of or damage to any property insured hereunder, is given the
68 benefit of any insurance effected thereon, shall render this policy of insurance null and void.

69 In case of any agreement by the assured, prior or subsequent hereto, whereby any right of recovery of the assured for loss of or
70 damage to any property insured hereunder, against any person or corporation, is released, impaired or lost, which would on acceptance
71 of abandonment or payment of a loss by this Company, have entailed to its benefit, but for such agreement or act, this Company shall
72 not be bound to pay any loss, but its right to retain or recover the premium shall not be affected.

73 Warranted by the assured, that the assignment of this policy or of any insurable interest therein, as also that the subrogation of
74 any right thereunder to any party, without the consent of this Company, shall render the insurance effected by such assignment or
75 subrogation, void.

1—Proof of loss to be authenticated by the Agent or
otherwise by a Correspondent of the Board
of Directors, and if neither be represented.

Dated at..... this..... day of..... 19..... Agent
P 12520 12-990 4-2-46

NAME OF ASSURED

1. For account of whom it may concern—loss, if any, payable to .....
2. This policy insures all shipments of lawful goods and/or merchandise of every kind and description, consisting principally of .....
3. The insurance provided by this policy shall attach and cover all shipments in which the assured has an insurable interest, whether made by or to the assured, for their own account or for the account of others from whom written instructions to insure have been received prior to sailing of vessel and before any loss is known or reported loss, damage or accident.
4. (a) AVERAGE TERMS AND CONDITIONS EXCEPT WHILE ON DECK.

- (b) ON DECK:  
Merchandise and/or goods while On Deck (which must be so declared by the assured) are insured:  
Free of Particular Average unless caused by the vessel being stranded, sunk, burnt, on fire, or in collision, but including jettison and/or washing overboard irrespective of percentage.
5. Where this policy by its terms covers while on docks, wharves, or elsewhere on shore and/or during land transportation, such overboardings, breakages, floods (unless the cause thereof is the assistance of docks, piers or other structures, and to pay loss or damage caused thereby, even though the insurance be otherwise F. P. A.
6. AT AND FROM:

7. Valued premium included, at amount of invoice including all charges therein, plus any prepaid and/or advanced and/or guaranteed freight not included in the invoice, plus .....% foreign currency to be converted into dollars at bankers' sight rate of exchange applicable to each invoice and/or credit and/or draft.
8. Per iron or steel steamers, iron or steel motor vessels (but excluding all auxiliary-engined vessels) and connecting conveyances.
9. This insurance attaches from the time the goods leave the Warehouse and/or Store at the place named in the declaration, certificate or special policy for the commencement of the transit and continues during the ordinary course of transit, including customary transshipment, if any, until the goods are discharged outside the overseas vessel at the final port. Thereafter the insurance continues until the goods are in transit and/or awaiting transit until delivered to final warehouse at the destination named in the declaration, certificate or special policy, or until the expiry of 30 days (or 30 days if the destination to which the goods are insured is outside the limits of this port) whichever shall first occur. The transit shall be deemed to have terminated when the goods are landed on which the discharge outside of the goods hereby insured from the overseas vessel is completed. Hold covered at a premium to be arranged in the event of transshipment, if any other than as above and/or in the event of delay in excess of the above time limits arising from circumstances beyond the control of the assured.

10. Note: It is necessary for the assured to give prompt notice to Underwriters when he becomes aware of an event for which he is "held covered" under this policy, and the right to such cover is dependent on compliance with this obligation.  
Provided prompt notice be given, the insurers when such facts are known to the assured and additional premium be paid if required, shall nevertheless be liable to indemnify the assured for the loss or damage to the goods in transit in any case where the loss or damage to the goods be transhipped by another vessel or vessel, or where the cargo is damaged by fire, theft, piracy, or other cause, or change of voyage, or any interruption or other variation of the voyage or risk beyond the control of the assured, this insurance shall nevertheless cover the goods until arrival at the final destination named in the declaration, certificate or special policy or until the subject matter insured is no longer at the risk of the assured, whichever may first occur. No additional risks (whether of delay or of any other description) are insured under this clause, which is intended merely to continue the insurance in force against the same risks named elsewhere in this policy; and if the risks of War, Strikes, Riots or Civil Commotions, or any of these risks, shall be named elsewhere in this policy, the insurance against such risks shall not be extended by this clause to cover contrary to any express provision of such insurance.
11. The risks covered by this policy are to include damage to or destruction of the goods hereby insured, resulting from explosion howsoever or whencesoever provided same is shown not to have been caused by or attributable to any of the risks excluded by the terms of the "Free of Capture & Seizure" or "Strikes, Riots & Civil Commotions" clauses in this policy.
12. When the property insured under this policy includes a machine or machine consisting when complete for sale or use of several parts, then in case of loss or damage covered by this insurance to any part of such machine this Company shall be liable only for the insured value of the part lost or damaged, or at the assured's option for the cost and expense, including labor and forwarding charges, of replacing the lost or damaged part; but in no event shall this Company be liable for more than the insured value of the complete machine.
13. In case of damage from perils insured against affecting labels, capsules or wrappers, this Company, if liable therefor under the terms of this policy, shall be liable only for the amount sufficient to pay the cost of new labels, capsules or wrappers and the cost of relabelling the goods; but in no event shall this Company be liable for more than the insured value of the damaged merchandise.

14. This policy to be deemed continuous and to cover and attach on all goods shipped on and after .....
15. This Company shall not be liable for more than \$ .....
16. Should there be an accumulation of interests beyond the limits expressed in this policy by reason of any interruption of transhipment or conveyance, this Company shall, provided notice be given to this Company as soon as known to the Assured, hold covered such excess interest and shall be liable for the full amount at risk, but in no event to exceed twice the policy limit.
17. This insurance shall not be vitiated by any unintentional error in description of vessel, voyage or interest, but any such error must be reported to this Company as soon as known to the assured, and additional premium paid if required.
18. Including (subject to all the terms herein) risks of craft to and from the vessel; which lighter, craft, or conveyance to be considered as if separately insured, and to pay for total loss of any package or packages which loading, transhipping or discharging. Also to cover any special supplementary lightages to take the goods to or from the warehouse; subject to an additional premium, if required.
19. The assured are not to be prejudiced by the agency of the Voyage, Defect Clause and/or Latent Defect Clause in the Bills of Lading and/or Charter Party. The seaworthiness of the vessel as between the assured and the insurers is hereby admitted.
20. Including General Average and Salvage Charges according to United States law and usage and/or as per Foreign Statement and/or as per York-Antwerp Rules (as prescribed in whole or part) if in accordance with the Contract of Affreightment.
21. This Company shall be liable for only such proportion of General Average and Salvage Charges as the sum hereby insured (less Particular Average for which this Company is liable hereunder, if any) bears to the Contributory Value of the property hereby insured.
22. It is understood and agreed that, where goods are shipped under a bill of lading containing the so-called "Both-to-Blame" Collision Clause this Company agrees, as to all losses covered by this insurance, to indemnify the assured for an amount (up to the amount insured) which the assured may be legally bound to pay to the shipowners under such clause. In the event that such liability is asserted, the assured agree to notify the Company, who shall have the right, at its own cost and expense, to defend the assured against such claim.
23. Notwithstanding anything contained herein to the contrary, this insurance is warranted free of claim for loss of market or for loss, expense, damage or deterioration arising from delay, whether such delay be caused by a peril insured against or otherwise, unless the delay is caused by a peril specifically covered by this insurance.

24. (A) It is a condition of this policy, and it is hereby agreed, that the assured's brokers, .....
- (B) The following Warranties shall be paramount and shall not be modified or superseded by any other provision included herein or stamped or endorsed hereon unless such other provision refers specifically to the risks excluded by these warranties and expressly assumes the said risks.
- (C) This Company shall have the privilege, at any time during business hours, to inspect the records of the assured as respects shipments coming within the terms of this policy.
25. It is a condition of this policy, and it is hereby agreed, that the assured's brokers, .....
26. The following Warranties shall be paramount and shall not be modified or superseded by any other provision included herein or stamped or endorsed hereon unless such other provision refers specifically to the risks excluded by these warranties and expressly assumes the said risks.

27. (A) Notwithstanding anything contained herein to the contrary, this insurance is warranted free from capture, seizure, arrest, restraint, detention, confiscation, preemption, requisition or nationalization, and the consequences thereof or any attempt or warlike operations (whether there be a declaration of war or not); but this warranty shall not exclude collisions, contact with any fixed or floating object (the voyage or interest for which the vessel concerned, or in the case of a collision, any other vessel involved therein, is performing) by a hostile act by or against a belligerent power; and for the purpose of this warranty "power" includes any authority maintaining naval, military or air forces in association with a power.
- Further warranted free from the consequences of civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or piracy.
- (B) Warranted free of loss or damage caused by or resulting from strikes, lockouts, labor disturbances, riots, civil commotions or the acts of any person or persons taking part in any such occurrence or disorder.

28. (A) It is a condition of this policy, and it is hereby agreed, that the assured's brokers, .....
- (B) The following Warranties shall be paramount and shall not be modified or superseded by any other provision included herein or stamped or endorsed hereon unless such other provision refers specifically to the risks excluded by these warranties and expressly assumes the said risks.
- (C) This Company shall have the privilege, at any time during business hours, to inspect the records of the assured as respects shipments coming within the terms of this policy.
29. It is a condition of this policy, and it is hereby agreed, that the assured's brokers, .....
30. The following Warranties shall be paramount and shall not be modified or superseded by any other provision included herein or stamped or endorsed hereon unless such other provision refers specifically to the risks excluded by these warranties and expressly assumes the said risks.

31. (A) Notwithstanding anything contained herein to the contrary, this insurance is warranted free from capture, seizure, arrest, restraint, detention, confiscation, preemption, requisition or nationalization, and the consequences thereof or any attempt or warlike operations (whether there be a declaration of war or not); but this warranty shall not exclude collisions, contact with any fixed or floating object (the voyage or interest for which the vessel concerned, or in the case of a collision, any other vessel involved therein, is performing) by a hostile act by or against a belligerent power; and for the purpose of this warranty "power" includes any authority maintaining naval, military or air forces in association with a power.
- Further warranted free from the consequences of civil war, revolution, rebellion, insurrection, or civil strife arising therefrom, or piracy.
- (B) Warranted free of loss or damage caused by or resulting from strikes, lockouts, labor disturbances, riots, civil commotions or the acts of any person or persons taking part in any such occurrence or disorder.

S. R. & C. C. .... of the  
Attaching to and forming part of Policy No. ....

Date .....  
SI-214 7500 4-15-44

Form 5b. Typical American Marine Policy Covering Cargo (continued)

ously ludicrous situation becomes evident both to B and C before the boat and its cargo have sunk and B and C frantically begin throwing the potatoes overboard without stopping to consider if the bags belong to B or C. After thus sacrificing 2500 bags, the boat is saved and makes Boston harbor. Upon unloading, it is determined that all the sacrificed potatoes belonged to B. Now, is it just and equitable to permit B to suffer this loss alone when it is remembered that the sacrifice of B's potatoes saved the boat, the 5000 bags belonging to C, and the balance of 2500 belonging to B? Assuming the value of the potatoes is \$1. a bag and the value of the boat is \$25,000., by sacrificing \$2,500. representing the value of the 2,500 bags of B potatoes, we have saved

The boat	value	\$25,000.
C's potatoes,	"	5,000.
Balance B's potatoes,	value	2,500.
	Total saved	<u>\$32,500.</u>

It is only fair, therefore, that each of these parties should contribute towards the loss, in the proportion which the safely landed value of his cargo bears to the aggregate value of the cargoes and other interests at risk at the time when the sacrifice was made. But we must regard B's interest as being the value of his saved cargo (\$2,500) plus the amount (\$2,500) which will be recoverable as contributions from all three affected interests, making B's total saved interest \$5,000, and the value of the total saved by the sacrifice \$35,000. Under these circumstances, A will be required to contribute towards B's loss  $25,000/35,000$  or  $5/7$  of the loss of \$2,500, or \$1,785.72; C will contribute  $5,000/35,000$  or  $1/7$  of \$2,500, or \$357.14; while B, himself, will bear  $5,000/35,000$  or  $1/7$  of \$2,500, or \$357.14. If the interests of A, B, and C were protected by insurance, the underwriters would make these contributions for their respective accounts.

(In actual practice, the interests involved in such a loss are represented not only by the ship and the cargo but also by the freight monies due for carrying the cargo. Each of the three separate interests pays its proportionate share of the loss incurred by the sacrifice.)

Steamship companies are not insurers also in the same sense that railroads are. Taking into consideration the rights and liabilities of shippers and sea carriers and especially the large list of immunities granted to such carriers, all by the provisions of the Carriage of Goods by Sea Act, it will be seen that in order for a merchant to be protected against loss caused by the many perils to which his goods may be exposed during ocean navigations for which the shipowner is relieved of responsibility by the terms of the bill of lading or by the law, he must rely on marine insurance, to the extent that the marine underwriters are willing to assume the coverage.

### The Marine Policy

**The Phraseology of the Policy.**—In no other commercial document has the original wording, which was adopted over two hundred years ago to fit conditions then existing, been preserved as closely as it has been in the basic marine policy issued today. Through the years, many changes have been made by the addition of new clauses to meet new situations as they arose, but the basic form to which these clauses are attached follows very closely the old Lloyd's form. Also, many newer clauses that are added to the basic form contain words and expressions which are not used in any other commercial document. But, since the meaning of the basic policy, and of the clauses which have been added, has been so firmly established by many court decisions, particularly by British and American courts, and due to the international character of marine insurance, underwriters have been reluctant to change phraseology which, in many cases, is peculiar to the business.

**Risks Covered by the Basic Policy.**—It must not be assumed that the marine policy covers all losses for which a shipowner is not liable. The marine policy is a contract of indemnity, agreeing to indemnify the assured for loss or damage to his goods caused by the perils enumerated in the policy, subject to its terms and conditions, including the provisions of any endorsements that may be attached. The intent of the policy is to protect

the assured against fortuitous losses from causes beyond his control while the goods are in the course of transportation.

The following is a summary of the principal perils which the basic marine policy insures :

1. **PERILS OF THE SEA.** This phrase is not intended to cover every conceivable loss that may occur to goods while they are on the sea. A better definition would be that it is intended to cover perils peculiar to the sea. Examples of such perils are: damage caused to vessel or cargo by the force of the waves; damage by contact with sea water, which, because of a storm or severe weakness in the vessel, enters the hold and causes damage to cargo; damage caused by the shifting of cargo in a vessel's hold due to the severity of storms; stranding of the vessel through striking a reef or shoal or being forced ashore; sinking of the vessel; and the collision of the vessel with another vessel or object.

2. **FIRE.** This is not a peril of the sea but the basic policy specifically names fire as an insured peril.

3. **JETTISON.** This means the voluntary throwing overboard of parts of the ship or of cargo in order to save the venture from impending peril.

4. **BARRATRY.** This means fraudulent or willful unlawful acts on the part of the master of the vessel or of the crew.

As has been previously indicated, the wording of the basic policy is antiquated, and without an understanding of custom and usage that has developed over many years and of the many court decisions that have established the meaning of every clause in the basic policy, the wording of these policies would be unintelligible to one unacquainted with the marine insurance business. Some of the risks named in the body of the policy, such as those relating to war risks and to pirates and rovers, are ruled out by other clauses that have been added to the policy in the course of years.

One of the most important of such clauses which rules out risks which are indicated as being covered in the body of the policy, is the Free of Capture & Seizure Clause (abbreviated F.C.&S.). But the wording of the body of the policy has re-

mained unchanged because of the reluctance of underwriters to change the basic form for the reasons that have been previously stated.

**Risks Not Covered by the Basic Policy.**—It may be well to indicate some of the perils that are not “perils of the sea” and which, therefore, are not covered under the ordinary form of marine policy. These include :

1. **INHERENT VICE.** Losses caused by the inherent nature of the insured goods are not covered. For instance, the goods may depreciate in value or become entirely worthless due to chemical changes which have spontaneously taken place.

2. **ORDINARY WEAR AND TEAR.**

3. **ORDINARY LEAKAGE OR BREAKAGE.**

4. **PILFERAGE.** Most policies cover “assailing thieves” which would cover theft by forceful entry of the vessel but would not cover petty thefts or pilferage.

### Losses in Marine Insurance

**Average.**—The term “average,” as used in marine insurance, has an unusual meaning. It means loss or damage and this special meaning is traced to the French word “avarie,” meaning damage.

**General Average.**—The marine policy covers general average losses. A general average loss is a loss due to the voluntary sacrifice of ship’s material or cargo or expense incurred, in order to avert a threatening or impending peril. The various interests at risk at the time the sacrifice was made, and which are saved by the sacrifice such as the vessel, the freight (by which is meant the money being earned for the carriage of the cargo) and the cargo itself, must all contribute to make good the loss. Each interest pays that proportion of the loss that the value of the interest saved by the sacrifice bears to the aggregate landed value of all the interests that were at risk at the time the sacrifice was made. Our potato venture, discussed on pages 101 and 106, exemplifies a general average loss in its simple form. Examples of other forms of general average losses, which result

from sacrifices voluntarily made of cargo or a portion of the ship to save the common interests from a threatening peril, are: damage to cargo caused by water or steam used in an attempt to extinguish a fire on shipboard; cutting away spars or other portions of the ship necessary to save the ship and cargo; expense of towing the ship to safety if the ship is in danger of being stranded in a storm; damage to ship's machinery caused by working the engines in efforts to float the vessel after it has stranded; and port of refuge expenses.

It must be borne in mind that the liability of cargo owners to contribute in general average for loss or damage suffered by other cargo owners or by the ship exists whether or not the goods are covered by marine insurance.

Under the basic policy the underwriters are liable for general average, subject to the laws of the country to which the goods are destined, unless special clauses to the contrary are inserted in the policy. It is now customary for underwriters to include in marine policies clauses stating that general average and salvage charges are payable according to United States laws and usage or per foreign statement or per York-Antwerp Rules, if in accordance with the contract of affreightment.

**The York-Antwerp Rules.**—The York-Antwerp Rules are a set of rules that were adopted at conferences first held at York, England, and afterward in Antwerp. The purpose of the rules was to reconcile the various laws of the different nations in respect to the adjustment of general average losses. It has become the custom of steamship companies to insert in their bills of lading that general average losses shall be adjusted in accordance with the York-Antwerp Rules.

**Particular Average.**—We have said that average means loss or damage. A particular average loss is defined by Phillips, the leading American authority on marine insurance, as “a loss borne wholly by the party upon whose property it takes place and is so called in distinction from general average for which diverse parties contribute.” It is damage fortuitously caused by a peril insured against, which damage amounts to less than a

total loss of the goods. A distinction is made between partial damage to the goods, which would come within the term particular average, and a total loss of part of a shipment such as the total loss of a number of units that comprise a shipment. In the latter case, the method of adjusting a loss would be different than in adjusting a particular average loss. Particular average losses are, of course, much more frequent than general average losses.

**The Franchise.**—Most policies issued in the United States provide in their basic forms that no partial loss or particular average shall be paid unless amounting to 5 per cent. This means that the underwriters shall not be liable unless the goods are damaged by a peril insured against to the extent of 5 per cent or more of their value. Once the damage amounts to 5 per cent or more, the underwriters become liable for the entire amount of the damage. The percentage limitation is called the franchise.

The chief purpose of the franchise is to free the underwriters from paying petty claims, which, although fortuitous and caused by a peril insured against, would be almost inevitable because of the nature of the goods or their packing. It also saves the assured from the trouble and expense of preparing and collecting numerous petty claims.

Of course, another effect which the percentage of franchise has is its influence on the rate of premium. It has a direct bearing on the loss ratio and, therefore, on the rates of premium that the underwriters must charge. In fact, the desire to secure a low rate of premium sometimes induces an assured to insure subject to a high franchise or to insure on Free of Particular Average (F.P.A.) terms. Under these terms the underwriters are not liable for partial losses unless the vessel meets with a major casualty such as is indicated in the F.P.A. clauses which will be discussed later.

**The Memorandum.**—The basic policy contains another clause, called the memorandum, which further restricts the coverage by imposing a higher franchise on some commodities or,

in respect to other named commodities, frees the underwriters from all average unless general. This means that particular average losses are not covered. Under such circumstances, the underwriters assume liability, in addition to general average, only for a total loss of the goods.

In modern practice, the memorandum and the 5 per cent franchise clause are usually overridden by clauses attached to the policy which stipulate higher or lower franchises, depending upon the nature of the goods and the wishes of the shipper and of the underwriters. The basic franchise provisions, however, mitigate and define the underwriters' liability in the event other special franchise clauses are not added which amend or override the basic clauses.

**Institute Clauses.**—The London and the American Institute of Marine Underwriters have both adopted sets of clauses which are in common use. The wording of the clauses in the two sets is very similar and the meanings practically identical. We shall not attempt a detailed explanation of all these clauses as, for the most part, their meaning is clear.

The use of these clauses is not mandatory. However, they have been generally accepted as approved clauses and many underwriters include them or similarly worded clauses, along with other clauses designed to meet the special requirements of the assured, in the rider or form that is attached to the policy and in the certificates issued under open policies.

Many of these clauses have the effect of broadening the terms of average by making the franchise apply to a stated number of shipping packages instead of to the entire shipment or, in the case of manufactured goods of relatively high value, to a single case or shipping package. As examples:

“Free of particular average unless amounting to 5% (or another percentage) each 25 bales separately insured.”

“Free of particular average unless amounting to —% (any agreed upon percentage) each case or shipping package separately insured.”

Under such clauses the underwriters are liable if the unit mentioned, i.e., any 25 bales or any one case or shipping package,

is damaged to the extent of the percentage mentioned in the clause.

**Non-deductible Franchises.**—In the average clauses heretofore mentioned, the franchise is non-deductible. Provided the damage amounts to the specified percentage, the underwriters are liable for the entire amount of the loss.

**Deductible Franchises.**—There is another form of average clause, the deductible average clause. A simple form of such a clause may read, "Warranted free of particular average under 10 per cent which is deductible." Under such a clause the underwriters would not be liable unless the damage exceeded 10 per cent of the value of the goods, in which event the underwriters would be liable only for the amount of damage over 10 per cent.

**Free of Particular Average.**—There are some commodities which underwriters may not be willing to insure against partial loss or damage, because of the nature of the involved commodities or because of the type of packing used. Also, the owner of goods which are not particularly subject to damage may be willing to run the risk of partial loss in order that he may receive the benefit of a lower rate of premium than the underwriters would charge for insuring the goods on broader terms. In such cases, goods are often insured on terms that will protect the owner only against major casualties such as sinking, stranding, burning, or collision of the vessel.

**Free of Particular Average English Conditions—F.P.A.-E.C.**—The clause most frequently used in such cases is the F.P.A.E.C. clause. These letters mean "Free of Particular Average English Conditions." The American version of this clause in use today is practically identical in wording and meaning to the clause used by English underwriters. That part of the clause used in England covering packages totally lost in loading, transshipment, or discharge, or losses attributed to explosion, does not appear in the American version but it is customary for American underwriters to cover specifically all these risks in other clauses that are printed in or affixed to the policy. Therefore, it would be redundant to include them in the American version of the F.P.A.E.C. clause.

The current form of this clause as used by American underwriters reads :

Warranted free from particular average unless the vessel or craft be stranded, sunk, or burnt, but notwithstanding this warranty the underwriters are to pay any loss of or damage to the interest insured which may reasonably be attributed to fire, collision or contact of the vessel and/or craft and/or conveyance with any external substance (ice included) other than water, or to discharge of cargo at port of distress. The foregoing warranty, however, shall not apply where broader terms of average are provided for hereon or in the certificate or policy to which these clauses are attached.

From the wording of the clause it will be seen that no particular average will be paid unless the vessel or craft meets with one or more of the casualties mentioned, or unless the loss can be attributed to fire, or to one other of the enumerated contingencies. The word craft in the clause refers to the craft or lighter conveying the goods to or from the vessel, if the goods are loaded and unloaded in that manner instead of directly to or from a wharf or dock.

The meaning of the clause is that the underwriters will be liable provided the loss or damage occurs during a voyage when the vessel meets with one of the casualties named in the clause. It is not necessary to show that the damage was directly or indirectly due to a stranding or to one of the other casualties in the clause. Even though it was proved that the damage was not due to such a casualty, nevertheless, if such a casualty had occurred during the voyage, then any damage by contact with sea water or from another marine peril would be covered. Probably this liberal construction given to the clause arose out of cases in which it was difficult to determine whether the damage was a direct result of one of the accidents enumerated in the clause. But such an interpretation has become firmly established and, of course, is strictly in accord with the wording of the clause.

There are certain commodities of a perishable nature which are practically always insured on F.P.A.E.C. terms. Grain shipped in bulk may be cited as an example.

**Free of Particular Average American Conditions—F.P.-A.A.C.**—Another F.P.A. clause that is sometimes used is the F.P.A.A.C. clause. These letters mean “Free of Particular Average American Conditions.” This clause, which should not be confused with the American version of the English Conditions clause, reads:

Free of particular average unless caused by the vessel being stranded, sunk, burnt, or in collision with another vessel.

Under this clause the underwriters are not liable unless the damage has been actually caused by one of the perils enumerated in the clause. This clause is not often used in insuring exports and imports by liners or by large approved steamers or motor vessels. Its use is confined, as a rule, to shipments by smaller vessels, or to extrahazardous routes or trades when the underwriters are not willing to insure on broader terms.

An example of shipments in connection with which this clause is frequently used is shipments forwarded on deck. The policies of some underwriters contain the following clause, which is the customary F.P.A.A.C. clause but extended to cover the risks of jettison and washing overboard also.

Free of particular average unless caused by the vessel being stranded, sunk, burnt, on fire, or in collision, but including jettison and/or washing overboard irrespective of percentage.

### War Risks

The practice has become almost universal in America to cover war risks, which include losses resulting from contact with war mines, under a separate policy. As has been previously stated, war risks are specifically excluded from the basic marine cargo policy by the F.C. & S. clause. Marine underwriters cover these risks but, owing to their special nature, it has been deemed advisable to cover them under separate war risks policies, instead of attempting to add the coverage to the marine policy.

It is advantageous to have both the marine and war risks policies placed with the same underwriters for the sake of avoiding any delay or dispute in regard to borderline cases in which

some doubt may exist as to whether a loss was caused by a marine or by a war peril.

Even before actual hostilities broke out in World War II, underwriters had perfected an organization by which, through an exchange of reinsurance among practically all the marine and fire insurance companies in the country, any company member of the group could assume liability up to the limit of liability it accepted under the marine policy. Open war risks insurance policies were issued to cover up to the same limits as the corresponding open policies covering the marine risks and issued by the same company. Naturally, during World War II, as was the case during World War I, war risks insurance rose to a position of great importance in protecting our foreign commerce. Shippers were always able to place their war risks insurance with their regular marine underwriters.

Now that the world is again at peace, it may be felt that war risks coverage is no longer necessary. The fact remains, however, that for some ten years after the ending of World War I vessels suffered damage from floating war mines. No doubt, this menace will be with us for some years to come. This contingency need not give much worry to the prudent shipper because, the lesser the danger becomes, the lesser also the premium for mine risk insurance, which is a peacetime war risk.

### Other Special Clauses

Many special clauses have been devised for insuring goods in special trades, such as raw silk, goods shipped in the refrigerated spaces on board ships, liquors, machinery of various types, and many other commodities. Not only the nature of the goods themselves and the shipping packages but also the types of vessels, climatic conditions at points of origin, destination, and while en route, and many other factors must be taken into consideration in marine underwriting, all of which have contributed to the drawing of a vast number of special clauses to meet the requirements of merchants and their insurers.

**Leakage.**—Thus, there are clauses that cover leakage of liquids. Usually, such clauses are written free of leakage unless amounting to a stated percentage, with another stated percentage

representing ordinary leakage to be deducted from all claims, the underwriters being liable only for the excess above the stipulated percentages.

**Ship's Sweat.**—On voyages during which the vessel proceeds from cold to warm climates or vice versa, moisture in the hold condenses on the ship's plating and beams in the form of what is called ship's sweat, which often damages cargo. It has become the practice in some trades for underwriters to assume damage caused by ship's sweat or steam of hold and such clauses also often are extended to cover damage caused by contact with fuel oil or other cargo.

**Skimmings Clause.**—Coffee from Brazil is usually insured under the so-called skimmings clause which provides that in case of damage by perils insured against, the damaged portion shall be skimmed off and sold as customary. The insurer pays the cost of skimming and rebagging and the depreciation of the skimmings without reference to percentage, insured units or insured value.

**Breakage.**—The risk of breakage is sometimes covered in excess of a stated percentage which shall be deducted from all claims unless the breakage is caused by the stranding, sinking, or collision of the vessel.

**Against All Risks.**—Various types of non-perishable goods, which are not from their nature especially susceptible to damage, are sometimes insured under the so-called All Risks clause, abbreviated A.A.R. A sample of such a clause reads :

This insurance covers against all risks of physical loss or damage from any external cause excepting risks excluded by the F.C. & S. (Free of Capture & Seizure) and Strikes, Riots and Civil Commotions warranties appearing elsewhere hereon.

It will be noted that the risks of war and of strikes, riots, and civil commotions are not covered by this clause, these risks being specially excepted. If such risks also are desired to be covered, underwriters usually will be willing to cover the risks of strikes, riots and civil commotions by a special endorsement

or rider to be attached to the policy and the war risks by a separate war risks policy.

In some cases, usually in connection with approved classes of manufactured goods, the franchise which may be in the basic policy or in an average clause may be voided or omitted from the average clause by a clause reading "Average payable irrespective of percentage."

**Strikes, Riots, and Civil Commotions.**—These risks are excluded from the basic policy and when covered under the marine policy, the coverage is evidenced by an endorsement added to the policy.

**Theft, Pilferage, and Non-delivery.**—These three risks generally go together but pilferage is the most troublesome. Pilferage occurs when a part of the contents or the entire contents of a case or shipping package have been stolen and the case has been stuffed with waste and, perhaps nailed up again. The carrier, having no knowledge of the original contents of the case, delivers the pilfered case, as is, to the consignee. If the owner of the pilfered goods is able to prove that an employee of the carrier did the pilfering, he may recover from the carrier. Theft occurs, on the other hand, when the entire case is stolen or is otherwise missing and this will bring about the non-delivery of the missing case. Where did the case disappear? When? While in whose custody? The answers to these questions will not concern the owner of the goods if he carries this type of insurance. The underwriters will pay and they, themselves, will endeavor to find the answers in the hope of fixing the responsibility for the theft and consequent non-delivery.

The rates charged by marine underwriters when these risks are assumed by them vary greatly, as they depend upon many factors, such as conditions at place of shipment and after arrival at port of destination, character of the goods, nature of shipping packages, etc.

**Warehouse-to-Warehouse Clause.**—As goods in overseas trade must necessarily leave the warehouse or store of the seller, be carted to the dock, and remain on the dock until loaded into the hold of the carrying vessel, it follows that the goods should

be covered by insurance until actually loaded, as the basic marine policy may not attach until then. Similarly, when the goods arrive at the consignee's port, they must be discharged from the vessel, remain on the dock for a space of time, and subsequently carted to the warehouse or store of the buyer. Should the buyer be located in the interior, it may be necessary to ship the goods to him by rail. The marine policy may not cover after the goods have been discharged.

In order not to permit the goods to be without adequate insurance while in transit but not actually in the hold of the carrying vessel, and in order not to compel the owner to obtain two policies of insurance, the one covering while the goods are in transit on land and the other while the same goods are in transit on water, marine underwriters are willing to cover the land risks also by the marine policy. This added coverage is reflected in the rate of premium, and is evidenced by the warehouse-to-warehouse clause either printed in the body of the policy or attached to the policy as a rider. The clause, as currently recommended by the American Institute of Marine Underwriters, reads as follows :

This insurance attaches from the time the goods leave the Warehouse and/or Store at the place named in the policy for the commencement of the transit and continues during the ordinary course of transit, including customary transshipment if any, until the goods are discharged overside from the overseas vessel at the final port. Thereafter the insurance continues whilst the goods are in transit and/or awaiting transit until delivered to final warehouse at the destination named in the policy or until the expiry of 15 days (or 30 days if the destination to which the goods are insured is outside the limits of the port) whichever shall first occur. The time limits referred to above to be reckoned from midnight of the day on which the discharge overside of the goods hereby insured from the overseas vessel is completed. Held covered at a premium to be arranged in the event of transshipment, if any, other than as above and/or in the event of delay in excess of the above time limits arising from circumstances beyond the control of the assured.

It is necessary for the assured to give prompt notice to Underwriters when they become aware of an event for which they are

“held covered” under this policy and the right to such cover is dependent on compliance with this obligation.

The use of the warehouse-to-warehouse clause has another advantage which is quite important to the owner of the goods. Oftentimes, it is quite difficult, if not impossible, to prove just when or where the loss occurred. If one insurance company covers the shipment while in transit on water and another company while the goods are in transit on land, the owner must prove if the loss was suffered under the marine or under the land policy in order to hold the affected insurance company liable for the loss. This difficult proof is not necessary when the one insurance company has covered the shipment during its several forms of transit from the seller to the buyer.

**Both to Blame Collision Clause.**—We have discussed the Both to Blame Collision clause, which is presently inserted in the bills of lading of steamship companies, in Chapter 5, Bills of Lading, page 64. The purpose of the clause as appearing in the bill of lading is to compel the owner of the cargo in the carrying vessel to reimburse the carrying vessel for amounts which it may have to pay to the other vessel at fault for damage to cargo in the carrying vessel, such damage having been caused by a both to blame collision. While the owner of the damaged cargo on the carrying vessel can collect no part of the damage from the carrying vessel, he collects his damage in full from the other vessel. On the other hand, the other vessel is permitted to charge one-half of its damage and expenses, including the monies paid to the owner of the damaged cargo on the carrying vessel, to the carrying vessel. Thus, the carrying vessel will be paying one-half of the damage suffered by the cargo owner, the said payment being made indirectly and through the other vessel, although the owner could recover no part of his loss from the carrying vessel direct. Ships are not liable for damage to their own cargo caused by faulty navigation or management.

The right of the carrying vessel for such relief has not as yet been definitely determined by our courts. It is possible that the courts may hold that the Both to Blame Collision clause in

bills of lading is invalid but meanwhile, marine underwriters, without any additional charge, have agreed to protect their assureds against this liability that has been and is being asserted against them by shipowners, and for this purpose are inserting in their policies the insurance Both to Blame clause which may read :

Where goods are shipped under a Bill of Lading containing the so-called "Both to Blame Collision" Clause, these assurers agree as to all losses covered by this insurance, to indemnify the assured for this policy's proportion of any amount (not exceeding the amount insured) which the assured may be legally bound to pay to the shipowners under such clause. In the event that such liability is asserted the assured agree to notify the assurers who shall have the right at their own cost and expense to defend the assured against such claim.

### Open Policies

Most exporters operate under open policies of insurance. As a rule, such policies automatically cover all shipments made by the assured (unless certain shipments are specially excluded) and they remain in full force and effect until cancelled by either party, usually on 30 days notice. Under open policies, the assured is obliged to declare all shipments to the underwriters and to pay premiums thereon at agreed rates. The open policy will describe shipments to be covered, voyages, etc., and will indicate conditions of insurance that are to apply to various classes of commodities.

**The Insurance Certificate.**—That insurance has been placed under an open policy is evidenced by the insurance certificate, prepared by the shipper on forms supplied by the underwriters. The certificate is an important document. It is a vital part of the documentary bill of exchange which a bank may buy or discount. It indicates to the negotiating bank that the involved merchandise, the collateral of the bank, is protected by insurance. The certificate describes the shipment and certifies that the goods have been insured with the named insurance company. It



should, and usually does, contain all the important clauses showing the terms on which the shipment is insured.

The insurance certificate is issued in negotiable form, losses being payable to a named party or to order. The names of settling and claim agents in various parts of the world to whom claims may be reported for adjustment are usually printed in the certificate and claims are usually settled abroad by the settling agents nearest to the port of destination.

Situations have occurred in which consignees, or other parties to whom certificates have been endorsed, have had difficulty in collecting claims owing to the fact that the original assured had not paid the premium. Many insurance companies insert in their certificates a clause freeing the holder of the certificate from any liability for unpaid premiums. It is recommended that merchants and banks make sure that such a clause is included in the certificates issued under open policies.

There may be occasions in which a bank may require a copy of the open policy and such a copy will usually be furnished by the underwriters but the custom of covering shipments by certificates issued under open policies has become well established and certificates of reputable insurance companies are freely accepted by banks in America and abroad in lieu of policies. If a consignee should, for some reason, demand a policy instead of a certificate on a given shipment, the underwriters are usually glad to issue a special policy in lieu of the certificate.

### **The Insurance Broker**

Because it is quite difficult for the average merchant to understand and to keep up with possible changes in rules and interpretations, it is almost indispensable that he select an insurance broker and confine all of his business to the broker thus selected. The broker receives his commissions from the underwriters and it is not likely that the merchant can obtain better rates by offering his business to the underwriters direct. The broker is an expert and he will place the business with companies which are financially strong and thoroughly equipped to take care of the requirements of the merchant. The merchant should

select his broker with the same care he uses in selecting his physician or lawyer.

**The Broker's Cover Note.**—This is a memorandum prepared by the broker to the effect that insurance has been purchased by him in connection with a given shipment. The cover note is not a policy nor a certificate issued under an open policy. It is not binding on the insurance company for the reason that the company does not sign it. Indeed, the identity of the company which is to insure may not be indicated in the cover note. There is always the possibility that the broker who has issued the note may have inadvertently neglected to place the business with a regularly established insurance company. Should a loss occur under these circumstances, the owner of the property which was to be insured may have a cause of action against the broker for negligence but no claim against any underwriters because no insurance was placed with any underwriters. It is precisely for these reasons that a cover note is not acceptable in lieu of a policy or certificate whenever documents are to be produced indicating that proper insurance has been placed in connection with some given properties.

The insurance policy should be substituted for the broker's cover note as promptly as possible.

### **The Bank's Interest in Insurance**

In becoming financially interested in bills of exchange to which shipping documents are attached, banks cannot question the form or terms of the insurance which has been purchased by the client unless the buyer of the merchandise has stipulated to the banks the exact coverage which the seller is to obtain. This occurs only when the buyer has arranged to make payment to the seller through a specified bank, as is done when the buyer establishes a commercial letter of credit in favor of the seller. In all other cases the bank is privileged to consider the insurance evidenced as being adequate or inadequate, and act accordingly.

At times, however, the bank accords a given client a line of credit for the purchase and discount of documentary foreign bills. In fixing such a line, the bank may have placed much

**Cover Note**  
**Underwriters at Lloyd's, London**  
(NOT INCORPORATED)

THROUGH CABLE AUTHORITY  
**ROLLINS BURDICK HUNTER CO.**

231 South La Salle St.  
**CHICAGO**  
Telephone Andover 5000

No. \_\_\_\_\_

ASSURED \_\_\_\_\_

ASSURED'S ADDRESS \_\_\_\_\_  
ACTING UPON YOUR INSTRUCTIONS, we have effected with certain Underwriters at Lloyd's, London,

insurance as noted below

AMOUNTS OR LIMITS \_\_\_\_\_ RAIL \_\_\_\_\_ PREMIUM \_\_\_\_\_

LOCATIONS \_\_\_\_\_

DATE AND HOUR \_\_\_\_\_  
EFFECTIVE FROM \_\_\_\_\_ TO \_\_\_\_\_

(Standard Time, at the place of location of risk or risks insured)

NATURE OF INSURANCE \_\_\_\_\_

This cover note and the insurance effected by it is subject to all the terms and conditions of the policy to be issued. This cover note shall be automatically terminated and voided by delivery of the policy to the Assured.

This cover note may, however, be cancelled on the customary short rate basis by the Assured at any time by written notice or by surrender of this cover note to Rollins Burdick Hunter Co. This cover note may also be cancelled by the Underwriters, or by Rollins Burdick Hunter Co., in their behalf (with or without the return or tender of the unearned premium), by delivering to the Assured or by sending to the Assured by mail registered or unregistered, at the Assured's address as shown herein, not less than ten days' written notice stating when the cancellation shall be effective, and in such case the Underwriters shall refund the paid premium less the earned portion thereof on demand.

It is expressly understood and agreed by the Assured by accepting this instrument that Rollins Burdick Hunter Co. is not an Assurer hereunder and that they shall not be in any way or to any extent liable for any loss or claim whatever, but that the Assurers hereunder are those individual Underwriters at Lloyd's, London, whose names will appear upon the policy when issued.

Loss, if any, to be payable in Chicago, Illinois, in United States currency.

This cover note shall not be valid unless signed by Rollins Burdick Hunter Co.

Signed at Chicago, Illinois, this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_

*United States Government internal revenue stamps in the amount of \$ \_\_\_\_\_ have this day been cancelled and attached to the original document of insurance of which this contract is evidence and held on file in the office of the undersigned broker.*

ROLLINS BURDICK HUNTER CO

BY \_\_\_\_\_

Date \_\_\_\_\_

ROLLINS BURDICK HUNTER CO.

BY \_\_\_\_\_

(Immediate notice must be given Rollins Burdick Hunter Co. by you if any changes are required in the above particulars of the insurance or of any occurrence which may result in a loss covered by the insurance.)

reliance upon the merchandise covered by the documentary bills. In such cases, it is incumbent upon the bank to make sure that the seller or the buyer has not overlooked insuring the shipment in an adequate manner and demand the policy or certificate evidencing the insurance. Inasmuch as the merchandise represents the bank's collateral, the collateral must be adequately insured.

Again, if the documentary bill is not accompanied by a policy or certificate, the bank should consult the shipper. It may be that the coverage has been made by the buyer under the buyer's own open policy, but when this is the case the seller should advise the bank to that effect. Under these circumstances, the bank must rely largely upon the credit standing of the seller as the terms of the insurance arranged by the buyer may or may not be adequate from the point of view of the bank.

### Conclusion

It must be apparent to the reader by now that marine insurance is not only a fascinating, but also a highly specialized form of insurance. So many factors enter into the assessment of a risk and the determination of proper clauses to cover a given risk and the rates to apply, that the subject can be only briefly outlined in a book of this character. From what has been said, however, the merchant will recognize the importance of entrusting the placing and writing of his marine insurance to competent hands. Banks do not become interested in the adequacy of insurance unless their interested clients have failed, in which case the banks will be obliged to look to the merchandise, as and if possible, for the repayment of the advances made to such clients. But merchants are always vitally interested in the adequacy of the insurance covering the merchandise which they export or import. If a loss occurs, they may or may not be properly covered. While the marine policy always covers general average and total losses caused by the perils insured against, it may or may not cover particular average losses (partial losses), depending on the form of particular average coverage indicated in the policy.

The merchant should clearly indicate to his broker the exact coverage which he desires and the broker should make plain to the merchant the possible circumstances under which the goods are not insured. There should be and there need be no misunderstanding between the merchant, the broker, and the underwriters as to the exact coverage indicated in the policy.

## CHAPTER 7

### CO-INSURANCE

It is well for us to have knowledge of the principles of co-insurance because it may be a condition of insurance policies covering buildings, machinery and goods in stock or in warehouse. Banks at times become financially interested in such properties. Co-insurance is applicable largely to fire and tornado insurance but it can be and often is extended to other forms of insurance as well. For the better understanding of its principles, we shall discuss co-insurance as applying to fire policies.

Let us assume that A, B, and C each purchased from a development company similarly built houses, each paying \$10,000. for his house. After taking possession of their respective houses, A insures his against fire for \$10,000., B insures his for \$8,000., and C insures his for \$6,000. Assuming the premium is at the rate of \$2 per \$1,000., A pays a premium of \$20., B pays \$16., and C pays \$12. It is a fixed rule of insurance that an insured can never collect more than the face value of his policy, irrespective of the real value of the destroyed property. Moreover, if a piece of property is overinsured, the insurance company will only pay the real value of the property at the time of the loss, as otherwise people may find it advantageous to insure their property for values in excess of the real values and then apply matches to the properties.

It is quite apparent, therefore, that A has overinsured his property by the value of the lot which, for our purposes, we will say is worth \$2,000. Lots do not burn up and should not be insured against fire. Again assuming that B's and C's lots are valued at \$2,000. each, it appears that B carries just about the right amount of insurance while C is underinsured by some \$2,000. Should a fire completely destroy the three houses owned by A, B, and C, A would recover \$8,000. only, although

he carried insurance for \$10,000. and paid premiums on the larger amount, B would recover \$8,000., the face amount of his policy, and C can only recover \$6,000., the face amount of his policy. C cannot complain because he deliberately carried less insurance than the replacement value of his property. A cannot complain because it was incumbent upon him to predetermine the correct replacement value of his property and insure accordingly. B recovers the full replacement value of his loss because he insured for the correct amount.

Insofar as the insurance company is concerned, there is no difficulty when fire completely destroys a piece of property. If it is over-insured the company pays the replacement value, less depreciation, of the destroyed property. The company should not be expected to give the insured a brand new house in place of the destroyed one in which the insured may have lived for a number of years.

If the property is underinsured, the company pays the value of the policy only and the insured must bear the difference between the value of the policy and the replacement value of the totally destroyed house.

The great majority of fire losses, however, are partial. The property is partially damaged by fire and is not completely destroyed. Let us assume that the three houses owned by A, B, and C have each suffered a fire damage amounting to \$1,000. Is it equitable to allow C the full recovery of his \$1,000. loss when we bear in mind that the annual premium which he paid was only \$12. while B paid an annual premium of \$16. and A paid an annual premium of \$20.? In order to oblige property owners to carry enough insurance so that the insurance companies will be justified in paying partial losses in full, many policies have what is known as a co-insurance clause, requiring the insured to carry the insurance at a certain percentage of the total value of the insured property, usually 80%. The clause reads about as follows :

The insured shall maintain insurance to the extent of at least 80% of the actual cash value at the time of the fire; and that failing so to do, the insured shall to the extent of such deficit bear his proportion of any loss.

The "cash value" indicated in the clause is always the replacement value at the time of the fire, less the depreciation on the property destroyed. For instance, if the kitchen of the house has burned out, destroying the gas range, refrigerator, and floor coverings (kitchen furniture and utensils are not covered by a fire policy insuring the premises) the insured should not expect a new range, new refrigerator, and new floor coverings when those destroyed were in use for some five years, more or less.

Bearing this clarification in mind, let us restudy the clause. Let us assume that the partial losses of \$1,000. each suffered by A, B, and C occurred immediately after the building and furnishing of the three houses so that, for the purposes of our efforts to simplify, we can eliminate from consideration the matter of depreciation and consider the cash value of each property as being \$8,000., allowing \$2,000. as the value of each plot which cannot burn and should not be insured. Under the 80% co-insurance clause, A, B, and C must each insure their respective properties in the amount of \$6,400., if they hope to fully recover for partial losses. But suppose C's policy, bearing the 80% co-insurance clause were for \$4,000. only, whereas he should have carried at least \$6,400. in order to qualify under the clause. We now have a situation where C is carrying only  $\frac{4000}{6400}$  or  $\frac{5}{8}$  of the required amount, and the second part of the clause indicates that he must bear  $\frac{3}{8}$  of any partial loss, because he is under-insured to that extent. To put it another way, the insured under a policy containing the co-insurance clause may always determine to what extent he becomes a co-insurer when not carrying sufficient insurance by the following formula:

$$\frac{\text{Insurance carried}}{\text{Insurance required}} \times \text{Loss} = \text{Amount of Recovery}$$

The difference between the Amount of Recovery and the Loss equals the amount of the loss which the insured himself must bear as a co-insurer. Using the actual figures with respect to C's loss of \$1,000., we have:

$$\frac{\$4000}{\$6400} = \frac{5}{8} \times \$1,000. = \$625.$$

In other words, C recovers \$625. from the insurance company and bears himself \$375. of the loss.

The co-insurance clause applies to partial losses only. In the case of total losses, the insured can collect in full up to the face value of the policy, always assuming the amount of the policy does not exceed replacement value of the property, less depreciation.

To obtain full recovery for full value of the property after a total loss, you must insure for the full replacement value of the property, less depreciation, which is considered to be the actual cash value. If you insure for 80% of the value and suffer a total loss, you recover 80% of the loss only.

To obtain full recovery of a partial loss, you must insure at least for the amount required by the clause. If the percentage of insurance required is 80%, the amount of insurance carried must be at least 80% of the value.

Under no circumstances can the insured recover an amount in excess of the amount of the policy or in excess of the actual replacement value at the time of the loss, less depreciation.

The following clearly exemplifies the operation of an 80% co-insurance fire policy :

Value of Property*	Insurance Required	Insurance Carried	Loss	Insurance Company Pays	Insured Bears
\$10,000.	\$8,000.	\$10,000.	\$10,000.	\$10,000.	0
10,000.	8,000.	10,000.	5,000.	5,000.	0
10,000.	8,000.	8,000.	5,000.	5,000.	0
10,000.	8,000.	8,000.	10,000.	8,000.	\$2,000.
10,000.	8,000.	6,000.	6,000.	4,500.	1,500.
10,000.	8,000.	4,000.	6,000.	3,000.	3,000.

\* This represents the replacement value of the property at time of loss, less depreciation, which is "the cash value at the time of the fire."

**Adequacy of Long Term Fire Insurance.**—Now that we understand the meaning of "cash value at time of fire," it may be useful to all of us to give some consideration to this phrase when applied to fire policies written for three year terms and covering premises and household goods. These policies run for three years. While the amount of a policy may be substantially correct at the time it is first written, the amount merely indicates

the maximum which the insurance company will pay and has no connection with the "cash value at time of loss." If the insurance covers a house and the cost of labor and building materials rises sharply after the fire coverage has been obtained, the recovery obtainable from the company may be entirely inadequate to permit rebuilding, simply because the property was under-insured. While the insurance company takes into account the increased costs, and determines the "cash value" accordingly, they cannot go beyond the face value of the policy and that may not be enough to the owner of the house. The owner should always bear this in mind and carry enough insurance to be prepared to meet the higher replacement costs. Long term fire insurance policies may be amended as to amount at any time before a loss occurs and before the policies expire.

The same comments apply to household furniture and effects. If the goods involved were purchased for \$3,000. and have been in use for five years, making the depreciation, say, 25% or \$750., a policy in the amount of \$2,250. or even \$3,000. would be inadequate if similar goods have advanced in price, say, 100%. Should such goods be completely destroyed, the "cash value at time of fire" may be \$4,500. (new replacement value being \$6,000. and depreciation, say, 25% or \$1,500.). But the insurance company will pay only up to the face amount of the policy, be it \$2,250. or \$3,000.

These difficulties do not arise in connection with short term policies, because the amounts are determined when the coverage is obtained and cannot be seriously affected by rising costs during the shorter periods involved—one year or less. Goods temporarily in storage carry their own current market values, but if the storage is for a long term, the amount of insurance should be re-examined from time to time to keep up with market conditions.

It may be well to mention, moreover, that whenever the amounts of long term policies have been increased to take care of increased costs, they should be re-examined and reduced whenever the replacement costs have substantially declined. Otherwise, the properties will be over-insured, thus imposing needless and useless premium expenses upon the owner.

## CHAPTER 8

### CONSULAR INVOICES AND OTHER CERTIFICATES

**Consular Invoices.**—Most foreign countries also require consular invoices in connection with their imports, just as we in the United States require this document in connection with goods imported by us. Very small shipments by parcel post or otherwise may not require this document, or may require in lieu thereof some other form of declaration as to the nature and value of the goods shipped.

The principal function of the consular invoice is to enable the authorities of the importing country to have an accurate record of the types of merchandise shipped to that country, its quantity, grade, and value, both for the purposes of fixing and assessing import duties and for general statistical purposes. It is highly important, therefore, that the details of the document be quite accurate and it is precisely for this reason that heavy fines and penalties are imposed when errors and omissions occur.

We shall not attempt to cover the details of the requirements of each foreign country because these requirements vary considerably and are subject to constant change. However, it is highly imperative that the document be prepared strictly within the requirements of each country, since errors and omissions are not tolerated. Most consuls supply to the exporter the consular invoice forms, and generally make a charge for the forms. After the exporter has filled out the forms, they are submitted to the consul of the buyer's country for certification. A charge is made for this service also.

The charges made by consuls vary considerably. When the charge is intended to cover the expense incident to the service only, it is quite nominal and does not vary according to the value of the relative shipment. On the other hand, if the charge is intended to create funds for the use of the foreign government of the shipper's country, it will be based upon the value of the

goods and, in effect, represents part of the import duties assessable against the importation. For instance, the Mexican consul in New York charges according to the value of the goods destined for Mexico. The revenue thus derived, in United States dollars, is used by the Mexican government to pay its diplomatic and consular salaries and expenses both in the United States and in other foreign countries. If this were not done, the Mexican government would be obliged to purchase monthly a large amount of dollars and other foreign currencies for the payment of such salaries and expenses. Other governments, charging according to the value of the shipment (*ad valorem*), use the dollars thus acquired and accumulated for servicing their dollar loans and for making purchases in this market. Consular expenses are almost invariably charged to the foreign buyer of the merchandise involved.

The foreign buyer should indicate all the papers he will require in connection with his purchase, including the consular invoice. If he neglects to enumerate the consular invoice as one of the required papers, the shipper must, nevertheless, make sure that such a document is not required. The shipper cannot afford to make the shipment without making sure that he has complied fully and correctly with all the rules and regulations of the buyer's country covering importations. This is not a very difficult task. If the seller uses the facilities of a foreign freight forwarder, the forwarder will know what is required. If he does not use the facilities of a forwarder but handles his foreign shipments through his own traffic department, the head of this department will know, from actual experience, just what consular papers may be required in connection with the various foreign sales made by his company. American banks which are called upon to buy, discount, or collect foreign bills of exchange are not expected to know the requirements as to consular papers. Banks are not in the shipping business. They assume that the shipper has taken care of all necessary details.

**Other Certificates.**—The documentary bill of exchange may have other certificates attached thereto, depending upon the nature of the commodity and the laws and regulations of the seller and buyer countries. Here are some such certificates.

**THE CERTIFICATE OF ORIGIN.** Due to preferential tariff rates between some countries, the foreign buyer may require the seller to accompany the shipping papers with a sworn statement to the effect that the merchandise involved has been produced or manufactured by the country of the seller and has not been purchased by the seller country from another country which may not have preferential tariff arrangements with the buyer country.

**THE NON-DUMPING CERTIFICATE.** Several of the countries affiliated with the British Commonwealth of Nations require this certificate, which gives the comparative difference in the export and domestic selling prices of the commodity in the seller's country, and must show that the export sale price is not decidedly lower than the price of the same goods sold in the exporter's country. Some years ago, whenever certain goods could not be sold in our domestic market, they were literally "dumped" on foreign markets at ridiculously low prices and this had a tendency to demoralize the newly established industries in such foreign markets producing similar goods.

**THE WEIGHT CERTIFICATE.** Goods sold in bulk, such as grains, oils, and similar products will generally require the official certificate of a public weigher.

**FOOD INSPECTION CERTIFICATES.** When meats, edible fats, and similar products are sold, the buyer's country may require a certificate from an official inspecting service of the seller country to the effect that the involved food product fully meets the standard requirements of the seller country.

**MERCHANDISE INVOICES AND PACKING LISTS.** In order that the buyer, the customs authorities of the buyer's country, and all intervening banks which may become financially interested in the shipment may have an accurate knowledge of the exact quantity, quality, nature, and price of each package making up the total shipment, it is customary to accompany the documentary bill of exchange with a number of copies of the detailed invoices and packing lists. The buyer will specify how many

copies of each are required. The packing list gives the details of the merchandise packed in each individually numbered package. It enables the buyer to open up the right case when he desires to put his hands on a particular item or items of his purchase.

The documentary bill of exchange may have attached to it, therefore, the following documents:

1. Bills of lading
2. Insurance policy or certificate
3. Consular invoice
4. Commercial invoices
5. Packing lists
6. Special certificates

## CHAPTER 9

### TRUST RECEIPTS

Whenever a merchant has signed a form of receipt for goods, documents of title, or securities, wherein it is recited that he is holding such matters in trust for the person from whom he has received such matters, we say that the merchant has executed a trust receipt. The merchant is called the trustee. The person or institution in whose favor the receipt runs is called the entruster.

As in all "in trust" operations, the legal title to the matter entrusted remains in the entruster, but the entruster gives to the trustee a form of title which is good and legal against everybody except the entruster. As between the entruster and the trustee, the entruster is always the legal owner of the matter involved. As between the trustee and the rest of the world, the trustee is the legal owner and whenever he sells the goods to a third party who has no knowledge of the existence of the trust receipt, such third party is protected and the entruster loses his legal ownership of the goods. There are exceptions to this broad statement, as will be noted later in this chapter.

Perhaps we can best appreciate the advantages and perils of a trust receipt operation by considering the details of such an operation. Let us assume that the Paterson Silk Co. has purchased from a Shanghai merchant five bales of raw silk valued at \$5,000. a bale, the transaction to be financed by the seller's documentary draft drawn on the buyer at 90 days sight, with the added condition that the shipping documents are not to be surrendered to the buyer unless and until the buyer pays the corresponding draft for \$25,000. The seller in Shanghai will have no difficulty in selling the draft to a bank in Shanghai as he, himself, may enjoy good credit standing, and the silk which is to be delivered to the buyer against the payment of the

draft only, serves as excellent security. Let us assume, moreover, that the bank in Shanghai which has purchased the draft has remitted it to the The Chase National Bank of the City of New York, for collection and credit of the proceeds to the dollar account of the Shanghai bank carried on the books of Chase Bank.

When the documents reach the Chase Bank, the bank will advise Paterson Silk Co. and request that company to call and accept the draft drawn on the company at 90 days sight. The acceptance is necessary in order to fix the maturity of the draft. Mr. Jones, the treasurer of the company, calls at the bank and supplies the required acceptance. The bank then advises Mr. Jones that the documents representing the silk are to be delivered to him when the acceptance is paid—either before or at maturity. This does not exactly suit Mr. Jones. He needs the silk for his plant and yet cannot conveniently make payment immediately. As the Paterson Silk Co. happens to be a client of Chase Bank, and enjoys good credit standing both with Chase Bank and in the silk trade, Mr. Jones makes the suggestion that the documents representing the silk be turned over to him against a trust receipt and the bank readily enough agrees to do so. It may be well to indicate at this point that perhaps the Chinese seller would have been willing to have the documents delivered to Paterson Silk Co. against the acceptance of the 90 days sight draft, had he as close information on the credit standing of the company as the Chase Bank.

The Chase Bank will then ask Mr. Jones to execute the trust receipt form as prepared by the Chase lawyers. The receipt will describe the silk and will recite that the Paterson Silk Co. will hold the silk in trust for the Chase Bank, will insure it against loss by fire and also, perhaps, by theft, will hold all funds realized from the sale of the silk in trust for the Chase Bank and will ultimately pay such funds to the Chase Bank, it being understood that these funds will be used for the payment of the 90 days sight acceptance.

Having thus obtained possession of the silk, the Paterson Silk Co. immediately begins to process it, and probably prior to the maturity of the acceptance the raw silk has become silk

piece goods and has been sold for cash to a silk merchant on Fourth Avenue in New York. The Paterson Silk Co. deposits the funds received for the value of the finished piece goods to its credit with the Chase Bank, and promptly instructs the Chase Bank to charge the outstanding acceptance to its account. Oftentimes, bills of this character are interest bearing, so that the sooner the acceptance is paid, the less interest the drawee company is obliged to pay.

Most trust receipt operations end thus quite happily for all concerned. But let us consider some of the difficulties which may arise. The existence of the trust receipt will always prove that, as between the entruster (Chase Bank) and the trustee (Paterson Silk Co.), the legal title to the silk is always in the entruster, and the entruster may at any time demand the return of the goods if the goods are still in the possession of the trustee and can be identified as the goods of the entruster. If the entruster's silk was mingled with other silks and cottons belonging to the trustee or to other entrusters of such silks and cottons and the mingled yarns are in the process of manufacturing piece goods, who can say that this part of the whole belongs to the entruster—Chase Bank? This situation may arise even though the trustee is quite honest and never intended to jeopardize the rights of the entruster.

But suppose the silk company had a dishonest streak and, after obtaining possession of the raw silk, had represented to their local bankers in Paterson that the silk was their own property, free and clear, and had obtained a loan from the Paterson bank against the same silk which was not in reality their property. The Paterson bank would have no knowledge of the trust receipt arrangement. Obviously, the Chase Bank cannot recover the silk from the company because the silk now is pledged to the Paterson bank as security for its own loan to the company. The Chase Bank may be able to bring about the conviction of the officers of the company for a crime, but that will not satisfy the books of the Chase Bank.

Now let us suppose that the silk company, after obtaining possession of the raw silk under the trust receipt in favor of the Chase Bank, finds it more convenient and profitable to

# TRUST RECEIPTS

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## TRUST RECEIPT

The undersigned hereby acknowledges receipt from **THE NATIONAL CITY BANK OF NEW YORK**, on behalf of \_\_\_\_\_ (hereinafter called the "Entruster") of the following goods, documents and/or instruments, viz

Bill of Lading per SS/RR \_\_\_\_\_

covering shipment made by \_\_\_\_\_

to \_\_\_\_\_

consisting of \_\_\_\_\_

Warehouse Receipt of \_\_\_\_\_ No \_\_\_\_\_

dated at \_\_\_\_\_ on \_\_\_\_\_

covering goods marked and numbered as follows

(If instruments are delivered herewith give description below)

possession of which is herewith entrusted to the undersigned as Trustee hereunder for any of the purposes specified in the sub-division(s) indicated below of Section 52(3) of the Uniform Trust Receipts Law of the State of New York

Sub-divisions of Section 52(3)

- (a) In the case of goods, documents or instruments, for the purpose of selling or exchanging them, or of procuring their sale or exchange, or
- (b) In the case of goods or documents, for the purpose of manufacturing or processing the goods delivered or covered by the documents, with the purpose of ultimate sale, or for the purpose of loading, unloading, storing, shipping, transshipping or otherwise dealing with them in a manner preliminary to or necessary to their sale, or
- (c) In the case of instruments, for the purpose of delivering them to a principal under whom the trustee is holding them, or for consummation of some transaction involving delivery to a depository or registrar, or for their presentation, collection, or renewal

The undersigned hereby agrees to hold any and all such goods, documents and/or instruments, together with the proceeds and avails thereof as and when received by the undersigned, IN TRUST for the Entruster and as security for any and all obligations for which the same were security before the delivery thereof hereunder to the undersigned and also for any new value given or agreed to be given by the Entruster to the undersigned as a part of this transaction, and the undersigned further agrees to keep any and all such trust property, in whatever form same may be at any time or times, separate and capable of identification, as the property of the Entruster, and to surrender same and account therefor to the Entruster forthwith upon demand

It is hereby recognized that a security interest in the said goods, documents and/or instruments, together with the proceeds and avails thereof as and when received by the undersigned, remains in or will remain in or has passed to or will pass to the Entruster, and that the Entruster, or the duly authorized representative thereof, may at any time terminate this trust, either with or without notice to the undersigned, and may enter into any place where any such trust property is kept or stored and resume possession thereof.

The undersigned further agrees to keep all merchandise represented by any of the documents hereinbefore referred to insured in the name of the Entruster, but at the sole cost and expense of the undersigned, against loss by fire and any other risks which may be designated by the Entruster at any time or times, and to deliver any and all policies covering such insurance to the Entruster

The undersigned further agrees that no failure or omission on the part of the undersigned to fulfill any of the provisions of this or any similar receipt or agreement shall be deemed a waiver by the Entruster of any of its rights or remedies, unless such waiver shall be in writing duly signed by the Entruster.

The rights of the Entruster as specified herein or in any relative agreement between the Entruster and the undersigned, shall include any and all rights to which the Entruster is or may be entitled under the provisions of the Uniform Trust Receipts Law of the State of New York, as amended from time to time, and/or under any other applicable statute or law now or hereafter existing at any time or times.

\_\_\_\_\_  
(Signature of Customer)

sell the silk to another silk manufacturer, instead of manufacturing it in its own plant. Assume that such a sale has been made and that, before receiving payment, the Paterson Silk Co. becomes bankrupt. Under these circumstances, the entruster (Chase Bank) may recover from the other manufacturer either the silk or the purchase price payable but not as yet paid by the other manufacturer to the trustee, Paterson Silk Co.

The dangers inherent to trust receipt operations hardly exist if the trustee is thoroughly honest. In some respects the trustee is the agent of the entruster and if he keeps this relationship uppermost in his mind, the rights of the entruster will be safeguarded in the majority of instances. The trustee should never represent to third parties, other than bona fide buyers, that he is the legal owner of merchandise which may be in his possession under trust receipts. He should never include such merchandise as part of his assets when issuing financial statements. When his books clearly indicate that certain goods are held by him in trust only, neither his receiver in bankruptcy nor his other creditors can claim such goods or the proceeds thereof, and the entruster's paramount right to the merchandise and/or the proceeds will prevail.

Trust receipt facilities are encouraged in England somewhat more than in the United States. This may be due to the fact that British businessmen can ill afford to create situations which may cause losses to entrusters as, with fewer banks operating in England, the English merchant is obliged to watch his business conduct scrupulously for fear that the existing banks may refuse him the credit facilities which he must have for the conduct of his business.

The trust receipt is widely used in the Far East and in some of the Continental countries, but not in Latin-American countries. The mercantile codes under which our Latin-American friends operate do not seem to cover this instrument and their unwritten "law merchant" is not sufficiently established to give it proper recognition and standing.

**The Uniform Trust Receipt Law.**—As of July 1, 1934, New York State adopted the Uniform Trust Receipt Law.

(Our Own Transactions)

## STATEMENT OF TRUST RECEIPT FINANCING

The Entruster, THE NATIONAL CITY BANK OF NEW YORK, whose chief place of business within this State is at No. 55 Wall Street, Borough of Manhattan, City of New York, is or expects to be engaged in financing under trust receipt transactions the acquisition by the Trustee, \_\_\_\_\_, whose chief place of business within this state is at \_\_\_\_\_ of goods of the following description.

SPECIMEN

THE NATIONAL CITY BANK OF NEW YORK, Entruster

\_\_\_\_\_  
(Authorized Signature)\_\_\_\_\_  
(Authorized Signature)

TRUSTEE

Dated: \_\_\_\_\_, 19

Form 9. Typical Statement of Trust Receipt Financing

This law is applicable to intra-state operations only, that is to say, when the subject matter of the receipt is located in New York State. The law covers the "security interest" of the entruster in:

1. Goods
2. Documents of title such as bills of lading and warehouse receipts
3. Instruments such as:
  - (a) Negotiable instruments as defined by the Negotiable Instruments Law
  - (b) Stocks and bonds
  - (c) Any instrument which gives the holder apparent title

Under this law, a trust receipt transaction protects the entruster and makes the operation valid for 30 days only unless he has filed with the Secretary of State a so-called "Statement of Trust Receipt Financing." This statement merely states in general terms that A, the entruster, has trust receipt financing with B, the trustee, and must be renewed annually. If the statement is not filed and the operation extends over a period of 30 days, the prior rights of the entruster may be frustrated.

## CHAPTER 10

### FOREIGN EXCHANGE

The term "foreign exchange" has three principal meanings:

1. The entire system under which the settlements of international obligations are conducted.
2. The medium used.
3. The rates at which such media are quoted.

**The Entire System.**—First, "foreign exchange" refers to the entire system under which international business operations are conducted. Foreign banking operations are foreign exchange operations. The Foreign Exchange Department of a bank is the Foreign Department of the bank. This is the general, over-all meaning of the term.

**The Medium Used.**—Second, "foreign exchange" refers to the medium used in all foreign banking operations. This is the most important of its three different meanings. It is its substantive meaning. In the study of foreign banking it is indispensable for the student to keep his feet firmly planted in his own country and to view the subject solely from the point of view of his own country. For instance, goods shipped from New York to London are considered as exports from the point of view of the American seller while the same goods are considered as imports when viewed from the point of view of the London buyer. Again, a draft drawn in United States dollars by the American seller on the London buyer is no different than another draft which the same American seller may draw against one of his customers in Chicago and, therefore, from his own point of view is similar to any other domestic operation. But the dollar draft on London becomes a foreign exchange operation when viewed from the point of view of the London buyer, because such London buyer has no dollars but

## FOREIGN EXCHANGE RATES

as quoted by *The New York Times*

Friday, January 6, 1922

## SIGHT EXCHANGE

	High	Low	Final	Thur-day's Final
London	4 20 <sup>3</sup> / <sub>4</sub>	4 19 <sup>3</sup> / <sub>4</sub>	4 19 <sup>3</sup> / <sub>4</sub>	4 19 <sup>3</sup> / <sub>4</sub>
Paris	8 05 <sup>3</sup> / <sub>4</sub>	8 01	8 03	7 97
Rome	4 33	4 31	4 32	4 27 <sup>1</sup> / <sub>2</sub>
Amsterdam	36 65	36 60	36 60	36 56
Berlin	.53 <sup>1</sup> / <sub>2</sub>	.52 <sup>3</sup> / <sub>4</sub>	.53 <sup>1</sup> / <sub>4</sub>	.50 <sup>3</sup> / <sub>4</sub>
Madrid	14.95	14.90	14 90	14 86

## CLOSING RATES

Parity of Exchange is given as reported by the United States Mint, except in countries with a silver standard, where parity fluctuates with the price of silver

## EUROPE

	Friday	Thurs- day	Week Ago	Year Ago		Friday	Thurs- day	Week Ago	Year Ago
Sterling—Par	\$4 86 <sup>3</sup> / <sub>4</sub>	per sovereign.			Poland—Par	23 8 cents per mark			
Demand	4.19 <sup>3</sup> / <sub>4</sub>	4 19 <sup>3</sup> / <sub>4</sub>	4 21	3 63 <sup>1</sup> / <sub>2</sub>	Demand	.03 <sup>5</sup> / <sub>8</sub>	.03 <sup>3</sup> / <sub>4</sub>	.03 <sup>1</sup> / <sub>2</sub>	.17
Cables	4 20	4 19 <sup>1</sup> / <sub>2</sub>	4 21 <sup>1</sup> / <sub>2</sub>	3 84 <sup>1</sup> / <sub>2</sub>	Cables	.04 <sup>1</sup> / <sub>2</sub>	.04 <sup>1</sup> / <sub>2</sub>	.04	.18
Com 60 days	4 16 <sup>1</sup> / <sub>4</sub>	4 15 <sup>1</sup> / <sub>2</sub>	4 17 <sup>3</sup> / <sub>4</sub>	3.58 <sup>1</sup> / <sub>2</sub>	Romania—Par	19 3 cents per leu.			
Com 90 days	4.15	4 14 <sup>3</sup> / <sub>4</sub>	4 16 <sup>1</sup> / <sub>2</sub>	3 56 <sup>1</sup> / <sub>4</sub>	Demand	.82	.80	.77	1 32
France—Par	19 3 cents per franc				Cables	83	.80 <sup>1</sup> / <sub>2</sub>	.77 <sup>1</sup> / <sub>2</sub>	1 34
Demand	8 03	7 97	8 08 <sup>1</sup> / <sub>2</sub>	5 96 <sup>3</sup> / <sub>4</sub>	Serbia-Belgrade—Par	19 3 cents per franc			
Cables	8 03 <sup>1</sup> / <sub>2</sub>	7 97 <sup>1</sup> / <sub>2</sub>	8.09	5 97 <sup>1</sup> / <sub>2</sub>	Demand	1 40	1 47	1.56	2 75
Italy—Par	19 3 cents per lira.				Cables	1 42	1.48	1.57	2.80
Demand	4 32	4 27 <sup>1</sup> / <sub>2</sub>	4.36	3 47	Spain—Par	19 3 cents per peseta.			
Cables	4 32 <sup>1</sup> / <sub>2</sub>	4.28	4 36 <sup>1</sup> / <sub>2</sub>	3 48	Demand	14 90	14 86	14 89	13 28
Belgium—Par	19 3 cents per franc				Cables	14 92	14 88	15 00	13 30
Demand	7.68 <sup>1</sup> / <sub>2</sub>	7.61	7 70 <sup>1</sup> / <sub>2</sub>	6.28	Sweden—Par	26 8 cents per krona.			
Cables	7.69	7.61 <sup>1</sup> / <sub>2</sub>	7.71	6.29	Demand	24.70	24 65	25 20	20.75
Germany—Par	23 8 cents per mark.				Cables	24 75	24.70	25.25	20.80
Demand	53 <sup>1</sup> / <sub>4</sub>	.50 <sup>3</sup> / <sub>4</sub>	54 <sup>1</sup> / <sub>2</sub>	1 38 <sup>1</sup> / <sub>2</sub>	Switzerland—Par	19 3 cents per franc			
Cables	53 <sup>3</sup> / <sub>4</sub>	.51 <sup>1</sup> / <sub>4</sub>	55	1 39	Demand	19 32	19 31	19 48	15 45
Austria—Par	20 3 cents per crown				Cables	19 35	19 33	19 50	15 50
Demand	.03 <sup>1</sup> / <sub>4</sub>	.03 <sup>1</sup> / <sub>2</sub>	.04	.23 <sup>1</sup> / <sub>2</sub>					
Cables	.04	.04	.04 <sup>1</sup> / <sub>2</sub>	.24					
Czechoslovakia—Par	20 3 cents per crown								
Demand	1 62	1 61	1 46	1 14					
Cables	1 64	1.62	1 47	1 15					
Denmark—Par	26 8 cents per krone								
Demand	19 80	19 85	20 00	16 25					
Cables	19 82	19 90	20 05	16.30					
Finland—Par	19 3 cents per Finnmark.								
Demand	1.86	1 88	1.97	3 00					
Cables	1.88	1.89	1 98	3 05					
Greece—Par	19 3 cents per drachma.								
Demand	4 42	4.40	4 30	7 42					
Cables	4.45	4 45	4 35	7 47					
Holland—Par	40 2 cents per florin								
Demand	36.60	33 56	36 92	31.00					
Cables	36 65	36 61	36 97	31.95					
Hungary—Par	20 3 cents per crown.								
Demand	.16 <sup>1</sup> / <sub>2</sub>	.16 <sup>3</sup> / <sub>4</sub>	.16 <sup>1</sup> / <sub>2</sub>	.17					
Cables	.17	.17 <sup>1</sup> / <sub>4</sub>	.17	.18					
Jugoslavia—Par	20 3 cents per crown.								
Demand	.35	.36 <sup>3</sup> / <sub>4</sub>	.39	.68					
Cables	.36	.37 <sup>1</sup> / <sub>2</sub>	.39 <sup>1</sup> / <sub>2</sub>	.69					
Norway—Par	26 8 cents per krone								
Demand	15 52	15 45	16 05	16 20					
Cables	15 55	15 50	16 10	16 25					

## FAR EAST

China—Cents per silver dollar for Hong Kong, per tael for Shanghai and Peking				
Hong Kong—				
Demand	55.875	55 375	54.75	58.25
Cables	56.00	55.50	54 875	58.35
Peking—				
Demand	80.00	78 50	79.50	83 00
Shanghai—				
Demand	74 75	74 50	75.00	76.50
Cables	75 00	74 75	75 20	77.00
India—Calcutta—Cents per rupee, nominally stabilized at one-tenth of a pound sterling				
Demand	27 93	27.875	28 00	27.25
Cables	28 06	28 00	28 125	27 50
Philippine Islands—Manila: Par 50 cents per silver peso				
Demand	50.00	49.50	47 75	46 00
Cables	50 25	49 75	48.00	46 25
Java—Par 40 02 per florin				
Demand	37.25	37 25	37.25	33.50

	Friday	Thurs- day	Week Ago	Year Ago
Japan—Par	49.8 cents	per yen.		
Demand	47.81	47.875	47.875	48.25
Cables	47.93	48.00	48.00	48.50

	Friday	Thurs- day	Week Ago	Year Ago
Uruguay—Par	\$1.0342	per gold peso.		
Demand	70.70	71.46	72.24	74.39
Cables	70.92	71.68	72.46	74.76

SOUTH AMERICA

Argentina—Par	42.44	cents per		Argentine
paper peso				
Demand	33.25	33.375	33.50	34.25
Cables	33.375	33.50	33.675	34.375
Brazil—Par	32.45	cents per paper milreis.		
Demand	12.75	12.75	12.875	14.375
Cables	12.875	12.875	13.00	14.875
Chile—Par	25	cents per paper peso.		
Demand	10.26	10.26	10.23	13.98
Cables	10.29	10.29	10.26	14.05

CANADA

Montreal—Par	100	cents per		Canadian dollar.
Demand	94.1	94.7	95.2	86.3

RUSSIAN CURRENCY

Prices for pre-revolution Russian ruble notes were as follows: Par, 51.40 cents per ruble.

	Bid	Asked
100 ruble notes, per ruble	.17½	.25
500 ruble notes, per ruble	.09¾	.10

Form 10. Foreign Exchange Rates, January 6, 1922

FOREIGN EXCHANGE RATES

as quoted by *The New York Times*

Monday, January 6, 1947

	High	Low	Final	Satur- day's Final
STERLING	4.03¾	4.03⅞	4.03⅞	4.03¾
CANADA (free)	95.12	94.88	95.06	95.12

EUROPE

	Monday	Satur- day	Week Ago	Year Ago
Sterling—Par	\$8.2397	per pound.		
Cables	4.03⅞	4.03¾	4.03¾	4.03½
Belgium—Basis:	43.8275	francs to the dollar		
Cables	2.28¼	2.28¼	2.28¼	2.32
France—Basis:	119.107	francs to the dollar.		
Cables	0.84½	0.84½	0.84½	0.85
Australia—Par	\$8.2397	per pound		
Cables	3.23	3.23	3.23	3.23½
New Zealand—Par	\$8.2397	per pound.		
Cables	3.24½	3.24½	3.24½	3.25
South Africa—Par	\$8.2397	per pound.		
Cables	4.03¾	4.03¾	4.03¾	4.03½
Sweden—Parity of gold dollar	not fixed			
Cables	27.85	27.85	27.85	23.86
Switzerland—Parity	changed Sept. 28, 1936, new value not yet determined.			
Cables	23.40	23.40	23.40	23.35

FAR EAST

India—Calcutta	61.7978	cents per rupee.		
Cables	30.26	30.26	30.26	30.35

LATIN AMERICA

	High	Low	Final	Satur- day's Final
Argentina—Par	71.8724	cents per Argentine paper peso.		
Cables	24.49	24.49	24.50	24.80
Brazil—Par	6.06	cents per paper cruzeiro.		
Cables (free)	5.46	5.44	5.41	5.25
Chile—Par	20.5990	cents per gold peso.		
Cables (export)	4.00	4.00	4.00	4.00
Colombia—Par	57.14	cents per gold peso.		
Cables (official)	58.50	58.50	58.50	58.50
Cuba—Par	\$1	per silver peso.		
Cables	100.12	100.12	100.12	100.12
Mexico—Parity	not yet determined			
Demand	20.70	20.70	20.70	20.70
Peru—Par	47.40	cents per sol.		
Cables	15.00	15.00	15.00	15.75
Uruguay—Par	65.83	cents per peso.		
Inland	56.40	56.40	56.40	56.40
Venezuela—Par	32.67	cents per bolivar.		
Cables	30.15	30.15	30.15	30.15

NOTE: In the quotations above the sterling currencies are in dollars and decimals of a dollar; others represent cents and decimals of a cent.

Form 11. Foreign Exchange Rates, January 6, 1947

must purchase them in the form of a check on New York from his bankers in London.

It follows, therefore, that any and all international operations in United States dollars, even though handled through the foreign department of an American bank, involve no foreign exchange operations upon the part of the American merchant or upon the part of his American bank but do involve foreign exchange operations upon the part of the foreign merchants with whom Americans are conducting the business at hand, and upon the part of their local bankers.

What, then, is the substantive meaning of foreign exchange when it refers to the medium used in foreign exchange operations? From our point of view, it is something which is payable in a currency foreign to us and which can be bought or sold in our market. It may be payable either here in the United States or abroad, although, most generally, it is payable abroad in the country in the currency of which the item is drawn. For instance, we may run across a check drawn in sterling on an American bank. The payee or endorsee of such a check may demand in payment a sterling check for the same amount of sterling drawn by the American drawee bank on its London correspondent. The American payee or endorsee then has a check on London which he may sell in the American market. As a rule, however, the American payee or endorsee of a sterling check drawn on an American bank will sell the sterling to the American bank against which the sterling check has been drawn, providing, of course, the owner of the check is satisfied with the rate quoted by the drawee bank.

To us in America, foreign monies, be they in the form of coins or in the form of paper money, are pieces of foreign exchange, readily saleable and purchasable in the United States.

Cable transfers payable in foreign currencies represent foreign exchange. A in New York wishes to pay B in London £1,000. very promptly. Instead of buying from an American bank a check on London for £1,000., in favor of B, which he could mail to B, A requests the American bank to instruct its correspondent bank in London by cable to make the payment to B. This is called a cable transfer.

Unused foreign postage stamps in New York may be regarded as substantive foreign exchange here in the New York market. The stamps may be purchased by us in New York and sent to our correspondent bank abroad for the credit of our sterling account with the correspondent bank. What happens, of course, is that the correspondent bank will purchase these stamps, crediting their face value to our sterling account with them. The correspondent bank will use these stamps in the same manner as they use other stamps which they purchase locally.

Foreign bonds, coupons, dividend checks, pension checks, promissory notes, are all pieces of foreign exchange to us in America, providing they call for the payment of a currency foreign to us.

The principal type of foreign exchange which we buy and sell in America is the bill of exchange in its multitudinous forms, such as bankers' checks, commercial checks, clean bills, documentary bills, sight bills, time bills, D/A bills, D/P bills, all of which may be drawn by banks, individuals, partnerships, or corporations. But to be foreign exchange to us in America, all such bills must call for the payment of a currency foreign to us and never U. S. dollars. A vast volume of these bills are issued by American exporters in cover of their exports. These bills are offered for sale to the larger banks in our commercial cities which maintain foreign departments and buy and sell foreign exchange as a part of the business of their foreign departments.

**As Applied to the Quotation of Rates.**—The third meaning of the term "foreign exchange" is that it covers, in a general way, the rates at which foreign exchange is quoted. When one asks "What's foreign exchange doing today?" he means to ask "Are rates for foreign exchange moving up or down?" This third meaning is not of particular importance.



PART III  
THE OPERATIONS OF THE FOREIGN  
DEPARTMENT



## CHAPTER 11

### THE BUYING AND SELLING OF FOREIGN EXCHANGE

So that we may discuss in a more understandable manner the operations of this very important section of the foreign department, let us reconsider the substantive meaning of foreign exchange. Foreign exchange must always be a currency foreign to us in the United States. It can never be United States dollars because it is impossible for anyone in the United States to buy and to sell United States dollars and produce a profit. British sterling is foreign exchange to us because we can buy sterling in this market with dollars and we can also sell sterling in this market for dollars and the difference between our buying price and selling price represents our profit. On the other hand, the United States dollar is foreign exchange in London and in all other countries which have their own currencies such as sterling, francs, marks, pesos, etc.

Whenever a sale of merchandise has been made by us to a foreign buyer in terms of United States dollars and the seller is called upon to draw a dollar draft on the buyer, the draft thus created is not foreign exchange to us in the United States. It cannot be sold to a bank, but may be offered to a bank for discount only. The discounting bank merely deducts interest for the length of time the draft will be in the process of being collected, plus the usual collection charges. But if the sale has been made in the currency of the buyer, the resulting draft, drawn in the currency of the buyer, may be offered for sale to a foreign exchange dealer or trader, usually a bank. The trader will purchase the draft at the then current price or rate for that type of foreign exchange. The purchase price will take into consideration the length of time the draft will be in process of collection and all other charges which may be incurred before

the net proceeds of the draft are placed to the credit of the trader on the books of its correspondent collecting bank located in the country in the currency of which the draft is drawn.

**The Foreign Exchange Trader.**—The men connected with banks who buy and sell foreign exchange are called foreign exchange traders or, for brevity, traders. In our larger banks the trader is usually a senior officer and may have two or more junior officers as assistant traders. While the senior executive committee of the bank may dictate the general policies of the trader to be followed each day, or as occasion may require such control, the trader is, nevertheless, largely his own master and is in a position to create not only large profits but also large losses for his bank. If his operations result in substantial profits, he is said to be a good trader, but if his operations result in substantial losses he is relieved of his position and, oftentimes, discharged from the bank.

It would seem that good traders are born and not made. Study and experience will, of course, enable a man to become an average trader. But the leaders seem to have something more, something which cannot be acquired from books or from long connection with the trader's department. He must be an economist of the first order. He must be an astute politician. He must sense slight tendencies which are apt to bring about big results. He must be courageous. The large majority of his convictions and decisions must be correct. He must be a good banker and must know to what extent he may safely buy exchange from those concerns all over the United States who are in the market as sellers.

No other bank officers are obliged to be so constantly alert. The officers on the domestic side of the bank who make loans are privileged to take their time and to examine all factors which are to be considered before making a decision. The trader must decide if he should buy an offering the minute the offering is made to him and some factors which he considers in making his decision to buy or not to buy may be in the abstract and entirely outside his power and outside the power of the seller to control.

In smaller banks the responsibility for making decisions may be vested solely in the management or in a special committee of which the trader is a member. Under such an arrangement the trader, who is most likely a senior clerk or junior officer, merely carries out the decisions made by the management. He is told what to buy and at what rates and what to sell and at what rates and is not required to lie awake nights planning the next day's operations.

**The Equipment of the Trader.**—The trader must have available, first of all, wires,—telegraph wires, telephone wires, and cable wires. In recent years he also utilizes radio communications. The more quickly he can communicate with his clients in the United States and with his correspondent banks abroad, the more successfully he can operate. He may have private telegraph wires to the larger cities in the United States and to the offices of the cable companies in New York. He may have a telephone switchboard separate from the general telephone board of his bank. The cable companies are required to give him the fastest possible service and, in normal times, he may send a cable to his London correspondent and receive a reply in about ten minutes. He will not hesitate to communicate with London, Paris, Havana, or Mexico City by telephone whenever the matter at hand warrants the expense.

The trader must also have accounts in all of the more important capitals throughout the world, in the currencies of these foreign countries. We call such accounts "Our Accounts" or "Nostro Accounts" (*nostro* being Latin for *our*) or "Due from Banks Accounts" to distinguish these accounts in our name from the dollar accounts which the same correspondent foreign banks have with us, which we call "Their Accounts" or "Vostro Accounts" (*vostro* being Latin for *your*) or "Due to Banks Accounts." The trader cannot operate without "Our Accounts" because these accounts are the accounts which he utilizes when buying or selling foreign exchange.

The trader must also have trained men to assist him because things move too fast in his division for untrained men. His assistants must be able to bring to the trader's attention

immediately the more important events and offerings coming in not only by wires but also through the other operating divisions or sections of the foreign department, as well as by customers and others at the traders' counter.

**The Foreign Exchange Market in New York.**—The foreign exchange market in New York is made up of banks, foreign exchange brokers and, of course, the commercial houses and individuals who buy and sell for their own account. There is no common meeting place similar to the Stock Exchange or the Produce Exchange but those interested in foreign exchange operations contact each other by wire, by mail, or in person. Only the larger banks maintaining complete foreign departments are in the market. The smaller banks do their buying and selling through these larger banks.

**Foreign Exchange Brokers.**—The brokers are of two types. One type, called a general broker or dealer, has a number of out-of-town customers for whom he buys and sells. Some years ago, when telegraph and telephone rates were higher, the cotton shipper in Texas would send his sterling bills to his New York broker and ask him to sell the bills at the best obtainable rates. Today, the Texas shipper is more apt to offer his bills to several New York banks by telegraph and will accept the best rate received, also by telegraph. As a consequence, this type of broker appears to have outlived his usefulness and the few who still operate do so largely because of long established relationships.

The second type of broker, who may be called a "running broker," has no organization and operates only as a go-between. He may have desk room with a concern in the financial district and be listed in the telephone directory, but that is all. Despite all this, he is indispensable to the trader. Without his services the trader could not possibly feel the market or determine if his competitors are in the market as buyers or as sellers.

Suppose trader A suddenly comes to the conclusion that he has accumulated a too large sterling balance and, fearing a drastic reduction of the rate for sterling, is anxious to reduce his holdings of this currency. How is he to accomplish this?

He cannot disclose his dilemma to trader B and trader C for fear that they may take advantage of his position and offer him a rate much lower than the actual market rate. Here is where the running broker helps. Without disclosing his actual sterling position to the broker, the trader will instruct him to consult other traders and ascertain at what rate he, trader A, may purchase or sell a large block of sterling. The broker immediately consults the principal foreign exchange traders, either by telephone or in person, and in a few minutes returns to the counter of trader A with a number of sterling offerings which will enable trader A to fix his own selling rate at the highest possible point for an immediate sale. If a sale or purchase is made through the intervention of the broker, the seller of the exchange pays the broker's commission, about 1/16%, but as operations between traders invariably involve large amounts, the intermediary broker makes a comfortable living.

Importers and exporters are members of the market. The importer, when making his foreign purchases in the currencies of his foreign suppliers, is obliged to purchase the required foreign currency from the trader of a large American bank with a complete foreign department. The exporter, when making his sales to foreigners in the currencies of the purchasers, must sell the foreign exchange represented by his drafts drawn on his foreign buyers, also to a trader.

Vast amounts of foreign funds are also purchased from American foreign exchange traders by individuals for remittance to friends, relatives and families residing abroad. While each individual purchase may be comparatively small, the sum total of such sales at the end of the day becomes consequential. The foreign exchange trader exists and functions because business houses and individuals are obliged to buy and to sell foreign exchange. The trader accommodates them in a manner and at rates most advantageous to these merchants and at the same time makes profits for his bank.

**The Unsettled Foreign Exchange Market Following World War II.**—World War I, the depression of the early 30's and World War II have so distorted the economy of the world

that it is very difficult to predict the manner in which the international trade of the immediate future is apt to be conducted. We shall refrain from making predictions. However, we can profitably review the procedures followed in more normal times, as sooner or later we must adopt the same procedures, or new procedures quite similar to the old. When impoverished Europe begs us for goods we may be able to insist upon selling in terms of the United States dollar, but a revived Europe may insist upon making purchases from us in their own currencies when we again experience a buyers' market in the United States after our pent-up industrial wants have been largely satisfied. With this thought in mind, let us now consider the international business operations which, in more normal times, create the supply of and the demand for foreign exchange.

**The Supply of Foreign Exchange.**—Generally speaking, whenever funds from abroad are to enter the United States, we have a situation or operation which may create a supply of foreign exchange. Here are five of these operations:

1. **DRAFTS DRAWN BY AMERICAN EXPORTERS OF GOODS, INCLUDING EXPORTS OF GOLD.** Assuming the goods have been sold in terms of the currency of the foreign buyer, the American exporter will draw a bill of exchange on the buyer, attach to it the relative shipping papers and offer the bill for sale to the foreign exchange trader. If the merchandise sale has been made and the covering bill has been drawn in United States dollars, such a bill does not create a supply of foreign exchange in the United States and is not foreign exchange to us. Similarly, if the foreign buyer of the goods has sent the required dollars with the order, or has arranged through his own bank abroad so that the American correspondent of the foreign bank will pay the American exporter as soon as the goods are shipped, we have no foreign exchange to buy or to sell here in the United States and, consequently, such operations do not create a supply of foreign exchange. In these cases, either the foreign importer or his local bank may purchase the required United States dollars in their own country and remit the dollars to us by mail

or by cable. However, the more dollar exchange is sold by banks abroad, the more dollars they will require and, if they are unable to buy dollar exchange in sufficient volume in their markets, they may acquire the needed dollars by offering their currency to the American trader at attractive rates, thus, indirectly, increasing the supply of exchange to the American trader. In normal times, political and economic conditions permitting, a large part of our merchandise sales to foreigners is made in the currencies of the foreign buyers.

When gold is shipped to foreign countries either for manufacturing or dental purposes, we treat it as any other commodity. However, when the gold markets are free and the possession and shipment of the metal is not prohibited by law, the trader will bring into the American market a large volume of exchange representing the value of gold which he has shipped to London to be sold to the Bank of England. He makes these gold shipments and draws and sells his sterling checks to other American traders and buyers of sterling exchange whenever he can build up a sterling balance of a given amount in this manner with a lesser outlay of dollars than he would be obliged to expend were he to build up the same balance by purchasing sterling bills at the then current rates, which are unusually high. The checks drawn against these gold shipments create an abundance of exchange in our market and this situation will soften the rate, and the shipments stop altogether as soon as sterling in the form of bills and cable transfers is again purchasable at lower rates. In this connection, see the section entitled "The Gold Export and the Gold Import Points," commencing on page 165.

2. DRAFTS DRAWN IN FOREIGN CURRENCIES BY AMERICAN SECURITIES DEALERS, REPRESENTING THE SALE OF AMERICAN SECURITIES TO FOREIGN INVESTORS. The stocks and bonds, in negotiable form, are attached to the bills and collateralize the bills in the same manner as a blank endorsed negotiable bill of lading attached to a bill. The sales are made in the currency of the foreign buyer, the bills are drawn in the foreign currency of the buyer and sold to the trader, thus creating a supply of foreign exchange in our market.

3. DRAFTS FORMERLY DRAWN BY AMERICAN BANKS ON THEIR FOREIGN CORRESPONDENTS, FOR THE PURPOSE OF ENABLING THESE FOREIGN CORRESPONDENTS TO INVEST FUNDS IN THE UNITED STATES. These drafts are called foreign loan drafts or bills. When a London bank wishes to make loans in the New York market, it makes the required funds available in New York by instructing its New York correspondent to draw sterling bills on the London bank at 90 days sight and to sell these sterling bills in the New York foreign exchange market. The dollars thus realized belong to the London bank and are invested by the New York bank according to the instructions, and for account, of the London bank. These 90 days sight sterling bills create a supply of exchange in the United States.

4. DRAFTS DRAWN IN THE PAST BY AMERICAN BANKS ON THEIR FOREIGN CORRESPONDENTS FOR THE PURPOSE OF CREATING DOLLARS TO BE INVESTED BY THE AMERICAN BANKS FOR THEIR OWN ACCOUNT. These bills are exactly similar to the foreign loan bills. The distinction is dictated solely by the motives which create these 90 days sight sterling bills. If created by order and for account of the foreign bank, we have a foreign loan bill; if created by order and for account of the American bank, we have a finance bill. Some call both types of bills finance bills, as both are issued for the purpose of creating dollar funds. Finance bills also create a supply of exchange in our market. It may be well to mention that foreign loan bills and finance bills may be issued by American banks in various foreign currencies but because of the greater amount of business between New York and London most of these finance bills are in sterling and between the New York and London banks. The creation of finance bills was stopped by the repercussions of World War II but may be resumed as times improve.

5. SIGHT DRAFTS OR CHECKS DRAWN BY AMERICANS IN COVER OF INTEREST AND PROFITS DUE THEM IN CONNECTION WITH AMERICAN CAPITAL INVESTED ABROAD. American manufacturers who maintain plants in foreign countries must, sooner or later, transfer the profits of these plants to their head

offices in the United States, and as these profits are held in the currencies of the foreign countries in which these plants operate, their head offices draw checks against these profits and sell the checks to American foreign exchange traders, thus creating supply of foreign exchange here in the United States.

While these five categories represent the principal operations which create supply of exchange in the United States, it is well to remember that any operation which represents the movement of funds from abroad to the United States will create supply only if bills of exchange drawn and payable in foreign currencies are created in the American market. The Ford Motor Company in Detroit operates a plant in England and, presumably, accumulates profits in England. The company in Detroit may choose to draw a check against these profits and sell the check to a trader in Detroit or in New York, or the company in Detroit may instruct the manager of its English plant to purchase with the accumulated profits a dollar check from an English bank and remit the dollar check to Detroit. If this is done, we have no foreign exchange operation in the United States but in England where the dollar check is sold and purchased.

**The Demand for Foreign Exchange.**—Now let us consider some of the principal operations which create the demand for foreign exchange. These are:

1. DRAFTS DRAWN IN FOREIGN CURRENCIES AND REQUIRED BY AMERICAN IMPORTERS FOR THE PURPOSE OF MAKING PAYMENT FOR IMPORTS PURCHASED IN THE CURRENCIES OF THE FOREIGN SELLERS, INCLUDING THE IMPORTS OF GOLD BULLION. Generally speaking, whenever funds are to move from the United States to foreign countries we are apt to have operations which create demand for foreign exchange here in the United States. When foreigners ship goods to us or render services for us, we become their debtors and the best way to discharge such indebtedness is for us to purchase the required currency from the foreign exchange traders, usually in the form of checks, and to remit such checks to our foreign creditors.

We must point out, however, that all imports do not necessarily create demand for exchange. If the goods have been sold by the foreign seller to the American importer in terms of United States dollars, we have no exchange operation in the United States. The seller will draw a dollar draft on the buyer and the buyer (the American importer) will pay the dollar draft by his own dollar check exactly in the same manner as a dollar draft drawn on him in domestic trade. But if the traders in foreign countries buy in their markets more dollar exchange than they can sell, their dollar balances in New York may become too large. Should this occur, the excessive dollar balances in America may be converted into the currencies of the traders in foreign countries, and this operation will create demand for foreign exchange in the American markets.

As to imports of gold bullion, the American trader, in normal times when gold shipments are permitted, would import such bullion, usually from London, whenever the rate for sterling in our market had declined to such a point that he would find it profitable to purchase the gold from the Bank of England. The trader would import the gold and sell it to our own Treasury Department. He would use the dollars received for the gold, less his profit, to purchase cheap sterling in our market and remit the sterling to his London correspondent to reimburse the correspondent for the sterling paid to the Bank of England when the gold was purchased for account of the American trader.

2. DRAFTS REQUIRED BY AMERICAN INVESTORS IN FOREIGN SECURITIES PURCHASED FOR THEM IN THE FOREIGN SECURITIES EXCHANGES. The securities are purchased in the currency of the foreign country and the American investor must make payment in that currency. He purchases the exchange (the foreign currency) from an American foreign exchange trader.

3. DRAFTS REQUIRED FOR THE PURPOSE OF REMITTING TO FOREIGN COUNTRIES INTEREST AND DIVIDENDS ON FOREIGN CAPITAL EMPLOYED IN THE UNITED STATES. In years past much foreign capital was invested here. America was young. Her industries were young. The demand for funds was great and the returns quite satisfactory. No one knows how much

foreign capital may be invested in America in the future, as the local demand for capital funds may be particularly brisk in the foreign countries now set back many decades by the devastations of World War II.

4. DRAFTS REQUIRED BY FOREIGN BUSINESS, PRINCIPALLY STEAMSHIP AND INSURANCE COMPANIES, OPERATING IN THE UNITED STATES. The freight charges on outgoing shipments and on many incoming shipments are paid to the foreign steamship companies at American seaboard cities. While Lloyd's and other foreign insurance companies may prefer to maintain their reserve for American business here in America, a certain volume of the premiums paid by Americans must be remitted to the head offices of these foreign insurance companies and the best way to remit such funds is a check purchased from an American foreign exchange trader, drawn in the currency of the nationality of the insurance company, which is then mailed to the head office of the company.

5. DRAFTS REQUIRED BY AMERICAN TOURISTS. While John Jones starts his tour with a travelers' letter of credit purchased from his American bank, Mrs. Jones may become interested in a fur coat displayed in Paris. Mr. Jones is apt to cable his New York office for Fcs. 100,000., which will be purchased in New York and remitted to him in Paris, either in the form of a draft or in the form of a cable transfer, depending upon the speed with which the francs may be required. Some wealthy Americans spend much of their leisure time abroad. They must either sell to foreign exchange dealers abroad their dollar checks drawn on their American banks or they must request their representatives in America to send them so many pounds or francs or marks, depending upon the country of their stay. If the second form of remittance is utilized we again have demand for foreign exchange in the United States.

6. DRAFTS REQUIRED TO LIQUIDATE FOREIGN LOAN AND FINANCE BILLS DISCUSSED UNDER SUPPLY OF EXCHANGE. These bills, drawn at 90 days sight, eventually mature and if they are not replaced by new sets of 90 days sight bills, must

be paid at maturity. In the case of the foreign loan bill, when the dollars created and invested in America are paid back to the lending American bank, the American bank will use the dollars to purchase a check or cable transfer on London and the London bank will use these demand funds to retire the maturing 90 days sight bills. In the case of finance bills, the American bank which has initiated the operation must remit to the foreign bank—upon which the 90 days sight bills were originally drawn—the funds with which to retire the 90 days sight bills. The funds, in the form of a check or cable transfer and in the currency of the foreign bank, must be supplied by an American trader in foreign exchange. This, again, creates demand.

7. DRAFTS REQUIRED BY AMERICANS OF FOREIGN EXTRACTION WHO REGULARLY REMIT FUNDS TO THEIR FAMILIES AND RELATIVES ABROAD, ESPECIALLY DURING HOLIDAY SEASONS. These remittances are bound to reach unprecedented volumes due to the economic situation prevailing in Europe and in some other sections of the world as a result of World War II. Each individual purchase may be small, but the aggregate may reach fantastic figures. These remittances are normally made in the currencies of the foreign beneficiaries, and when so made, create demand for exchange here in the United States.

While the above categories give us an idea of the principal operations creating demand, any operation based upon the proposition that funds are to be remitted from the United States to points abroad will create demand providing, always, that the remittance is made by us in the currency of the foreign beneficiary. If dollars are remitted, we have no foreign exchange operation in the United States and such dollar remittances cannot create a demand for foreign exchange here in the United States.

### Fixing the Exchange Rate

It is possible for a foreign exchange trader to begin his day by using his closing rates of the previous day, or to take as his guide for the new day the exchange rates as published in the

morning papers. A trader who attempts this is just a "follower" and not a leader. He takes no part in advancing or reducing the current rate but merely accepts the rate as determined for him by the competent leaders in the field. No real trader determines rates in this manner but takes into consideration the following factors.

**The Gold Export and the Gold Import Points.**—Before the principal exchange rates became pegged or controlled by governmental purchases and sales in order that the rates would remain more or less constant, and before the abandonment of free gold markets, the currencies had points above which rates could not advance and points below which the rates could not fall. Here in the United States we call these, respectively, the gold export points and the gold import points. The trader knew, therefore, that his rate for a given currency was obliged to be somewhere between the gold export and gold import points of that currency. For instance, whenever the rate quoted in New York for sterling checks on London advanced too high (reached the gold export point) the trader, instead of acquiring sterling by purchasing sterling bills and cable transfers on London, would find it cheaper to obtain sterling by shipping gold bars to London to be sold to the Bank of England. The Bank of England, much like the United States Treasury, is required to purchase all gold offered to it at a price fixed by law.

Let us put this problem another way. If an American wishes to make a payment in sterling to a creditor in London, and ascertains that the rate quoted for a check on London is quite high, he may discharge his indebtedness more economically by purchasing gold from the United States Treasury which gold he will then ship to his London creditor with instructions to sell it to the Bank of England and apply the sterling proceeds against his indebtedness. However, merchants dislike shipping small lots of gold for their own account and it is not necessary, because the foreign exchange traders begin shipping large amounts of gold for their own account and sell the sterling proceeds of such shipments to American buyers of sterling exchange somewhat more economically and in the exact desired

amounts. The more gold is shipped the more sterling exchange we will have in our market. This easy supply of exchange will bring down the sterling rate to a point where the trader can again acquire the desired exchange by purchasing bills and cable transfers. The gold shipments stop altogether when the lower rates obtainable will not cover the cost of the metal and its incidental shipping charges.

The gold import point is reached when the rate for an exchange quoted in our market is so low that an American who has funds abroad, say in London, may convert his foreign funds into gold, import the foreign gold, sell it to the United States Treasury, and realize more dollars than he would have realized had he sold his foreign balance to an American trader at the low quoted rates. But, again, individual merchants find it unnecessary to become involved with shipments of actual gold because the foreign exchange trader will enter the picture and give him even better results.

When the rate is quite low—below the gold import point—the trader will instruct his London correspondent to buy and ship him a large amount of gold. When received in New York, he sells the gold to the United States Treasury at the legally fixed price. He will then buy checks or cable transfers on London at the prevailing low rates and remit the exchange thus purchased to his London correspondent to reimburse the correspondent for the gold. These imports oblige the American trader to become a large buyer of sterling exchange, the demand for sterling exchange increases sharply and that, in turn, stiffens the rate. The imports stop altogether as soon as the rates advance enough to make the movement of gold unprofitable to the trader.

**Other Factors Which Help the Trader to Fix Rates.**—The difference in time helps the trader determine exchange rates. When it is 9:00 A.M. in New York, it is 2:00 P.M. in London, and 9:00 P.M. in Shanghai. This difference in time enables our trader to ascertain just how a certain currency has been acting during the day in the foreign markets. The rate in the United States must be in line with the foreign markets, since traders

buy and sell in all markets throughout the world. If, for instance, our trader needs £10,000. and he discovers that sterling may be obtained by the expenditure of less dollars when purchased in Paris, he is apt to buy French francs in the form of a cable transfer and request his Paris correspondent to invest the francs thus purchased in a cable transfer of pounds sterling, which sterling will then be credited to our trader's account in London.

The law of supply and demand enables the trader to determine the trend of exchange rates. If we are making large exports to Europe the supply of exchange in the United States will be large and this overabundance of offerings has a tendency to soften exchange rates.

Money rates, both here and abroad, have a bearing on exchange rates. If London banks pay higher rates for money, American investors are apt to transfer their idle reserves to London. The transfer is made by purchasing a sterling draft or cable transfer from a trader in the United States and these purchases create an abnormal demand for foreign exchange in the American market, thus strengthening the rate. The reverse is true if money rates in the United States are higher than the prevailing rates in London. English banks will then instruct their New York correspondents to draw drafts on the English banks, sell the drafts in the New York market and invest the dollars thus realized for account of the English banks. This creates an abnormal supply of sterling exchange in the American market and weakens the rate in our market for sterling.

The cash position and convictions of the individual trader will prompt him to fix the rate either slightly higher or lower than the actual market. A trader may have believed some weeks ago that French francs would become firmer and he may have built up a large franc balance in Paris in order to sell when the rate has become higher. Suddenly, he reaches the conclusion that his conviction was all wrong and the franc market, instead of becoming firmer, is softening. Now he is anxious to unload his large franc balance and is apt to offer francs at a rate slightly under the actual market. To be able to predict correctly the performance of rates is an art peculiar to the good trader. He

may be considerably assisted by the connections which he has abroad—connections which keep him promptly posted as to political and economic events which are apt to affect rates.

The alert trader in foreign exchange, much like the good trader in coffee or in any other staple commodity, has little difficulty in determining quite promptly the proper rates or prices to apply. Both take into consideration the current supply and demand, the rates or prices quoted by their competitors, and their own position in the commodities involved, as well as their own convictions as to trends. The gap between the rate at which the trader buys foreign exchange and the rate at which he sells the same exchange, represents his profit, and the bigger he can make this gap, the bigger profits he can turn in. He must buy as cheaply as he can and sell as dearly as he can.

**Per Mil.**—Not only the trader, but also the section of the foreign department collecting bills payable abroad, is constantly working with per mils as well as per cents. The bill stamp tariffs of foreign countries may be in percentages or in per mils. The collection charges of foreign banks may be quoted in per mils or in percentages. Books on banking subjects always seem to assume that the student should know the meaning of the term per mil, and do not sufficiently explain it. Admittedly, it is a simple matter when once clearly and conclusively learned.

The term "per cent" is derived from Latin (centum meaning one hundred) and designates one unit out of one hundred units. The term "per mil" is also derived from Latin (mil meaning one thousand) and designates one unit out of one thousand units. One per cent may be written decimally as .01 and is read as 1/100. One per mil may be written decimally as .001 and is read as 1/1000. The per cent sign is %. The per mil sign is ‰.

We must never lose track of the fact that per cents and per mils, two different things, cannot be added together unless and until we give them the same denomination. We obtain this result by indicating per mils in terms of per cents. For example, 1‰ may be indicated as  $\frac{1}{10}\%$  or .1%;  $\frac{1}{2}\%$  may be indicated as  $\frac{1}{20}\%$  or .05%; and 2‰ may be indicated as  $\frac{2}{10}\%$  ( $\frac{1}{5}\%$ )

or .2%. The average student attempts to obtain the same denomination by writing both per cents and per mills in their true decimal forms, indicating 1% as .01, 1‰ as .001, ½‰ as .0005, and 2‰ as .002. This method, although correct, is apt to cause errors and confusion because of the number of zeros which must be employed. For the purpose of simplification, let us move the decimal point to the right by two places, thereby discarding the zeros, and indicate the change by the per cent sign, %. We may then write .01 as 1%, .001 as .1%, .0005 as .05% and .002 as .2%, thus placing the per cents and per mills in the same denomination and in the simplest form of numbers for the purpose of adding.

Here are two examples which clarify this step. Suppose we are required to add ⅛%, 2‰, ¼%, ½‰, and 1%. If we follow the normal decimal rule that 1% = .01, we must write these per cents and per mills decimally as follows:

⅛%	=	.00125	
2‰	=	.002	
¼%	=	.000625	
½‰	=	.0005	
1%	=	.01	
Total		.014375	= 1.4375%

We are apt to avoid errors by eliminating the zeros and by using the percentage sign in the following manner:

⅛%	=	.125%
2‰	=	.20%
¼%	=	.0625%
½‰	=	.05%
1%	=	1.00%
Total		1.4375%

**Short Form of Calculating Interest.**—Presumably we all know how to figure simple interest. Moreover, most clerks in the foreign department have calculating machines at their elbows which do just about any problem in mathematics. Despite this, the clerk is often called upon to calculate interest on a given amount without the aid of machines and without the time to work out the problem as taught him in elementary school.

In the first place, it should be borne in mind that, when working out an interest problem, the less figures we put down on paper the less we are apt to become confused. In the second place, banks invariably consider the year as having 360 days when charging interest and 365 or 366 days when allowing interest. We shall not attempt to justify this, since the customers of the bank do not seem to care. When figuring debit interest, therefore, we can always begin by stating to ourselves: "60 days at 6% = 1%." If we charge interest on \$100. for 360 days at 6% per annum, we obtain \$6. which is 6% of \$100. It follows, therefore, that we collect  $\frac{1}{2}\%$  or 50 cents for each twelve 30 day periods in the year, since  $12 \times \frac{1}{2}\% = 6\%$ . It also follows that for each 60 day (2 months) period we collect  $2 \times \frac{1}{2}\%$ , or 1%, or \$1. The phrase "60 days at 6% = 1%" is axiomatic and with it in mind, we are in a position to calculate quickly and accurately debit interest on any amount for any period of time. Let us take some examples:

To find interest on \$1,450.74 for 93 days at 4% per annum:

60 days at 6% = 1% of \$1450.74	= \$14.5074
30 days at 6% = $\frac{1}{2}\%$ of \$1450.74	= 7.2537
3 days at 6% = $\frac{1}{10}$ of $\frac{1}{2}\%$ of \$1450.74	= .72537
<u>93 days at 6% =</u>	<u>\$22.48647</u>
93 days at 1% = $\frac{1}{6}$ of \$22.48647	= 3.747745
93 days at 4% = 4 times \$3.747745	= \$14.99098

or we may deduct from \$22.48647 one third (2%) thereof, amounting to \$7.49549, leaving as a result the required two thirds (4%) or \$14.99098.

After a little practice this sort of problem can be solved by merely placing on paper the dollars and cents figures of the column at the right. Here is another example:

To find interest on \$7,450. for 150 days at 3% per annum:

60 days at 6% = 1% of \$7450	= \$74.50
60 days at 6% = 1% of \$7450	= 74.50
30 days at 6% = $\frac{1}{2}\%$ of \$7450	= 37.25
<u>150 " " 6% =</u>	<u>\$186.25</u>
150 " " 3% = $\frac{1}{2}$ of \$186.25	= \$ 93.125

### The Operations of the Foreign Exchange Trader

Buying and selling foreign exchange is much like buying and selling other commodities, except that foreign exchange is a somewhat intangible commodity not requiring cartage, warehousing, or insurance. The profit made from a given operation—purchase and sale—may be quite small. It is the number of turnovers which enable the trader to show real profits. Let us assume that the trader starts his day having at his disposal some \$8,000. for trading purposes and let us suppose that the current rate for buying sterling is \$4. for each pound and the selling rate is \$4.0025. The spread between the two rates is  $\frac{1}{4}$  cent per pound. He buys from A a sight draft for £2,000. at \$4., paying him \$8,000., and at the same time he sells to B his own check on London for £2,000 at \$4.0025, receiving from B \$8,005. He has made \$5. on this turnover, and, having gotten his dollars back from B, is now ready for another operation. He may repeat this simple operation some two hundred times that very day and at the end of the day he will still have his original \$8,000., plus a gross profit of \$1,000.

We must bear in mind, moreover, that in putting through these two hundred operations the trader has taken no exchange risks whatsoever. While the rate for sterling may have changed several times during the day, the spread between his buying and selling rates remains constant and he does not have to buy unless he can sell. But trading is not so simple as all this, as we shall presently see.

It may be well to mention here that although the trader will buy, at rates satisfactory to him, foreign exchange payable at sight or at long usances, he will sell the exchange which he has thus purchased in the forms of cable transfers and checks only. He will not draw and sell his own drafts drawn at 60 days sight or 90 days sight, except in the case of finance bills operations, when such operations are profitable and permissible. The need on the part of buyers of exchange to meet payments to be made in the future is best satisfied by means of future contracts, contracts by which the merchants buy the required exchange at rates quoted at the time the contracts are made, the exchange to be de-

livered to them in the form of a check or cable transfer at the future dates when the exchange is to be used by them. As a rule, the purchasers of future contracts are not required to make payment to the trader's bank until the exchange purchased has been delivered to them. We shall describe future contracts in greater detail a little later. The only point which we wish to emphasize at this time is that while the trader will buy exchange of all usances—short and long bills—he will sell the exchange thus purchased only in the forms of checks and cable transfers.

**Taking a Position in Foreign Exchange.**—A & Co., butter merchants, have a feeling that butter prices are due for a substantial rise. They buy all the butter they can and carefully store away the tubs in their cold storage warehouse. They do not sell and soon have on hand thousands of tubs of butter awaiting that rise in prices. We say A & Co. have a long position. If the higher prices materialize, A & Co. would be regarded as butter merchants who know how to make money but if they have guessed wrong, they are apt to find themselves in the bankruptcy courts. So it is with the trader. If he builds up a long position in a given currency and his expectations of higher rates materialize, he is regarded as a money maker. The trader may also take a short position. He may sell sterling which he does not have to his credit with his London correspondent, thus overdrawing his sterling account and paying interest on the overdraft. In normal times international banks give overdraft facilities to each other. The trader does not cover his overdrawn position because he believes the sterling rate is to decline shortly when he will be able to purchase the required sterling at lower rates and, consequently, for a smaller outlay of dollars.

It will be readily seen that taking a position either way—long or short—may make or break a trader. But this is the only way he can make abnormally large profits, inasmuch as the spread between the buying and selling rates is not large enough to give him substantial profits, unless the number of his turnovers is abnormally large. Consequently, all traders, governmental and banking regulations permitting, will take a position now and then, always hoping their conviction as to trend of rates is right.

**Selling Demand Exchange Against the Purchase of Demand Exchange. Selling Cable Transfer Against the Purchase of Cable Transfer.**—These are simple operations. The trader buys a check drawn on, let us say, a London bank, and sells his own check against the sterling thus acquired. Or he may purchase a cable transfer from another trader and sell his own cable transfer against the sterling thus bought. In the case of the check, the check which he purchases may be drawn by a commercial house while the check which he sells is drawn by his bank and it is only natural that the bank check should be worth a little more than the commercial check. The bank check carries with it the credit responsibility of a large American bank while the commercial check is backed up by the limited resources of the commercial house.

Cable transfers are usually purchased from banks—other dealers in foreign exchange—and consequently are, from a credit point of view, just as good as the cable transfer which our trader sells. The spread between the buying and selling rates of cable transfers is less than the spread between the buying and selling rates of demand exchange—checks and sight drafts. The trader's buying rate for a class of exchange must always be slightly less than his selling rate for the same class of exchange, as, otherwise, he could not make a profit.

**Selling Cable Transfers Against the Purchase of Checks and Sight Bills.**—The demand exchange which the trader buys may be from other banks (bank checks) or checks and sight bills, both clean and documentary, issued by and purchased from individuals and commercial houses. The demand exchange thus purchased is remitted to the foreign point (the country in the currency of which the exchange is drawn) for the credit of his account. Assuming the trader does not wish to establish a long position in the currency involved, he must immediately sell the demand exchange which he has just purchased. He is now looking for buyers of that exchange. The American Import Company is required to make an immediate payment to a foreign supplier in the country of that same exchange. They wish to purchase a cable transfer and not a check. But the trader is

not in a position to sell the exact exchange which he has bought because that exchange, in the form of checks and sight bills, must first reach the foreign point, be collected, and credited to the trader's account, while the cable transfer which he is called upon to sell takes immediate effect. In selling the cable transfer, our trader instructs his correspondent by cable to debit his account and pay the funds to the creditors of American Import Company. This should create an overdraft in the trader's sterling account until such time when the proceeds of the demand exchange which he has purchased and remitted are collected and credited to his account. He takes this overdraft into consideration when he sells the cable transfer to American Import Co.

The rate demanded for a cable transfer is always higher than the rate demanded for a check and the difference in the rates is based upon this element of overdraft interest as well as the normal difference between the buying and selling rates of cable transfers. If the trader buys a cable transfer and immediately sells the exchange thus acquired, also in the form of a cable transfer, the element of interest does not enter into the operation but only the difference between the buying and selling rates of the trader for cable transfers.

**Selling Demand Against the Purchase of Cable Transfers.—**

The cable transfers purchased are credited to the trader's account abroad the day the purchases are made, or the next business day. As a rule, the trader receives interest on his credit balances. When he sells a check against the exchange which represents the proceeds of the cable transfer, the check cannot be presented for payment until it arrives at the foreign point and, in the meantime, the funds to the trader's credit are earning interest. The trader takes into consideration the interest thus earned when fixing his buying rate for the cable transfer, as well as the normal difference between his buying and selling rates for that particular exchange.

**Selling Demand Against the Purchase of Long Bills.—**

This operation is perhaps best understood if we confine our consideration to transactions between New York and London. The same procedure may be followed, however, with respect to trans-

actions between New York and all the other important money centers of the world, with very slight variations due to laws and regulations peculiar to each foreign point involved. But the basic principles are the same. Unless the trader desires to purchase and hold exchange for the purpose of building up a long position in a given currency, he is anxious to manipulate every operation so that he can get his dollars out of the operation as quickly as possible. If he does not quickly sell the currency which he has purchased, his dollars will be tied-up in his purchases and he must ask his bank for more dollars with which to operate. This may not be prudent or convenient. The trader can show better profits and with less risks if he can turn over the dollars placed at his disposal more often. He depends upon turnover. He can make \$10,000. do the work of \$100,000. if he can do ten operations with the \$10,000. instead of one with the \$100,000.

**The Bill Market in London.**—We have a bill market in London, made up of bankers, brokers and investors. These men are constantly investing in bills which have usances of 30, 60, and 90 days and which have been duly accepted by their respective drawees. These drawees may be English banks or English commercial houses. This form of investment is very popular, first, because the time element is short and second, because the credit risk is negligible.

Let us follow one such bill. An American trader purchases a bill of exchange for £1,000. drawn at 90 days sight by an American exporter on an English importer. The bill is drawn either to the order of the trader's bank or is endorsed to the order of the trader's bank, which, for our purposes, may be Irving Trust Co. After paying the American exporter for the value of the bill, Irving Trust Co. will endorse it to the order of its London correspondent, say Barclays Bank, and will remit it to Barclays for acceptance, collection, and credit to the sterling account of Irving. If the Irving trader does not need sterling promptly or wishes to take a mildly long position in sterling, he will instruct Barclays to have the bill accepted and held "in depot" or "in portfolio," meaning that the accepted bill is to be held by Barclays, for account of Irving, until it matures or until

Irving cables some other disposition to Barclays while the bill is running to maturity. When this is done, Irving will be earning the interest on the bill which interest is represented by the low rate at which the trader has purchased the long bill, compared with the rate at which he was purchasing checks at the moment when he purchased the 90 days sight bill.

It should hardly be necessary to point out that when a trader is purchasing sight exchange on London at 4.02 and expects the proceeds thereof to be credited to his sterling account some seven days later (steamer time between New York and London), he will pay decidedly less for a 90 days sight bill when the proceeds of such a bill are not to be credited to his sterling account until some one hundred days later, allowing seven days as steamer time, ninety days for the usance of the bill and three days of grace. The trader, however, may prefer to have the proceeds of the 90 days sight bill placed to his credit immediately after the bill has been accepted by the drawee. In this event, he instructs Barclays to have the bill accepted and then immediately discounted in the London bill market. As Irving Trust Co. has endorsed the bill to the order of Barclays Bank, Barclays Bank is obliged to endorse it either in blank or to the order of the individual or concern which may desire to invest in the bill by taking it at a discount for the number of days the bill will be running to maturity.

You will notice that when the bill reaches the hands of the investor, it will have the endorsement of Irving Trust Co. and the endorsement of Barclays Bank, in addition to the signature of the drawer and the acceptance of the drawee. Indeed, the investor may rely entirely on the two bank endorsements for credit security. To be sure, when the bill is discounted the Irving's account is credited with the face amount of the bill less the discount, but this loss is entirely made up by the lower rate paid for the 90 days sight bill compared with the trader's buying rate for checks at the time when he purchased the bill. By discounting the bill the trader is in the same position as if he had purchased a sight draft instead of a 90 days sight draft and he may proceed to sell checks and cable transfers against the sterling thus acquired.

**Determining the Buying Rate for Long Bills.**—Assuming the trader's buying rate for checks on London is 4.02, at what rate may he purchase a 90 days sight draft so that he may have the time draft discounted in the London market and sell his own check against the sterling represented by the time draft, and still make a profit? To obtain the answer to this question, the trader takes into consideration the prevailing discount rate in London, the number of days the bill must run to maturity, and the cost of English bill stamps. The discount rate changes from time to time, but let us assume that, for the solution of our problem, it is 1% per annum. If the bill is drawn at 90 days sight, it means that it will be paid by the drawee 93 days after the date of acceptance. All bills payable in Great Britain and Ireland, except checks and sight drafts, are subject to three days grace. The trader does not take into consideration the time in transit, New York to London, for the reason that his buying rate for sight drafts also covers transit time. This is the reason his buying rate for sight drafts is lower than his buying rate for cable transfers. The last element to consider is the cost of bill stamps. All checks and all time drafts up to three days sight payable in Great Britain must bear a 2 pence (2d.) bill stamp, while time drafts drawn for usances longer than 3 days sight must be stamped at the rate of  $\frac{1}{2}$  per mil ( $\frac{1}{2}\%$ ). A time bill for £1,000. is subject to a stamp charge of  $\frac{1}{2}$  pound or 10 shillings. Assuming the trader's buying rate for check or sight draft is \$4.02, the price paid for a check in the amount of £1,000. will be :

$$1,000 \times \$4.02 = \$4,020.$$

He now deducts from the \$4,020., interest for 93 days at 1% per annum, some \$10.38 and also the cost of the British bill stamp at the rate of  $\frac{1}{2}$  per mil, some \$2.01, and we have the following result : At buying rate for check London,

£1,000. at \$4.02 =		\$4,020.00
Less interest 93 days at 1% per annum	\$10.38	
" bill stamp $\frac{1}{2}\%$	2.01	12.39
Dollar outlay for £1,000. at 90 d/s		\$4,007.61
Dollar outlay or rate for £1 at 90 d/s		\$4.00761

In other words, if the trader buys a 90 days sight bill at the rate of \$4.00761 when his buying rate for check London is \$4.02, he has, in fact, bought the time bill at his buying rate for checks, deducting from the check rate the interest and bill stamp charges incident to the time bill. Should the trader be in the market for sterling he may make his buying rate for 90 days sight bills 4.00 $\frac{7}{8}$  (4.00875). Should he be in a comfortable sterling position, he may shade slightly his buying rate for 90 days sight bills by offering 4.00 $\frac{3}{4}$  (4.0075).

By discounting in the London market his purchases of long bills, the trader is in a position to sell his checks against the sterling thus acquired at the very time when he purchases long bills, and thus eliminate exchange risks. If he does not sell out simultaneously the sterling proceeds of the long bills purchased, the rate for sterling may soften by the time the long bills mature, and at that time he must sell his checks on London at a rate lower than the prevailing rate at the time when the long bills were purchased, and on which check rate his 90 days sight rate was predicated. The question then arises as to the stability of the discount rate in London. Suppose at the moment he purchases the long bills, the discount rate in London is 1% and when the bills arrive in London some seven or ten days later the rate is changed to 2%. Under such circumstances, the trader would be taking a big risk and would lose 1% per annum. In order to circumvent this possibility and at the same time properly feel the London market, the trader receives by cable each morning, or as often as changes are made, three discount rates from his London correspondent. These are, the bank rate, the market rate, and the "to arrive" rate in London.

**The Bank Rate.**—The bank rate in London is the going discount rate of the Bank of England for discounting paper for its member banks. In other countries it is the rate charged by the central banks for similar operations. This rate controls money rates in the market. It is made high when the authorities wish to tighten money rates and low when the economic situation is easy.

**The Market Rate.**—The market rate in London, as well as in other financial centers, is the going rate charged by banks, bankers, brokers, and other investors for discounting bills. This rate is usually lower than the bank rate because the facilities of the central bank are to be used sparingly and only when a discount house has discounted more than it can conveniently handle. This rate fluctuates from time to time. Whenever the American trader decides not to offer for discount his purchases of long bills on the day when such bills are duly accepted, but prefers to have his London correspondent hold the acceptances in portfolio, it is the market rate which will be applied should he decide, some time later and before their respective maturities, to have the acceptances discounted.

**The "To Arrive" Rate.**—The "to arrive" rate in London is the rate which the trader's correspondent agrees to apply to the discount of long bills to reach the correspondent by the next steamer leaving New York. This rate is similar to the offer in a contract. Should the American trader elect to use it or accept the offer, he cables back to his correspondent the amount of long bills which are being forwarded by the next steamer and the contract is closed. Irrespective of the bank rate or the market rate which may be in effect at the time the long bills reach the correspondent, they will be discounted at the previously contracted "to arrive" rate. It is this facility,—the "to arrive" rate—which enables the trader to fix his rates for long bills without risk as to interest charges, based upon his rates for sight exchange.

The rates for time bills of other usances are determined in exactly the same manner as the rates for 90 days sight bills.

**Long Documents Against Payment Bills not Discountable.**—While the trader may readily discount in the London market clean long bills and long D/A bills, it is not feasible to discount long D/P bills, and such D/P bills which he may purchase from time to time must be held by him "in depot" until maturity. The reason for this is that the drawee of the D/P bill is anxious to pay the bill just as soon as he has the funds

and before maturity, and he would not know who may be holding the accepted draft and the shipping documents were the bill discounted and rediscounted while running to maturity.

**Contracts for Future Delivery of Foreign Exchange.—**

In the trading operations heretofore discussed, we mentioned that while the trader is in the market as a buyer of long bills, he seldom sells exchange except in the form of checks and cable transfers. The reason for this is to prevent the flooding of discount markets with a large number of long bills drawn by his bank, as that sort of thing may weaken the standing of his bank in the foreign markets. No one would know just what volume of such bills issued by a given bank may be outstanding or what the credit position of the American drawer bank may be by the time the long bills mature. Then again, the drawing and selling of long bills involve the acceptance of the drawee bank and the American bank would not wish to obligate its foreign correspondent to become primarily liable on these bills, as drawee, unless the correspondent-drawee protects itself by debiting the account of the American drawer bank. However, the trader does not wish his account debited until the long bills mature, as he may not have or expect to have the required funds to his credit until the bills are to be presented for payment at maturity. Moreover, every international commercial operation which may call for the payment of funds at a future time can be financed by means of a future foreign exchange contract instead of by the sale of long bills.

**Future Contracts Enable Exporters and Importers to Fix Their Selling and Buying Prices.—**

The supply of future exchange is largely created by American exporters, and the demand for future exchange is largely created by American importers. The exporter may be negotiating with a Liverpool concern for the sale of some merchandise in terms of sterling. The exporter knows that he will not be able to make the shipment until some ninety days after the merchandise contract has been closed. But he cannot defer selling the resulting sterling until some ninety days later because the sterling rate then current may be considerably lower than the going rate at the time when the mer-

chandise contract is closed, thus causing him a loss in exchange. To avoid such a loss, he consults the trader when the negotiations for the sale of the merchandise are going on, ascertains the rate of exchange which the trader will apply to the purchase by him of a sight draft on Liverpool to be delivered to the trader by the exporter approximately ninety days later. The selling price of the merchandise is based upon this tentative rate and as soon as the merchandise contract is definitely closed, the exporter makes an exchange contract with the trader by which the exporter sells to the trader and the trader purchases from the exporter, the exporter's sight draft for an approximate amount of sterling at an agreed rate, the exchange to be delivered and paid for some ninety days later. Having made this future contract, the exporter is not concerned with the fluctuations of the sterling rate which may be higher or lower than the contracted rate on the date he issues and delivers to the trader his sight draft on Liverpool.

If an American importer wishes to eliminate exchange risks in connection with his imports, he covers himself in a similar manner. Assuming he has received a quotation on olive oil in lire, he first consults the trader and ascertains the rate of exchange which the trader will apply to the importer's future requirement for an approximate amount of lire. If he buys the olive oil and ascertains that the shipment will arrive in New York from Genoa some sixty days later, he immediately makes a contract with the trader, whereby the trader agrees to sell and the importer agrees to buy the required lire in the form of a check on Genoa at a rate of exchange then fixed, the delivery of the exchange and payment for the exchange to be made some sixty days later.

Some exporters and importers prefer not to make future contracts but assume the exchange risk, hoping that the rate will be in their favor when they have exchange to sell or when they are obliged to buy exchange at a future date. They apparently wish to be in the exchange as well as in the merchandising business. This is a very risky procedure upon their part, and their contemplated profits from the turnover of the merchandise is often wiped out by their losses in exchange. They take chances

which the trader, who is an expert in exchange, hesitates to take. The trader is in a position to cover his purchases of futures by his sales of futures, while the exporter takes a long position and the importer a short position. Future exchange contracts enable exporters to fix their selling prices and importers to fix their buying prices for merchandise without taking exchange risks and it would seem that the prudent merchant should take advantage of this facility and be satisfied to make his profits from the turnover of the merchandise which he handles as a business.

**Future Contracts Enable the Trader to Purchase Long Documents Against Payment Bills.**—We have already mentioned the fact that long D/P bills are not discountable because the drawee may have difficulty in knowing the identity of the discount house holding such a bill at the time when he should desire to pay the bill and receive the corresponding documents before maturity. The purpose of the practice of drawing long bills on Europe and at the same time stipulating that the documents are to be surrendered to the drawees when they have actually paid the bills and not when they accept the bills, is that the drawees may have an opportunity to resell the merchandise before they, themselves, are obliged to pay the bills. D/P bills on Europe usually cover valuable but perishable goods, such as meats and meat products. The drawee of such bills seldom buys for his own account but is in business more in the sense of a broker who sells for cash. His American suppliers are satisfied with his salesmanship but not necessarily with his credit standing. They are satisfied to make the merchandise readily available to the drawee without giving him title to the merchandise until he can make full payment for the same.

The trader, however, is offered these long D/P bills from time to time and he purchases them at a rate based largely upon the interest return which he may wish to obtain from such purchases on the dollars tied up in such bills. The good trader always endeavors to eliminate exchange risks and accomplishes this by selling the exchange represented by the long D/P bills in the form of future exchange. Experience teaches him when bills of this type are usually paid—how many days before matur-

ity—and he is thus able to sell the exchange for delivery at the approximate date when the long bills are paid. Were he not in a position to cover his purchases of long D/P bills by the sales for future delivery he could not purchase the long bills without both tying up his working dollars and taking a long exchange position.

#### **Future Contracts Make "Swap" Operations Possible.—**

Future contracts serve a third purpose. Oftentimes an American merchant has foreign funds to his credit with a bank abroad, which funds he intends to use at a date some months later. He may have acquired the funds at a particularly favorable rate and does not wish to sell the funds (exchange) because he must have those funds for the payment of an obligation to be created or becoming due some months hence.

To be sure, the American merchant could allow the funds to remain on deposit with the foreign bank until he is obliged to meet the obligation due several months later. But this also involves the tying up of capital, which may or may not be convenient. Can he sell his exchange and still have it? Yes, he can, in this instance. Let us assume he has on deposit with the Midland Bank, London, the sum of £1,200. Let us assume, moreover, that the present is December 15, 1947, and that on or about March 1, 1948, he will have to meet an obligation in London in the amount of £1,200. Our merchant consults the trader who advises him that he, the trader, will purchase at his current buying rate the £1,200. from the merchant in the form of a check. At the same time the trader makes a contract with the merchant by which he will agree to sell him, the merchant, a check on London for £1,200. and the merchant will agree to purchase the £1,200. check at a definitely fixed rate, the exchange to be delivered and paid for at any time during the second half of February 1948, the exact date to be left to the option of the merchant.

The rate indicated in the future contract is based on the rate current when the contract is made, influenced by interest considerations and not necessarily by the performance of the exchange market as between December 15, 1947 and March 1,

1948. After all, the trader knows ahead of time that he must deliver to the merchant a check on London for £1,200. towards the end of February 1948, and it will be relatively easy for him to have the sterling available at the required time. The trader can readily enough cover his contract to sell for future delivery by purchasing exchange from others also for future delivery. An operation of this character is called a "swap." In a swap transaction we must always have the same trader, the same merchant, and the same currency. It is called a swap because the merchant who presently has at his disposal foreign exchange for which he may have no immediate need, may swap it for the same exchange to be made available to him at a future date when he actually needs it. These operations could not be consummated without the facilities of future exchange contracts.

**Margins in Future Contracts.**—The credit standing of the trader's bank being undoubted, the trader is not required to give marginal guaranties for his side of a contract to buy or to sell. As much cannot always be said for the credit standing of the other party to future contracts. The merchant involved may be a wealthy concern of undoubted credit standing or an individual with limited means. If the merchant who has contracted to buy £1,200. for March 1, 1948 delivery, refuses or finds himself unable to take delivery and make payment, the trader is obliged to find a new buyer for that exchange on the contract delivery date and at the rate then prevailing instead of at the contract rate. Should sterling have softened in the meantime, the trader must take a loss. In order to avoid such a loss, the trader may require the merchant to deposit a certain amount of dollars as a guaranty at the time the future contract is made, the amount being roughly the difference between the contract rate and the lowest possible rate to which the given exchange might fall during the pendency of the contract.

Similarly, the trader is apt to take a loss if the merchant who has sold him a future cannot deliver, in which event the trader must go in the open market and buy at the then prevailing possibly higher rates. In the event the rate has gone decidedly in favor of the merchant during the pendency of the contract and he does not care to take or to make delivery, he need only notify

the trader to cover himself in the open market and to send him, the merchant, the difference between the contract rate and the then current rate in the open market. For instance, if, at the time the future contract is made, the rate for a purchase (by the trader) contract is 4.03, March 1, 1948 delivery, and the buying rate for spot exchange on March 1 has declined to 4.00, the merchant need not deliver the expensive exchange and the trader will cover his position by purchasing the spot exchange in the open market, thus acquiring the exchange called for by the contract at 4.00, or 3 cents per pound less than the contract rate. As the trader is now relieved from the contract, the extra and unlooked-for profit of 3 cents a pound belongs to the merchant. If the trader has sold the exchange for future delivery, the purchasing merchant will obtain a profit if the rate has advanced above the rate mentioned in the contract, and the trader will have no difficulty in selling the unwanted exchange in the open market.

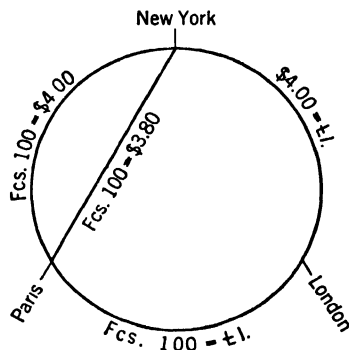
**Arbitrage Operations.**—Another profitable operation of a shrewd and well-equipped trader is what is known as arbitrage. If the trader is in the market for sterling and ascertains that he can acquire the required sterling in the Paris market for less dollars than for the purchase of the same amount of sterling bought in the New York market, he, naturally, will make his purchase by way of Paris. To understand this operation easily, we must first consider what is known as parities in exchange.

**Mint Pars of Exchange.**—It is not many years ago that the currencies of most of the commercial countries of the world were backed by actual gold and the outstanding paper monies of these countries were redeemable in gold at the option of the holder of the paper money. Each unit of currency such as the dollar, the pound sterling and the French franc, contained a quantity of pure gold as fixed by the laws of the various countries. For instance, the old dollar contained 23.22 grains fine gold, the pound 113 grains, and the old French franc 4.48 grains. Now, if we divide 113 grains by 23.22 grains, we obtain the result of 4.8665 which is another way of saying that there is 4.8665 times as much gold in the pound as there is in the dollar and therefore, in terms of gold £1. = \$4.8665.

Similarly, if we divide 4.48 grains by 23.22 grains we arrive at the answer of .193, which means that there was in the old French franc gold of the value of  $19\frac{3}{10}$  cents in terms of the United States dollar. In other words, based upon the gold content of each, and in terms of United States dollars, the pound had a mint par of \$4.8665 and the French franc a mint par of \$.193, or the pound was worth \$4.8665 and the franc  $19\frac{3}{10}$  cents. In this manner, knowing the exact pure gold content of any currency based on gold, we could readily obtain the mint par value of every such currency.

**Operational Pars.**—So long as almost every currency is off the gold standard and the possession of gold is forbidden by law, the old mint parities are meaningless. As each country declined to continue to redeem its currency in gold, it set an arbitrary value on its currency in terms of other currencies and began maintaining that arbitrary value by governmental sales and purchases in the open market. Let us assume that the British Government decides that the pound is to have a value of \$4.00 in its trade with the United States. If, due to supply and demand, the sterling rate in New York advances, the Government will put exchange into the market, thus causing the rate to recede. If the rate in New York softens, the Government will enter the market as a buyer of sterling and thus strengthen the rate. This is called “pegging” and such a rate is called a “pegged” rate. Bearing this in mind, we can establish an operational parity between rates. Assuming the pound is pegged at 4.00 and the French franc at 4 cents, we may have an operational parity such as:  $\$4.00 = \pounds 1. = \text{Fr.Fcs.}100$ . although the trader will indicate the same parity on his records by showing the value of the sterling at \$4.00 and the value of the franc at 4 cents. If, due to the law of supply and demand, one of these rates changes, the parity is broken and a new one must be calculated and set up.

**Three-Point Arbitrage.**—With the foregoing short but sufficient description of parities, we are ready with our arbitrage problem. Taking into consideration the operational parity of:  $\$4.00 = \pounds 1. = \text{Fr.Fcs.}100$ . we may illustrate this graphically:



The arc Paris-New York = the arc New York-London = the arc Paris-London. Now suppose that, due to any one of a number of possible causes, the rate for francs in New York softens while the rates between New York and London and between Paris and London remain steady. Let us assume the rate for francs in New York has declined from 4 cents to 3.8 cents, which is an abnormal drop but, nevertheless, serves our purpose. This will mean that the trader in New York can now buy Fcs.100. by an outlay of \$3.80 only, as indicated by the shorter straight line Paris-New York. When such a situation presents itself, the New York trader will purchase the francs in New York in the form of a cable transfer on Paris. These francs will be placed to his credit in Paris. He will at the same time instruct his Paris correspondent by cable to use these francs to purchase sterling in Paris in the form of a cable transfer on London at the unchanged rate of Fcs.100. = £1. and have this sterling placed to his credit with a designated correspondent bank in London.

By these two operations, both initiated in New York, the first executed in New York (the purchase of francs) and the second executed in Paris (the purchase of sterling) the New York trader has acquired £1. in London with an outlay of \$3.80 only whereas, if he had purchased the sterling in New York, it would have cost him \$4.00. Having acquired his sterling at a saving of 20 cents for each pound, he, the New York trader, immediately sells the sterling in New York at the going rate of

\$4.00 = £1. in the form of a check or cable transfer and he is back to his original position, the three point operation completed, with a profit of 20 cents on each pound. He may repeat this operation so long as the franc rate in New York is below 4 cents while the rates New York-London and Paris-London remain steady. But the opportunity is a fleeting one, for if one trader sees this opportunity, other traders see it also, with the result that there will be created in New York a very abnormal demand for French francs and this abnormal demand will immediately strengthen the franc rate in New York and within a matter of minutes the franc rate will revert to the operational parity of 4 cents. If this does not happen, then the rates at the three points must sag together so that we have a new but lower parity as between the three currencies involved.

In order not to confuse the reader, we have omitted from consideration the difference between buying and selling rates, the difference between check and cable rates and also the cost of the required cables, all of which the trader must consider.

While most arbitrage operations are three point affairs, it is possible for a trader to utilize more points. The theory, however, is the same. Instead of buying a given currency direct, he makes the purchase through one or more other foreign points, providing he can thus acquire the given currency somewhat cheaper. Arbitrage operations can be executed only by cable transfers or by telephone and must be executed instantly, before the rates again acquire their operational parity.

### Conclusion

We have outlined in this chapter the principal operations of the foreign exchange trader. Because of the peculiar problems created by World War II and the dubious outlook concerning operations in the near future, we are omitting extended comments as to gold shipments and finance bills. Gold shipments are not now permissible. Finance bills are not now created because foreign countries have no idle funds to invest in our market, and our own banks have larger deposits of dollars than they can profitably invest.

## CHAPTER 12

### THE PURCHASING, THE DISCOUNTING, AND THE COLLECTING OF BILLS PAYABLE ABROAD

In our previous chapter we placed stress upon the various operations of the trader. We are now prepared to examine in greater detail the credit problems involved in purchasing exchange, and the requirements which must be observed in forwarding the exchange purchased to correspondent banks abroad for the purpose of collection.

These problems do not arise in connection with the sale of foreign exchange. When the trader sells his check or his cable transfer, he receives payment for the exchange immediately and is not concerned with the credit standing of the buyer. Moreover, the trader is not concerned with the collection of the checks which he has sold. The buyer may either mail the checks to his foreign creditor or sell them himself as pieces of foreign exchange, to other American buyers of exchange. The mechanics of cable transfers are quite simple. The seller of the cable transfer, usually a bank, orders his foreign correspondent by an authenticated cable to pay the funds to the beneficiary designated by the purchaser of the cable transfer and to debit the payment to the account of the seller on the books of the correspondent bank.

The bills purchased by the trader are always delivered to another section of the foreign department which, under the direction of the trader, examines the exchange delivered to the bank by its sellers, makes the payments for the exchange to the sellers, and remits the exchange to correspondent banks for ultimate collection from the drawees of the bills. This section of the foreign department will also purchase all foreign exchange which may be offered to the bank without first being offered to the trader, with the understanding that the trader's

bank is to purchase it at its then current rates for that class of foreign exchange and in those particular forms. As a large volume of small checks drawn in foreign currencies are constantly offered for sale to the trader's bank, mostly by country banks, the trader will instruct this section to purchase these checks, when their nominal values do not exceed a certain amount, say £50. or French Francs 1,000., at rates previously supplied to the section by the trader which rates are to hold for the day or longer, until changed by the trader. The difference in rates as applied by this section for small items and the rates as applied by the trader himself, for large offerings, is of no particular importance to a seller of a £10. check.

**The Outward Bills Department.**—The section of the foreign department mentioned above may be known as the Outward Bills Department, or Section, or Division. It takes care of the collection of all foreign currency bills purchased by the trader, the foreign collection bills which have been delivered to the bank for collection only—not sold to the bank when first delivered to the bank—all dollar bills which are offered for discount, and all dollar bills which are offered for simple collection. We call this section the *Outward* Bills Department because it handles only bills which are payable abroad, the largest portion of which represents the values of export (outward) shipments.

**How Incoming Foreign Bills Are Handled.**—This department is not concerned with and does not handle foreign bills which are drawn abroad on American drawees. Bills of this class are very similar to bills drawn in and payable within the United States. They are handled on the domestic side of the bank through the City Collections and Country Collections Departments, depending upon the place of payment. If the volume of such bills is large, they may be received in the first instance by a special section of the foreign department which will record them and subsequently route them to the City and Country Collections Departments for collection. When paid, these two domestic departments will account to the receiving section of the foreign department and that section will pass the

entries crediting the dollar accounts of the foreign remitters and mail out the credit advices. Should any of these bills originating abroad, and payable within the United States meet with difficulties, the necessary correspondence with the foreign remitters is also conducted by this special section. The larger banks which have such a section in their foreign departments call the section the Inward Collections Department, the Import Collections Department, or some similar name to distinguish it from the Outward Bills Department.

**The Scope of the Work of the Outward Bills Department.—**

It must be evident to the reader by now that this Outward Bills Department will handle all bills reaching the foreign department which are payable in foreign countries. While these bills are largely drawn in the United States, they may be drawn in foreign countries also. For instance, if a Mexican sells a bill of goods to a merchant in Liverpool and the sale has been made in terms of United States dollars, the Mexican is apt to send the corresponding dollar bill on Liverpool to his bank in New York with instructions to collect it and to credit its proceeds to the dollar account on the books of the New York bank in the name of the Mexican. Bills of this character are also handled by the Outward Bills Department because they are payable abroad. We may summarize the functions of this department as follows:

1. It examines all bills purchased by the trader, makes payment to the sellers, and remits the bills to correspondent foreign banks for collection.

2. It purchases small foreign currency bills reaching the bank for sale, applying either standing rates furnished by the trader or rates currently obtained from the trader, makes payment to the sellers, and remits the bills to correspondent foreign banks for collection.

3. It discounts all dollar bills payable abroad and offered for discount, pays the clients, and remits the bills to foreign correspondent banks for collection.

4. It attends to the collection of all bills payable abroad and offered for simple collection (not offered for sale or for dis-

count) be they drawn in dollars or in foreign currencies and makes payment to the clients when such collection items have been duly reported paid.

5. It makes advances against dollar bills which have been entered for collection and liquidates the advances as the collections are reported paid.

6. It accepts time drafts drawn against the bank, secured by the export bills of the drawers, thus creating bankers' acceptances which can be discounted in our own discount markets.

7. It keeps the records of all bills pending collection and carries on the necessary correspondence with the clients and with the foreign collecting banks.

**The Extension of Credit.**—As a rule, the Outward Bills Department is not accorded discretion for extending credit facilities to the clients of the department. It operates within credit lines established by the credit-giving officers of the bank, usually in the Domestic department of the bank, or submits to the same credit officers each offering as received. Even the foreign exchange trader who, as a senior officer of the bank may exercise his discretion as to the bills which he purchases, must lean heavily upon the credit-giving officers in the Domestic department, because the domestic officers are in closer contact with the clients of the bank, be they exporters, importers, or manufacturers. Most of these clients are depositors of the bank and their accounts and relations with the bank are always supervised by the domestic officers.

**Lines of Credit.**—A "line of credit" is a commitment of the bank for extending credit facilities to a client, up to a fixed amount subject to the conditions stipulated therein. If the line reads "\$50,000. own paper," it means that the bank will discount the client's promissory notes up to that amount. Should the line read "\$50,000. secured by warehouse receipts," it means the bank will discount the client's promissory note up to that amount collateralized by warehouse receipts, in negotiable form, covering a commodity satisfactory to the bank. If the line is to cover the purchase by the trader of bills drawn in

foreign currencies, it may read "\$50,000. for the purchase of foreign bills," under which line the trader may purchase either the clean or documentary bills of the particular client.

The conditions which apply to a line may vary considerably, due to the standing of the client, the nature of the commodity in which he deals, the foreign countries to which he ships, etc. For instance, the line may read "\$50,000. covering the purchase and/or discount of sight documentary bills drawn on approved drawees in Argentina." Under such a line, the client's bill must be at sight, to which must be attached complete shipping documents, insurance certificates, and other necessary documents, all endorsed in blank so that the bank obtains title to the shipment, drawn on a merchant in Argentina who is well regarded by the bank. Should the bill offered not meet every condition indicated in the line, the offering must be referred to the same credit officers who established the line, and they may or may not take on the bill as an exception.

Lines of credit, when communicated to the interested clients, serve a double purpose. They not only give advance notice to the client as to how far the bank may go in extending him credit facilities, but they also serve as a guide to the operating divisions of the bank. In the absence of lines, the trader is obliged to consult the domestic credit officers whenever he is offered foreign bills for purchase and the Outward Bills Department must consult them also whenever foreign bills drawn in dollars are offered for discount. When a line is not communicated to the interested client, it is approved for the convenience and guidance of the trader and the interested operating divisions.

When lines of credit are established in connection with foreign bills to be bought and/or discounted, they are said to be of a revolving nature. As the bank knows or can readily enough estimate the payment dates of the bills, unless it receives a cable advice from its collecting correspondent bank abroad that a given bill is unpaid, the bank will assume that the bill was duly paid at maturity and will immediately make available to the client, as part of the unused portion of the line, the value of the bill matured and presumably paid abroad, although the

actual advice of payment may not reach the bank until some thirty days later. If a bill is reported unpaid by cable or otherwise, its value will be held against the line of credit until definite advice of payment has been received. Long bills drawn on banks are freed from the line upon their acceptance, as the accepting banks are not apt to dishonor their own acceptances.

**Credit History of Bills.**—The Outward Bills Department, which keeps the records of bills purchased and/or discounted, can be of inestimable value to the credit officers by reporting to them the history of such bills. If the records disclose that a large number of the bills of a given client are dishonored, it follows that the client is not carrying on in a proper manner. He may not be using sufficient care in passing upon the credit standing of his foreign buyers. He may be disregarding the terms of his sales by either not shipping within the specified time and within the other stipulations of the buyer, or he may not be shipping exactly what the buyer has ordered. Obviously, in a market of falling prices, the probabilities are that all of the foreign bills of such a shipper may be dishonored, in which event he may become bankrupt and the bank which discounted the bills will be required to salvage what it may from the questionable foreign buyers, or from the distressed merchandise.

**The Exchange Delivered Must Be Exactly the Exchange Purchased.**—The trader may never see the exchange which he purchases, because the drafts and documents are invariably delivered to the Outward Bills Department. Whenever the trader makes a purchase he immediately prepares and sends to the Outward Bills Department a "Bought Slip" or "Bought Contract" which gives all the important details of the purchase. The actual exchange may not come in for several days or weeks, but the delivery date is in the contract. If the exchange, when delivered, is exactly as described in the contract, the department pays the client and forwards the exchange, for collection, in keeping with the instructions of the trader. If there are discrepancies between the contract and the exchange actually delivered, the department must immediately bring them to the attention of the trader, who will then take appropriate action.

Some of these discrepancies may seem trivial but they are not. For instance, if the trader has purchased £1,000., 90 days sight D/A London, he cannot accept in fulfillment of this contract a bill on Manchester. The trader has his sterling "Our Account" in London and the proceeds of a bill on Manchester may not be made available to him until some two or three days later than the proceeds of the bill payable in London. Similarly, if the contract calls for a long D/A bill he cannot accept in its place a long D/P bill without adjusting the rate, as long D/P bills cannot be discounted. No matter how trivial the variance may seem, the decision to accept it or not must be left to the sole discretion of the trader.

Oftentimes the exchange delivered may be exactly as described in the contract but may be accompanied by instructions which affect the trader. The drawer may instruct the giving of a discount for payment before maturity at a rate of interest considerably higher than the rate considered by the trader when he fixed his buying rate based upon the "to arrive" rate cabled him at the time by his London correspondent. At times a drawer may request that the bill should not be presented for acceptance (long bill) or for payment (sight bill) until the fulfillment of some condition, such as the actual arrival of the steamer carrying the merchandise or the inspection of the merchandise by a designated authority. Such instructions may be followed, providing the drawer is required to make the necessary interest adjustments with the trader, and the trader should be advised, in order that he can make the arrangements with the seller of the exchange before the seller has been paid.

**Fixing the Rate on Bills Offered for Sale Without a Previously Made Contract.**—Many pieces of foreign exchange reach the Outward Bills Department with the request that they be purchased at the best going rate. For some reason or other, the owners of this exchange have not previously consulted the trader and are satisfied to accept the going rate when the exchange is received by the bank. The vast majority of such exchange is in the form of checks, small in amount, and therefore, the rate applied is not very consequential. It happens

often, however, that exchange in substantial amounts is thus received and such exchange requires immediate special attention. The trader may be in the market for sterling and he may be bidding up the rate in order to cover his short sterling position as rapidly as possible. One can well imagine his frame of mind when the Outward Bills Department informs him belatedly at 11:00 A.M. that a substantial block of sterling exchange has been in the department some two hours without the trader's knowledge. He should have been advised and the rate fixed at the moment when the exchange first reached the department.

Any delay in fixing the rate on exchange offered for sale without a previously made contract, brings about awkward situations and bad feelings between the bank and its clients. Suppose a cotton exporter in Houston mails on the same day a number of documentary sterling bills to Guaranty Trust Company of New York and another lot of such bills to The National City Bank of New York, with the request to both banks that the exchange be purchased at the best going rate. Barring delays in the postal service, both lots will be delivered to the respective addressee banks at say 8:00 A.M. of the same day. Let us suppose that the offering intended for Guaranty is brought to its trader's attention at 9:00 A.M. and the rate is fixed at that hour. With the opening of trading, the market for that exchange begins to weaken. At about 11:30 A.M. the offering intended for the City Bank trader is first brought to his attention and the exchange is purchased by him at the then (11:30 A.M.) current rate which is now several points lower than the 9:00 A.M. rate.

In due course, the cotton man in Houston receives the proceeds of his sales from Guaranty and from City Bank and discovers that the City Bank rate is considerably lower. Knowing that he mailed the exchange to both banks at the same time and having every reason to believe that both New York banks should have received the exchange intended for them at the same hour of the same day, he writes to City Bank for an explanation of the lower rate. How can the trader explain? If he attempts to justify his rate, he is apt to lose the future business of this client. If he admits that some clerk neglected

to report the receipt of the exchange from 9:00 A.M. to 11:30 A.M., he must apply the higher rate prevailing at 9:00 A.M. and this may mean the taking of a loss. It should be observed, moreover, that had the rate improved by 11:30 A.M. and the trader, not knowing that the exchange has been available ever since 9:00 A.M., had applied the better rate prevailing at 11:30 A.M., the Guaranty trader would then be in difficulty in applying the lower rate.

All this leads us to one important conclusion. Whenever exchange in substantial amounts is offered for sale at the best going rate, the trader must be advised immediately, so that he can apply the going rate at that particular moment. As all mail received by the bank is time stamped, he can always justify the correctness of his rate, applied correctly as to time, no matter how the rate may go during subsequent hours.

**The Trader Must Designate the Correspondent Collecting Bank.**—The trader must specify the collecting bank abroad because he must determine the foreign bank which is to hold the proceeds. When selling exchange, the trader indicates the foreign bank against which the sold exchange is to be drawn. Obviously, he will wish to make sure that there are enough funds to his credit to take care of the sold drafts and cable transfers. If he has an account at a given foreign point with one bank only, all the exchange on that point which he buys will be sent to that one bank for collection. Should the drawer designate the collecting bank and the trader has no account with the bank thus designated but with two or more other banks at the same point, the designated bank is used but the trader must indicate to which of his correspondent banks the proceeds are to be ultimately delivered by the bank designated by drawer.

Oftentimes the trader will purchase exchange drawn on a foreign point where he does not have an account. For instance, he may have purchased a 90 days sight draft drawn on Manchester although his sterling account may be with Midland Bank of London. He can, of course, send the bill to Midland Bank in London and the London bank can forward it for collection to its branch in Manchester. But such a procedure

may delay the acceptance of the bill and its ultimate payment by several days. In order to eliminate this delay, the American trader will instruct his Outward Bills Department to remit the original draft and documents to the Midland Bank in Manchester direct, with instructions to have the bill duly accepted and to forward the acceptance to its Head Office in London, subject to such instructions which the American trader may give to the London Head Office. The duplicate draft and documents will be sent to the Head Office of Midland Bank in London, and as the same will be accompanied by the duplicate of the remittance letter addressed to its Manchester branch, the Head Office will be on the lookout for the acceptance. If the acceptance is not discounted in the London market for account of the American trader, a few days before its maturity the acceptance will be returned to Manchester for payment and when paid, the proceeds are remitted to Midland Bank, London, for the credit of the American trader's account.

**The Trader Must Instruct if His Purchases of Long Bills Are to Be Discounted or Held "In Portfolio."**—The trader must also instruct if the time bills which he has purchased are to be discounted immediately after they have been accepted, or held "in portfolio" (or "in depot") until maturity. If such bills are held in portfolio, the trader may order their discount by cable at any time before they mature, depending upon the discount rate then prevailing, his own exchange position, and the debit and credit interest rates of the correspondent bank.

**Credit Considerations in Connection with Dollar Bills Offered for Discount.**—The credit problem in connection with dollar bills offered for discount is, of course, quite similar to the credit considerations and procedures mentioned in connection with foreign currency bills offered for sale to the trader by American exporters. Still greater care must be exercised, however, in discounting dollar bills. Large foreign currency bills usually cover staples such as cotton, grain, meats, oil, coal, etc., drawn by shippers of undoubted standing against foreign buyers who are financially strong enough to handle these types of merchandise. Dollar bills offered for discount cover mer-

chandise of every description and the sellers (drawers) and the foreign buyers (drawees) may be financially strong or weak.

**The Moral Standing of the Seller Must Be Good.**—In determining the desirability of discounting a given bill, the first thing to take into consideration is the character of the client offering the bill for discount, usually the shipper and the drawer of the bill. If his moral standing is not good, the offering must be declined. If the offering is a clean draft, he may have drawn it for the sole purpose of having the use of its proceeds until such time when the drawee refuses to honor the bill, at which time he, the drawer, may hope to reimburse the discounting bank. Should the bill be documentary, the goods may be misrepresented or indeed, the documents may be mere forgeries. The good standing of the drawee cannot be taken into consideration when the drawer is of questionable character, because he, too, may be a victim of the unscrupulous drawer.

**The Financial Position of the Seller Must Be Adequate.**—Assuming the drawer's moral standing is good, the next thing to take into consideration is his financial standing. If the bank is quite willing to discount the particular client's note for the amount involved, the bank will just as readily discount that client's dollar bill drawn against a foreigner, be the bill clean or documentary. It is understood that he is good for the amount involved.

**The Nature of the Merchandise Must Be Considered.**—On the other hand, should the client not enjoy clean credit facilities at the bank, we must decline to consider his clean foreign bills for discount. Should the offering be documentary, we must take into consideration the nature of the merchandise and the price at which it has been sold to the foreign buyer. The merchandise is to become the bank's collateral. It is worthless as collateral if it has been fabricated to meet a special need or is marked with the foreign buyer's name or packed in a special way and with special markings in accordance with the buyer's wishes. Should the buyer decline or find himself unable to accept the shipment and pay the corresponding draft,

the bank will find it extremely difficult to sell such merchandise to other merchants in the town of the original buyer.

**The Usance of the Bill Must Be Considered.**—The next factor to take into consideration is the usance or tenor of the bill. If drawn at sight and documentary, the drawee will be permitted to take possession of the goods only when he pays the sight bill. The discounting bank has collateral until the bill is paid by the drawee. In the case of long documentary bills, the documents are, as a rule, released to the drawees when they accept the bills.

**The Moral and Financial Standing of the Drawee Must Be Considered.**—Does the acceptance of a drawee constitute as good collateral to the discounting bank as the merchandise thus released to the drawee? That depends upon the moral and financial standing of the drawee. The standing of a drawee is often decidedly better than the standing of his drawer and in such cases the discounting bank is quite justified in placing greater reliance upon the acceptance than upon the merchandise.

If the offering is in the nature of a long clean bill, the standing of the drawee becomes of great importance. Until a long clean bill has been accepted, the discounting bank relies solely upon the signature of the drawer, but after acceptance the bank relies both upon the drawee and upon the drawer. An acceptance is two-name paper. It follows, therefore, that whenever a not-financially strong client offers long bills for discount, be they clean or documentary, we must take into consideration the credit standing of the drawee. The bank cannot ask for reimbursement from the drawer unless and until the bill has been dishonored by the drawee. The acceptance of a weak drawee is not particularly reassuring to the bank's credit granting officers, especially when the drawer also is of questionable credit standing.

**The Collection Services of the Bank Should Be Extended to Merchants of Good Character Only.**—It is not customary for the larger American banks to undertake to collect foreign bills for any and all persons who may desire this service. These banks are willing to collect the bills of any person or concern of good standing, but whenever an unknown or questionable person

seeks this service he is politely told to handle his bills through his own local bank. These larger banks much prefer to have the direct relationship with the local bank. This policy is not an arbitrary one upon the part of the larger banks. While a collecting bank does not discount the draft or otherwise acquire any financial interest in the same, the bank may become involved with a collection and suffer losses.

**Simple Collections May Create Expenses Chargeable to the American Collecting Bank.**—In the first place, the collecting bank in America is obliged to use the facilities of its branch or correspondent bank at the drawee's domicile (where drawee operates), for effecting the collection from the drawee. The banks abroad usually have no way of knowing what interest their American correspondents may have in the involved drafts. They do not know if the bank from which they have received a bill for collection has discounted the bill or what other interest it may have in the bill. They simply go on the theory that the bill is the property of the forwarding American bank, their American correspondent, and use every means to take care of the best interests of the American bank. They may go so far as to clear the merchandise from customs, pay the duties, have the goods carted to a warehouse for storage and insure it. These services are sometimes extended in connection with refused shipments and the local customs regulations make it more advantageous to clear refused merchandise promptly. These expenses will be billed to the American bank which forwarded the collection to the foreign bank. The American bank may not be able to collect these charges from the owner of the collection.

Aside from these special expenses, a collection generally involves the cost of foreign bill stamps which must be attached to a bill of exchange before being presented to the drawee, the collection charges of the foreign bank, the collection charges of the American bank, and protest fees, if the collection has been protested for dishonor. Will the American bank be able to collect these charges from the owner of the collection? If the collection is in the form of a clean draft, the drawer may simply abandon the transaction and the American collecting bank will be obliged to reimburse its foreign correspondent and charge off

these out-of-pocket expenses. Even in the case of documentary collections, some shippers find it cheaper to abandon their shipments rather than pay fines, storage charges, or the charges incident to the return of the shipment back to the American point of origin.

**Difficulty of Legally Binding an Unknown Owner of Collection Items.**—Whenever a bank undertakes to collect a bill for an unknown or not sufficiently well-regarded concern, it courts trouble because the bank has no knowledge whether the person giving instructions on behalf of the concern has proper authority and can legally bind the concern. Suppose the collection is for some \$1,000. and the drawee has refused to pay and demands a reduction of \$250. After the exchange of several cables, the drawer concern authorizes the reduction. But when the proceeds are forwarded to the concern in the form of a Cashier's check, the check is promptly returned with the statement that the reduction of \$250. was not authorized by an officer or member of the drawer concern. They may go so far as to state that the reduction was authorized by a junior clerk who gave the instructions to the bank without authority. At best, we have a lawsuit on our hands. Such situations do not arise when the concern is a depositor of the bank and the bank holds the specimen signatures of the concern's officers.

**Collection Facilities Offered to an Unworthy Concern May Unintentionally Give Credit Responsibility to That Concern.**—Finally, by handling the collections of an irresponsible drawer, we accord him, unintentionally, credit respectability and this may mislead banks and merchants abroad. In the absence of other information, a foreign bank or merchant will judge the American merchant by the standing of the bank which handles his business. They naturally assume that the merchant must be good because he apparently is a client or has good relations with the big and strong American bank which handles his drafts. This is not apt to happen when the unknown drawer is requested to put his collections through his own local bank because such drafts will bear the endorsement of the local bank and our friends abroad will realize that the big American bank is handling the

draft, not for account of the drawer, but for account of the local bank.

**The Flat Discount Rate Applicable to Dollar Drafts.—**

In normal times, when steamer sailings are regular and it is easy to estimate time in transit, it is customary for banks to discount dollar drafts at definite flat rates which include all interest, bill stamp, and collection charges. In fixing a flat rate, the bank takes into consideration four elements. These are:

1. The collection charge of the American bank
2. The collection charge of the foreign bank
3. The rate of interest and time for which interest is to be charged
4. The cost of bill stamps

However, all these four elements need not actually become parts of the flat rate, although each of the four must be considered. The discounting bank in New York, for example, may choose to waive its collection charge, especially with respect to bills payable at foreign points where the bank has branches, and these branches make a substantial charge for their collection services. Some foreign banks, in their eagerness to receive dollar collections, make no charge for their services and are satisfied with the profit to be made from the sale of dollars to the drawee for the payment of the collection. While most foreign countries have bill stamp laws, the expense, especially with respect to sight bills, may be so nominal that the American bank ignores it altogether in fixing its flat rates. Interest must be taken into consideration in every instance but even this item is subject to variations. One bank may take the basic interest rate at 3% per annum while another bank may be quite satisfied with an interest rate of  $2\frac{1}{2}\%$  per annum. Time in transit is an estimated thing and the estimates of the banks are apt to differ. One bank may estimate transit time to Buenos Aires at 30 days each way while another bank may consider 25 days each way as being nearer the mark.

We are now ready to fix flat discount rates. Let us, first of all, determine the flat rate for a sight bill on London, to be

discounted by a New York bank, taking into consideration the following factors :

Collection charge of New York bank	$\frac{1}{8}\%$	=	.125%
Collection charge of London bank	$\frac{1}{2}\%$	=	— .05%
Bill stamp (nominal-waived)	2d (2 pence)	=	.00
Interest 3% per annum,—			
Time in transit, 20 days (10 days each way)		=	.166%
Total			<u>.341%</u>

As flat rates are generally quoted in eighths, we determine the rate for this bill as .375 or  $\frac{3}{8}\%$ . As to the interest item, the bill will be in process of collection for a period of 20 days (10 days New York to London and 10 days London to New York) and using the "60 days at 6% = 1%" rule, we find that 20 days at 3% = .166%.

Now let us determine the flat rate of a 120-days date bill on London, using the same collection charges and the same time in transit and the same annual interest rate. In considering a time bill on London, we must bear in mind that the bill stamp charge becomes  $\frac{1}{2}\%$ , and that the bill will be subject to 3 days of grace. Bearing these changes in mind, we put down the four factors as follows :

Collection charge of New York bank	$\frac{1}{8}\%$	=	.125%
Collection charge of London bank	$\frac{1}{2}\%$	=	.05%
Bill stamps	$\frac{1}{2}\%$	=	.05%
Interest for 133 days at 3%		=	1.108%
Total			<u>1.333%</u>

Considering the rate in terms of eighths, we have 1.375, or  $1\frac{3}{8}\%$ . As to the interest item, the bill being payable 120 days after *date*, we ignore the time in transit between New York and London, as the bill will be running to maturity during the outward trip, but consider the usance of the bill, 120 days, plus the 3 days of grace, and plus the time in transit, London to New York, 10 days, making a total of 133 days. Were the bill drawn payable so many days after sight, we would be obliged to take into account the outward trip also, as the bill would not be accepted until it had arrived in London and the usance of the

bill would not commence to run until the acceptance of the drawee had been secured.

**The Proceeds of Dollar Bills Must Be Made Available in New York.**—It may be well to digress a moment and clear up another point which gives both merchants and bank clerks a good deal of trouble. Some people have an idea that the discounting bank in New York receives payment the moment the drawee pays the bill to the foreign correspondent of the New York bank. This is not true. Foreign bills drawn in dollars are payable by the drawee at the foreign collecting bank's selling rate on date of payment for checks on New York. If the bill is for \$1,000. and has been forwarded for collection by Irving Trust Co. to Midland Bank in London, on the date of maturity the drawee is obliged to pay it by means of a London banker's check for \$1,000. drawn on a New York bank, which check the drawee may purchase either from Midland Bank or from another good London bank.

If the dollar exchange is to be purchased from the collecting bank (the Midland Bank, in this instance) no check is actually issued and delivered to the drawee who, in turn, would be obliged to deliver it back to the issuing bank. The same result is obtained when Midland Bank indicates to the drawee its selling rate for checks on New York and the drawee then pays to the bank enough sterling to equal the dollar value of the draft converted at the quoted rate. In advising the payment to the Irving Trust Co., Midland Bank will merely state that the dollar bill has been paid, the proceeds, less the charges and expenses of Midland Bank, amount to so much, and that Irving Trust Co. is to reimburse itself by debiting the value of the net proceeds to the dollar account which Midland Bank maintains with Irving Trust Co.

**Dollar Drafts May Be Drawn Payable at the Collecting Bank's Selling Rate for Cable Transfers on New York.**—Occasionally, dollar drafts are drawn which specifically provide that the drawees are to pay them, not with checks on New York, but by means of cable transfers on New York. This method of payment is more expensive to drawees and can be demanded only

when properly provided for in the merchandise sale contract. If a bill is paid at the collecting bank's selling rate for cable transfers on New York, the New York bank will receive the dollar proceeds of the bill on the day of payment abroad or on the following day. It may be well to mention, moreover, that whenever a bill is to be paid abroad at the cable instead of at the check rate, we ignore the time in transit from the foreign point to New York, when fixing the flat discount rate for such a bill.

Let us now determine the flat discount rate on a few dollar bills drawn on Latin America. First of all, consider the rate for a 90 days sight bill on Bogota, Colombia. It so happens that The National City Bank of New York has a branch in Bogota and the banks in Bogota charge  $\frac{1}{2}\%$  for collecting bills. As this rate is higher than usual, it may be that The National City Bank, in order to obtain as many bills on Bogota as is possible, may waive the usual collection charge of  $\frac{1}{8}\%$  made for the services of its Head Office in New York. The profits of the branch will be remitted to Head Office sooner or later and the more business Head Office is able to send to Bogota branch, the greater will be the profits of the bank as a whole.

Bearing in mind the fact that merchandise intended for Bogota usually reaches that city by the Magdalena River boats and that buyers in Bogota do not, as a rule, honor drafts until the goods have arrived in Bogota, we may estimate the time in transit as 30 days each way. Let us take the interest at 2% per annum. The Colombian bill stamp charge is 1%. Using these factors, let us determine the flat discount rate for a 90 days sight bill on Bogota.

Collection charge of New York bank (waived)	=	.00
Collection charge of Bogota bank	$\frac{1}{2}\%$	= .50%
Bill stamp	1%	= 1.00%
Interest for 150 days (30 + 90 + 30) at 2%		= .833%
(Time in transit 30 days each way)		
	Total	<u>2.333%</u>

The nearest eighth to 2.33 is  $2\frac{3}{8}\%$  and  $2\frac{3}{8}\%$  becomes the flat rate.

Now let us find the flat discount rate for a 90 days date bill on Antofagasta, Chile, using the four factors as indicated:

Collection charge of New York bank	$\frac{1}{8}\%$	=	.125%
Collection charge of Antofagasta bank	$\frac{1}{8}\%$	=	.125%
Bill stamp	$1\frac{3}{4}\%$	=	.175%
Interest 120 days (90 + 30) at 4%		=	1.333%
(Time in transit, one way only, 30 days)			
Total			<u>1.758%</u>

and the flat discount rate will be  $1\frac{3}{4}\%$ .

**Discounting by Way of Making Full or Partial Advances Against Each Bill.**—During wartime and whenever the mails are irregular for other reasons, it is impossible to quote flat rates for discounting dollar bills because the transit time cannot be properly estimated. At such times the American bank will advance to the client the full face amount of the draft and, when the collection has been effected and the proceeds received in America, will charge the client's account with the collection expenses and interest for the exact number of days the bill has been in the process of collection. In other such cases, the bank may advance to the client 80% or 90% of the face amount of the bill and, upon receiving the proceeds of the bill, will deduct from the 20% or 10% retained, the collection charges and the earned interest, and credit the client's account with the difference or send the client a check for the difference. When mails are regular, it is to the client's advantage to discount his dollar bills at flat rates, which are competitive and enable the client to know definitely, at the outset, how much the discount is to cost him.

**Flat Discount Rates Are Advantageous to Drawees.**—Flat discount rates are also advantageous to the drawee because the annual rate of interest charged the drawer is usually lower than the interest rate prevailing in the drawee's country. Most sales contracts provide for the payment of collection and interest charges by the drawee. If the flat discount rate of a given bill is  $2\frac{1}{2}\%$  and the drawer includes the equivalent of this charge in his merchandise invoice and draws his bill for an amount which includes the discount charges which the bank will deduct, the drawee will have received the benefit of the lower interest rate and the drawer will have placed his merchandise into his buyer's hands with the minimum of expense.

**When Bank Is Requested to Collect Discount Charges from Drawee.**—Despite these advantages both to drawer and drawee, flat rates are not too popular with many drawers because of the difficulty of including the discount expense in their invoices and drafts correctly, and find it much easier simply to request the discounting bank to pay them the face amounts of their drafts and to collect all interest and collection charges from the drawees. This is bad practice. The drawee may feel that at least part of the charges should be borne by the drawer. Whenever the payment of interest and collection charges by the drawee is not clearly indicated in the sale contract, the drawee may feel that the bank has already collected these expenses from the drawer and may refuse to pay them, thus delaying the payment of the bill until several cables have been exchanged. Whenever these expenses are included in the merchandise invoice and in the covering draft, the discounting bank in America and the collecting bank abroad are out of the controversy and the probabilities are that the drawee will pay the bill as drawn by the drawer and take up his complaint with the drawer direct.

Then again, if the discounting bank is requested to collect all of the charges from the drawee, in all probability the bank will charge the drawee interest at the rate of 6% per annum, instead of at the lower rate when the interest is to be paid in the first instance by the drawer. There is no reason why a bank should apply a lower rate to a foreign merchant when the interest rates current in his country are considerably higher than 6%. As a matter of fact, should the discounting bank apply a lower rate to the drawee there is always the possibility that he will request several extensions, since the low rate gives him working capital more cheaply than borrowing from his own local bank.

**How to Include the Discount Charges in Invoices and Drafts.**—American Export Corporation desires to include in its invoice and covering draft the charges in connection with a 90 days sight bill on Rio de Janeiro which it wishes to offer for discount. It telephones to the bank and is told that the flat discount rate will be  $2\frac{1}{2}\%$ . Assuming the invoice value of the merchandise and shipping charges amount to \$1,450.92, the Corporation

may add to this amount of \$1,450.92 an item reading "Discount charge  $2\frac{1}{2}\%$  = \$36.27 making the total amount of the invoice  $\$1,450.92 + \$36.27 = \$1,487.19$ . It may then draw the draft for \$1,487.19. The discounting bank will put the operation through in the usual manner and send to the Export Corporation a credit memorandum reading somewhat as follows:

Amount of draft	\$1,487.19
Less discount $2\frac{1}{2}\%$	37.18
Proceeds	<u>\$1,450.01</u>
Your account credited	\$1,450.01

When the Corporation receives this memorandum it realizes that it has received some 91 cents less than it wished to have and yet no fault can be found with the figures of the bank because the bank discounted a draft for \$1,487.19 and  $2\frac{1}{2}\%$  of that amount equals \$37.18, leaving a net balance of \$1,450.01. What to do about the difference of 91 cents is a problem and this is the precise reason why so many drawers prefer to instruct the discounting bank to collect all the charges from the drawee. But the solution of this problem is not difficult.

If the full amount of the invoice, including the discount charges	= 100%
and the discount charges	= $2\frac{1}{2}\%$
then the amount of the invoice, without the discount charges	= $97\frac{1}{2}\%$
As the amount of the invoice, without the discount charges also	= \$1,450.92
	$97\frac{1}{2}\%$ = \$1,450.92
	1% = \$ 14.8812
	$2\frac{1}{2}\%$ = \$ 37.20

The invoice should be completed, therefore, by the addition of an item reading "Discount and collection charges—\$37.20" making the total amount of the invoice \$1,488.12 ( $\$1,450.92 + \$37.20$ ) and the draft drawn in the amount of \$1,488.12. When the discounting bank deducts the discount of  $2\frac{1}{2}\%$  or \$37.20 from the draft amount of \$1,488.12, the exporter will receive the amount of \$1,450.92 which is the exact cost of the

merchandise plus the shipping charges. This operation is not so difficult as it appears. When the bank quotes a flat discount rate, the rate quoted deducted from 100% always gives the percentage value of the amount representing the value of the merchandise and shipping charges which the shipper wishes to obtain from the bank. In our above example, the rate quoted is  $2\frac{1}{2}\%$  and the percentage value of the invoice without the discount expense is then  $97\frac{1}{2}\%$ . If the rate quoted is  $1\frac{5}{8}\%$  (which may also be indicated as 1.625%) the percentage value of the invoice will be 98.375%. The exporter may now turn to his calculating machine and quickly enough ascertain the value of 1% (by dividing the invoice amount by 98.375) and the amount for which the draft should be drawn becomes evident immediately.

The same result may be obtained almost mentally, when the flat rate and the invoice value are in simple figures, by the following method commonly used in banks: If the rate is 2% and the invoice amount \$2,500., we first take 2% of \$2,500. which amounts to \$50. and put the \$50. figure to one side. We then take 2% of \$50. which amounts to \$1. and put this \$1. under the \$50. We then take 2% of \$1. which is \$.02 and put that under the \$1. and we keep up this process until the result of the succeeding percentage becomes considerably less than one cent. The figures put to one side are then added, as follows:

2% of \$2,500.	=	\$50.00
2% of \$ 50.	=	1.00
2% of \$ 1.	=	<u>.02</u>
Total		<u>\$51.02</u>

The \$51.02 thus obtained represents the amount to be added to the invoice value so that when the bank deducts 2% from the face amount of the draft the drawer will receive exactly \$2,500.

Proof: Amount of Invoice	\$2,500.00
Amount added	51.02
Draft amount	<u>\$2,551.02</u>
Less 2%	51.02
Invoice amount	<u>\$2,500.00</u>

If the shipper finds these methods of calculating the exact amount to be added to his invoices too involved, he may still obtain the desired end of including in the invoices and drafts all discount charges (whenever it is agreed that these expenses are to be for the buyer's account), by the following procedure: He knows or can easily enough obtain from the bank the length of time for which the bank will charge interest in connection with a given bill. He can also ascertain from the bank the collection and bill stamp charges applicable to the bill. Calculating interest at the rate of 6% per annum and adding thereto the collection and bill stamp charges, he may now include in his invoice an item reading "Interest and bank charges \_\_\_\_\_ \$\_\_\_\_\_" the amount being a generous estimate of these expenses. The drawee will not question this item, providing he has definitely agreed in the sales contract to bear the discounting expenses. Neither is he in a position definitely to check the rate of interest, the number of days for which interest is charged, or the collection charges of the discounting bank in America. The shipper draws the draft and offers it to his bank for discount.

Assuming the invoice value of the shipment is \$1,584.10, the draft is on Buenos Aires at 90 days sight, the transit time is 30 days each way, and the collection and bill stamp charges add up to .55% ( $\frac{1}{4}\%$  + 3%) and the flat discount rate (based upon interest at 3% per annum) is  $1\frac{3}{4}\%$ , the situation unfolds in this manner:

Amount of invoice	\$1,584.10
"Interest and bank charges" (estimated at 2%)	31.68
Draft amount	<u>\$1,615.78</u>
Less flat rate $1\frac{3}{4}\%$	28.28
Amount paid drawer	<u>\$1,587.50</u>

Obviously, the drawer will receive \$3.40 more than the amount of his invoice. What should he do with this \$3.40? Let him credit it to an account on his books called "Exchange Account" or "Discount Adjustment Account" or some other such similar designation. He may also debit this special account should he ever underestimate the interest and bank charges. At the end of the fiscal year our exporter may find a tidy credit bal-

ance in this account, which he may transfer to his Profit and Loss Account.

By following one of these procedures and drawing his draft for an amount which includes the discounting charges, the foreign buyer may be granted the more favorable interest rates prevailing in the United States, thus reducing the cost of the merchandise to the buyer. This cannot be accomplished so readily if the collecting bank is instructed to collect all the discount expenses from the drawee over and above the face amount of the draft. The discounting bank cannot and will not object because many collection difficulties will be eliminated whenever the bill is drawn for an amount which includes all the interest and collection charges which the drawee is to pay. As indicated previously, foreign drawees question these expenses, when demanded by the collecting bank over and above the face amounts of the drafts.

An exporter should not include interest and collection charges in his draft or request the collecting bank to collect the same from the drawee of the draft unless the contract of sale specifically provides that the buyer is to pay them. Prices can be quoted which cover the absorption of these incidental expenses by the seller. Many exporters give this matter no consideration whatsoever when the sale negotiations are going on but, when offering the bill for discount, request the bank to collect these charges from the drawee, and should the drawee refuse to pay, to waive them. Such a practice is not only embarrassing to the bank but is not conducive to the establishment of good relations between sellers and buyers. Whenever the collecting bank waives these expenses, the drawer feels that the bank did not try hard enough while the drawee feels that the bank attempted to take advantage of him. All these misunderstandings are avoided by a definite agreement between buyer and seller, in the sale contract, indicating clearly if the interest and collection charges are to be absorbed by the seller or paid by the buyer.

**Dollar Bills Drawn on Countries Wherein the American Dollar Is Legal Tender.**—Whenever an American exporter sells a bill of goods in dollars to a buyer in a foreign country

wherein the United States dollar is not legal tender, it is understood that the buyer must pay the seller's dollar draft by means of an approved banker's dollar check on New York or at the collecting bank's selling rate for such dollar exchange. The United States dollar is legal tender or is in general use in several foreign countries and U. S. possessions, such as Panama, Cuba, Canal Zone, Dominican Republic, Haiti, Puerto Rico, Virgin Islands, and Bermuda.

Let us consider the situation of a merchant in Panama who has purchased 10 gross of shirts from an American manufacturer at \$100. per gross with the understanding that the buyer will pay the shipping charges also. Assuming the shipping charges amount to \$84.15, the exporter will draw his draft for \$1,084.15. Let us assume, moreover, that the seller will absorb interest and collection charges. When the collecting bank in Panama presents the \$1,084.15 draft to the drawee, the drawee counts out and delivers to the bank's messenger exactly \$1,084.15 in United States bills and fractional currency which are freely obtainable in Panama. The messenger demands  $\frac{1}{4}\%$  or \$2.71 more explaining that this is the exchange charge made by the bank for transferring the face amount of the bill to the drawer. The drawee protests and takes the position that he made the purchase in United States dollars, at so much per gross and that he is ready and willing to pay the draft in full in such dollars and that he is not concerned with what the collecting bank, which is the agent of the drawer, does with the \$1,084.15. Who is to say that the drawee's position is not sound? He had as much right to consider that the draft was to be liquidated by the payment of United States dollars in Panama as the seller had to consider that the liquidation was to be made by the payment of United States dollars in New York. This point must be properly considered and definitely covered in the sale contract, if friction is to be avoided. The shirts should have been quoted at "\$100. per gross, New York funds." This problem takes on added importance if the drawee's country imposes a tax upon the remittance of funds to foreign points, such as we have had in Cuba for several years and which is known as the Cuban Public Works Tax. Obviously, if because of a lack of agreement, a

Cuban buyer can pay the draft of a New York exporter by means of United States dollars in Cuba, the proceeds of the draft becomes the property of the seller and if he wishes to have the funds remitted to him in New York, he must pay not only the ruling exchange for New York funds but the Public Works Tax as well. On the other hand, if the Cuban buyer had agreed to pay the draft in New York funds both the exchange and tax would be for his own account.

Now that the United States dollar has become the best currency in the world and may be found in abundance both in dollar and non-dollar foreign countries, the American exporter should always quote his prices in terms of New York funds and not merely in United States dollars. These are factors which can be properly covered when the sale is effected. Enough difficulties arise between buyers and sellers as to quality, packing, delays in shipping and in transit without complicating the sales by the omission of agreement as to matters which exist in every sale and which can be definitely covered when terms and prices are being discussed.

## CHAPTER 13

### THE PURCHASING, THE DISCOUNTING, AND THE COLLECTING OF BILLS PAYABLE ABROAD (CONTINUED)

#### Instructions of Drawer to Collecting Banks

It is within the exclusive province of the drawer to indicate to the collecting banks the procedures to be followed under all circumstances which are apt to arise. This is true not only with respect to bills offered for collection only, but also with respect to foreign currency bills sold to the trader and with respect to dollar bills offered for discount. Providing the drawer's instructions follow the established usages of commercial practice, the bank cannot question such instructions. If the instructions accompanying foreign currency bills offered for sale and dollar bills offered for discount are unsatisfactory to the bank, the bank is privileged to decline the offerings and the drawer's remedy is either to have the bills entered for collection only, or to offer them for sale or for discount to another bank. While a bank may question the definite but irregular instructions of the drawer, it cannot ignore or change such instructions without the drawer's knowledge and approval.

**The Bank Should Supply Missing Instructions, Subject to the Drawer's Confirmation.**—Should the drawer neglect to give any necessary instructions and it is not possible for the bank to consult with and to obtain from the drawer the lacking instructions before forwarding the bill to the foreign point, the bank may use its best discretion, following the commercial practice. But it is incumbent upon the bank to acquaint the drawer with the instructions supplied by the bank, and to obtain the drawer's confirmation of such instructions. While the failure of the drawer to confirm in writing the instructions supplied by the



## COLLECTING OF BILLS PAYABLE ABROAD

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1-44 1938							
To Guaranty Trust Company of New York, 140 Broadway, New York 13, N. Y. _____ 19____							
Gentlemen: We enclose (for collection) (as collateral for an advance) the draft and documents described as follows.							
Draft No. _____		Date of Draft _____		Tenor _____		Amount _____	
Drawer _____				Drawee _____			
City Where Payable _____				Country _____			
DOCUMENTS ENCLOSED							
BILLS OF LADING	PARCEL POST RECEIPTS	INSURANCE CERTIFICATES	INVOICES AND LETTERS	CONSULAR INVOICES	CERTIFICATES OF INSPECTION	CERTIFICATES OF ORIGIN	OTHER DOCUMENTS
<i>Please handle in accordance with instructions marked "X"</i>							
<input type="checkbox"/> Deliver documents against _____ acceptance _____ payment _____ mail <input type="checkbox"/> Advise non-acceptance by _____ giving reasons _____ cable _____ mail <input type="checkbox"/> Advise non-payment by _____ giving reasons _____ cable <input type="checkbox"/> All charges are for drawees account. <input type="checkbox"/> Waive charges if refused. <input type="checkbox"/> Do not waive charges. <input type="checkbox"/> Collect interest at _____ % per annum from date of draft to date of approximate arrival of funds in New York <input type="checkbox"/> Payable for face amount by prime bankers check on New York. <input type="checkbox"/> Payable for face amount by prime bankers check on New York and remit proceeds by cable transfer with charges for our account <input type="checkbox"/> Payable at cable transfer rate. Cost of cable for drawees account <input type="checkbox"/> Permit drawee to _____ inspect _____ acceptance _____ merchandise before _____ payment <input type="checkbox"/> Your collection charge and necessary airmail and cable expense for our account All other charges of any character are for drawees account and must not be waived				<input type="checkbox"/> Protest for _____ non-acceptance _____ non-payment <input type="checkbox"/> Do not protest <input type="checkbox"/> Hold for arrival of merchandise <input type="checkbox"/> Allow drawee discount at _____ % per annum for anticipated payment. <input type="checkbox"/> Advise _____ acceptance _____ by cable _____ payment <input type="checkbox"/> Please remit proceeds via airmail. <input type="checkbox"/> Merchandise covered by this draft has been consigned to your goodselves. Where an agent is designated it is important to set forth the extent of his powers. <input type="checkbox"/> IN CASE OF NEFD* refer to Name _____ Address _____ who is empowered by us <input type="checkbox"/> To act fully on our behalf i. e., authorize reductions, extensions, free delivery, waiving of protests, etc <input type="checkbox"/> To assist in obtaining acceptance or payment of draft, as drawn, but not to alter its terms in any way *On advance items the Guaranty Trust Company of New York may exercise its discretion in connection with the above powers to the same effect as though it were the only one having an interest in the item			
OTHER INSTRUCTIONS:-							
In the absence of definite instructions the Guaranty Trust Company of New York may instruct the collecting bank to advise refusal by cable of items of \$500.00 or over, unless instructed to the contrary, whether or not an agent is given. Also in the absence of our instructions relative to protest, it is agreed that the collecting bank may use its discretion regarding protesting the instrument							
1				BY _____ (AUTHORIZED SIGNATURE)			

bank may be regarded as an acquiescence upon the part of the drawer, it is best, from the bank's point of view, to insist upon written confirmations. If, by chance, the drawer is not satisfied with any of the instructions as supplied by the bank, the real wishes of the drawer must be communicated to the foreign collecting bank by cable or by air mail, at the expense of the drawer who should have accompanied the bill with his definite instructions at the time when he sent it to the American bank.

It is now customary for banks handling foreign bills to supply their customers with specially prepared instruction letter forms. The forms now used by The National City Bank of New York and by Guaranty Trust Company of New York are shown by Form 12 and Form 13. The use of such forms is of great advantage both to the merchant and to the bank. The points with respect to which the merchant must instruct are clearly indicated in the form. The merchant prepares the form in duplicate and submits the original and carbon copy to the bank with the relative draft and documents. The bank will time-stamp the carbon copy and return it to the merchant. This becomes the merchant's receipt for the draft and documents. The time stamp will clearly indicate if the papers were received by the bank in time to make a certain mail, usually the mail by the same steamer which carries the merchandise.

From the bank's point of view the form becomes its work sheet and the last part is prepared by a competent clerk and passed on to the typist who is to prepare the remittance letter addressed to the foreign collecting bank. The use of the form considerably speeds up the work of the typist, because the remittance letter form addressed to the foreign collecting bank follows the same general pattern. Any device which enables the bank to get the bills out expeditiously insures the catching of mails and the avoidance of the difficulties which always arise when the merchandise arrives ahead of the corresponding documents.

The Guaranty Trust Company letter of instructions is quite novel in that the form is in quadruplicate, with three sheets of carbon paper between. The first copy is addressed to Guaranty, the second and third copies are sent to the foreign collecting bank with the original and duplicate copies of the bill and docu-

ments, while the fourth copy is the receipt and office copy of the drawer. While the use of this form obviates the necessity for typing independent letters of instruction, addressed to the collecting bank, it is expensive and may not fit in with the procedures of other banks which prefer to type independent letters to the collecting banks abroad, using the carbon copies of such letters for tracing and bookkeeping purposes. Each bank, no doubt, has evolved a system which best serves its purposes.

Now let us examine closely the principal points with respect to which the drawer must instruct.

**The Drawer Must Instruct Whether the Documents Attached to a Time Bill Are to Be Delivered to the Drawee Against the Acceptance or Against the Payment of the Bill.—**

This question does not arise with respect to clean bills as clean bills have no documents attached. It does not arise with respect to documentary bills drawn at sight because sight bills are not accepted and, of course, the documents attached to sight bills must be released to the drawees when the bills are paid. Our consideration is narrowed down to the documents attached to time bills, payable so many days after sight or so many days after date. While a seller and a buyer may always make a contract of sale which does not follow the standard practice and such contracts are enforceable, most sales contracts do not specifically provide if the documents to be attached to the time bills covering the sales are to be released to the buyer-drawees against their formal acceptance of the bills or against the payment of the bills. They assume that the standard practice will be followed.

A foreign buyer may request 90 days sight terms for one of two reasons. First, he may wish the documents representing the merchandise to be made available to him the moment he accepts the drawer's 90 days sight draft, so that he may resell the merchandise within the ninety day period, collect from his own buyers, and pay the acceptance at maturity, some ninety days after the date of acceptance. In this instance he seeks and is given credit—credit for ninety days. But, in the second place, the buyer may not be entitled to credit and not only he but also his seller may appreciate this fact.

Some means must be found, therefore, to make the merchandise readily available to the buyer without obliging him to make immediate payment as contemplated, for instance, by a draft payable at sight. The long D/P bill serves this purpose. The buyer will accept the long draft but the goods will be held or stored for his account and expense until he is able to pay the acceptance either at or before maturity. Such a drawee, usually a good salesman with limited capital, will be in a position to resell his purchase for cash, and use the cash to anticipate the payment of the D/P bill previously accepted by him.

**Time Bills on the Far East Are D/P.**—Documents attached to time bills are generally deliverable against payment when the bills are drawn on points in the Far East, such as India, China, Japan, Siam, Philippine Islands, and the Netherlands Indies. In all probability the rule would be the same as to bills payable in Middle East countries such as Iran, Iraq, and Saudi Arabia, although sales to countries of this category are usually made either under commercial letters of credit or under sight drafts, and the question does not arise.

While China is still far off and while it is still somewhat difficult to obtain credit information concerning Chinese importers, you can well imagine the magnitude of these difficulties some fifty years back, when it took some three to six months to carry mail and cargo from New York to Shanghai and when it was almost impossible to obtain any credit information whatsoever on Shanghai merchants. To overcome this difficulty and at the same time extend to Far Eastern buyers some credit consideration, the D/P rule with respect to time bills was adopted. By this device foreign goods are made readily available to the Far Easterner but, insofar as the drawer is concerned, the buyer cannot take possession until he pays the covering draft. The buyer may and generally does obtain possession before paying the draft (but without the knowledge or consent of either the drawer or of the American bank which has remitted the bill for collection to the Far Eastern bank) under the trust receipt facilities which he may have with the Far Eastern collecting bank. This facility is extended to Far Eastern merchants by Far East-

ern banks on either a clean or secured basis, depending upon the standing of the merchant and his relationship with the bank.

It will be noted that in delivering to the drawee against trust receipts the documents attached to a D/P bill, the Far Eastern bank ignores the definite instructions of the American remitting bank to deliver such documents to the drawee against payment only. Consequently, the Far Eastern bank becomes absolutely responsible for the payment of the bill on or before maturity. The net result of these operations is that the Far Eastern bank and not the drawer or the American bank passes judgment upon the credit standing of the Far Eastern merchant. This is a highly satisfactory procedure because of the fact that the Far Eastern bank is in the best position for the exercise of such judgment and for keeping in proper proportions the operations of the Far Eastern merchant.

With much improved mail facilities to the Far East and with much improved banking facilities in the Far East, some American exporters now grant D/A terms to their Far Eastern buyers, especially after having satisfactory relations with such buyers over a period of years. The fact remains, however, that if a Far Eastern buyer is entitled to D/A terms, he must have trust receipt facilities with his local bankers, and D/P terms are not burdensome to him.

**Time Bills on Europe May Be D/A or D/P.**—The documents attached to time bills drawn on Europe are deliverable against acceptance whenever the buyer is of good credit standing and the merchandise involved is non-perishable. If the merchandise is perishable, such as grains, flour, meat and meat products, the documents are generally deliverable against payment. The foreign buyers of such food products are usually brokers—good salesmen with limited capital—who sell for cash and who are anxious to have the merchandise readily available without being required to make immediate payment. The American shipper is adequately protected. When the goods arrive, the broker-buyer instructs the foreign collecting bank to store the goods in an adequate warehouse satisfactory to the bank. The drawee will pay the storage charges as well as the necessary insurance premiums. He may be permitted to take

samples of the goods thus stored and insured. He makes his sales from the samples, for cash. When he, himself, receives payment, he pays the collecting bank which, thereupon, delivers to the buyer a delivery order addressed to the warehouse. With this delivery order, the buyer obtains possession of the goods involved.

**Time Bills on Other Points Are Almost Invariably D/A.—**

The documents attached to time bills drawn on Canada, South America, Central America, the West Indies, including Bermuda, Australasia (Australia and New Zealand), and South Africa are almost always deliverable against acceptance. If an exception to the rule is attempted, the point must be definitely covered in the sale contract and the intervening banks must be especially advised. The D/A rule as to bills on Latin America is so strict that should the American bank, erroneously or casually, instruct the Latin-American collecting bank to deliver the documents against payment, the foreign bank will ignore such instructions and deliver the documents against acceptance. The banks, merchants, and courts of the Latin countries seem to take the position that unless the acceptor of a draft, the drawee, obtains possession of the documents attached to the draft, the acceptance is without consideration and, therefore, voidable. If the foreign bank declines to deliver the documents to the drawee, the drawee who has accepted the draft will readily enough obtain an order from his local courts compelling the delivery of the documents to him against his acceptance of the draft.

The drawers of documentary time foreign bills must instruct if documents are to be delivered to drawees against acceptance or against payment. The American banks taking such bills for collection or for discount will not question the instructions of the drawers if such instructions follow the above general rules. Should the instructions of the drawers be contrary to these general rules, it is the duty of the banks to outline the correct practice and procedure to the drawers and to obtain revised instructions. If the drawers omit to instruct one way or the other and there is not time enough to go back to the drawers for instructions, the American banks give the necessary instructions to the foreign collecting banks in accordance with the general rules,

advise the drawers of their action and request the drawers to confirm their action.

**The Drawer Must Instruct if a Rebate of Interest Is to Be Allowed, and at What Rate, in the Event the Drawee Wishes to Pay Before the Maturity of the Bill.**—This instruction is applicable to time bills which are payable for the fixed amounts in which they are drawn. In other words, the drawer has either absorbed the interest expense or has included the expense in the amounts for which the drafts are drawn. It is not applicable to a bill in connection with which the collecting bank is to collect interest at a stipulated rate from the date of the bill until the approximate date on which the proceeds will arrive back to the American bank, assuming the bill is in dollars. The sooner the bill is paid, the less interest is collected. When a foreign currency bill is involved, we must remember the trader has purchased such a bill at his buying rate for that usance, based upon his buying rate for sight exchange and the “to arrive” interest rate. If the foreign currency bill is drawn at 90 days sight, obviously the drawee is entitled to some consideration if he pays the bill, say, 10 days after acceptance instead of 93 days after the date of acceptance. In the case of foreign currency bills the trader is satisfied to allow the drawees a rebate of interest for anticipated payments (payment prior to maturity) without the instructions of the drawer. As a rule, the foreign currency bill has been purchased by the trader, is his property and he does not mind the rebate, providing the interest rate allowed is lower than the rate considered by him in determining his buying rate for the usance bill.

The problem is not so simple with respect to dollar bills. If a dollar bill is being handled for collection only, it remains the property of the drawer and he, and not the collecting bank, is interested in the giving of an interest rebate for anticipated payment and the actual rate of interest used. If the bill has been discounted, the discounting bank will not be willing to allow the drawee the rebate at a higher rate of interest than the interest rate used in the discounting, unless the drawer is willing to make good the difference. Thus, should the discounting be based upon an interest rate of 3% per annum and the drawee is allowed

a rebate at 6% per annum, the bank will lose the difference between 3% and 6% for the period of time by which the maturity has been anticipated. Should this occur, the discounting bank will justly require reimbursement for the difference of 3% per annum from the drawer. It is apparent, therefore, that it is the drawer of dollar bills who must determine if a rebate is to be allowed for anticipated payment and the rate of interest which should be utilized.

A drawer gives long terms to a buyer because circumstances compel him to do so. He would much prefer to receive cash with the order or to draw on the buyer at sight, documents against payment. The sight draft reduces the credit risk and at the same time enables him to obtain payment within a comparatively short time. It would seem, therefore, that it is to the drawer's decided advantage to have the maturities of his bills anticipated by the drawees, as the more prompt payments not only stop the running of the credit risk but also give him his cash sooner. What is the value of these advantages in terms of interest rates? Is it good business on the part of the drawer to offer his foreign buyer an attractive interest rate so that the buyer would be tempted to pay the obligation ahead of its maturity? Because of the fact that interest rates abroad, especially in Latin America, are usually higher than the going rates in the United States, a rate less than 6% per annum would not be attractive to the drawee. A higher rate would penalize the drawer as he can almost always borrow at not more than 6% per annum. Considering the fact that payment always discharges the credit risk, it would seem to be good business on the part of the drawer to allow the rebate at 6% per annum which rate, incidentally, is the rate which the drawer would demand from the drawee were the drawee to pay interest, over and above the face amount of the draft, for the time the bill is in the process of collection.

Some drawers, however, will not allow rebates at any rate of interest whatsoever, and still the payment of their foreign bills is anticipated. This comes about in this manner. Suppose the seller agrees with the buyer that the seller will ship under 60 days sight terms with the understanding that the outstanding commitments shall never exceed the total amount of \$25,000.

Assuming the buyer already owes the seller some \$25,000. represented by 60 days sight drafts of the seller duly accepted by the buyer but not due, and that the next draft will mature some three weeks later, the buyer cannot cable a new order to the seller and expect the seller to ship such new order by the boat sailing that week unless he can assure the seller that the new order will not exceed the \$25,000. total amount to be outstanding at any one time. He can give this assurance only by anticipating the payment of bills outstanding up to the value of the new order and by having the foreign collecting bank cable the fact of such anticipations to the drawer through the American bank from which the foreign bank has received the anticipated bills.

This condition will obtain, however, only when the buyer is obliged to purchase the particular type of merchandise from one supplier or whenever the demand for goods exceeds the supply of goods. The intervening collecting banks, having no knowledge of possible private arrangements between the seller and buyer, must look to the buyer for instructions as to rebates and the rate of interest to be applied whenever the buyer should desire to pay an outstanding acceptance before maturity. If the seller has failed to give instructions as to this point with respect to dollar bills, the collecting bank abroad, in all probability, will allow the rebate at 6% per annum and the American bank and the seller (the drawer) must adjust the allowance between themselves. As indicated before, the problem is inconsequential when arising in connection with foreign currency bills because the rate of interest used is invariably lower than the rate utilized by the trader in determining his buying rate.

**The Drawer Must Instruct if the Bill Is to Be Protested for Dishonor.**—As will be fully noted from the following comments on the protesting of bills, the drawer is obliged to give definite instructions to the bank which buys his foreign currency bills, or discounts his dollar bills, or handles his bills as simple collections, if such bills are to be protested for dishonor, or if protest is waived. He cannot do this in an intelligent manner unless he thoroughly understands and appreciates the purposes and consequences of protesting bills of exchange. While, admittedly, the drawer should look to his lawyers for the

## EXPORT-IMPORT BANKING

necessary explanations, he often hesitates to do so because his lawyers may not have sufficient knowledge of the customs and requirements of foreign countries. The drawer feels, and perhaps properly, that his banker may be in a better position to advise him on this subject and appeals to him for the information, instead of to his lawyers. The fact remains that both the drawer and his banker must understand the subject quite thoroughly as their respective interests are not the same.

**What Is Protest?**—As used with reference to negotiable instruments, protest is a formal statement in writing, generally prepared by a notary in a manner prescribed by the Negotiable

CERTIFICATE OF PROTEST								
UNITED STATES OF AMERICA	}	ss..						
STATE OF NEW YORK								
COUNTY OF NEW YORK								
<p>THE UNDERSIGNED, A NOTARY PUBLIC OF THE STATE OF NEW YORK DULY COMMISSIONED AND SWORN, DO HEREBY CERTIFY THAT ON <span style="float: right;">193</span></p>								
FOR		<input type="checkbox"/> CHECK OR BILL OF EXCHANGE <input type="checkbox"/> PROMISSORY NOTE AND <u>      </u> DOLLARS <span style="font-size: small;">100</span>						
DRAWN OR MADE BY								
DRAWN ON AND/OR PAYABLE AT								
AT		NEW YORK CITY						
PAYABLE TO THE ORDER OF								
DATED	DUE	BEARING NO.						
WHICH IS HERETO ANNEXED WAS DULY PRESENTED AND <input type="checkbox"/> PAYMENT <span style="margin-left: 100px;"><input type="checkbox"/> ACCEPTANCE</span> <span style="float: right;">DEMANDED WHICH WAS</span>								
REFUSED FOR THE REASON.								
<p>WHEREUPON, I, THE SAID NOTARY, AT THE REQUEST OF THE HOLDER THEREOF DID PROTEST, AND BY THESE PRESENTS DO PUBLICLY AND SOLEMNLY PROTEST AS WELL AGAINST THE MAKER(S), DRAWER(S), ACCEPTOR(S) AND/OR ENDORSER(S) OF SAID INSTRUMENT AS AGAINST ALL OTHERS WHOM IT DOETH OR MAY CONCERN FOR EXCHANGE, RE-EXCHANGE AND ALL COSTS, DAMAGES AND INTEREST ALREADY INCURRED, AND TO BE HEREAFTER INCURRED, FOR WANT OF PAYMENT OR ACCEPTANCE, AS ABOVE INDICATED, OF THE SAID INSTRUMENT.</p>								
<p>THUS DONE AND PROTESTED IN THE CITY OF NEW YORK.</p> <p>IN TESTIMONY WHEREOF, I HAVE HEREUNTO SUBSCRIBED MY NAME AND AFFIXED MY OFFICIAL SEAL, THE DAY AND YEAR FIRST ABOVE WRITTEN.</p>								
FEES \$	10 100	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%;">AMOUNT OF ITEM</th> <th style="width: 50%;"></th> </tr> </thead> <tbody> <tr> <td> </td> <td> </td> </tr> <tr> <td> </td> <td> </td> </tr> </tbody> </table>	AMOUNT OF ITEM					
AMOUNT OF ITEM								
NOTARY PUBLIC 88 WALL STREET NEW YORK, N. Y. TEL. BR 8-1002								

Instruments Law, that the described instrument was on a certain day presented for payment or acceptance, and that such payment or acceptance was refused. The holder of the dishonored instrument may or may not have it protested. When the holder does not wish the dishonored instrument to be protested, we say he has waived protest. The waiver may apply either to dishonor for non-payment or to dishonor for non-acceptance or for both.

Protest is not required for the dishonor of inland bills of exchange, which are defined by the Negotiable Instruments Law of New York as bills both drawn and payable within the state. All other bills, with respect to New York State and New York law, are foreign bills. A bill drawn in Illinois and payable in New York is a foreign bill and must be protested under certain circumstances. A bill both drawn and payable in the State of New York is an inland bill and need not be protested. Bills drawn in any of the American states, payable abroad, are foreign bills. Bills drawn abroad but payable within the State, are foreign bills. The law provides that unless a dishonored foreign bill in the hands of a purchaser thereof has been duly protested, the drawer and indorsers are discharged (freed from liability), but that they are not so discharged if they have waived protest.

**The Mechanics of Protest.**—As a rule, protests are made by notaries public, commissioned from time to time by the State. The procedures followed in the various states of the United States are much alike, as is the entire law of negotiable instruments. The procedures followed in foreign countries differ, but the general pattern is the same as in the United States. American drawers, endorsers, and banks are principally interested in the American procedure because their respective rights and liabilities are determined under the American law and procedure. For this reason, let us follow the mechanics of protesting by an American notary public. The holder of a dishonored bill which is to be protested delivers the bill to a notary the same day when it matures and is dishonored, with instructions to protest. The notary, thereupon and on the same business day, re-presents the bill to the drawee. If the bill is again dishonored, the notary returns to his office and “notes” the bill for protest; that is to

say, in a loose-leaf or bound record, he makes a note of the fact that on that given day he presented the bill to the drawee and the drawee did not honor it or could not be found. He notes in his records all the details of the bill, including the names of all the parties to the bill, the drawer, drawee, and endorsers, together with their addresses as found on the bill or as he can otherwise ascertain. This is the first step of protest.

Protest laws invariably provide that notice of dishonor must be given to all of the interested parties to a bill and also prescribe the time within which such notices must be given. As a rule, the notary who protests a bill prepares and mails the notices. In most states the notices intended for persons residing in the same city as that of the drawee must be mailed in time to reach them by the next business day, while notices intended for persons residing outside of such city must be mailed within the day following the day of dishonor. The fact that these notices do not reach the addressees is immaterial. The law is satisfied if they are properly prepared, addressed, and mailed. This is the second step of protest.

The third and last step is the preparation of the Certificate of Protest, which recites the fact of protest and the mailing of the notices. This certificate may be made any time after the date of dishonor but must be dated the same date as the date of dishonor which is also the date of noting. As a practical thing, the notary prepares the certificate the same day when he mails the notices, attaches it to the protested bill and delivers the bill with the certificate to his principal, the person or bank who requested his services.

**The Purposes of Protest.**—In view of the fact that bills are almost invariably protested by notaries and the notices of dishonor are prepared and mailed by them, it would seem that protest, in its full sense, serves two purposes. First, it establishes the actual fact of dishonor, by a disinterested party, the notary. When duly protested and the certificate of protest has been attached to the dishonored item by the notary, no one who has an interest in the dishonored bill may take the position that it was not promptly presented to the drawee for acceptance or for

payment, as the case may be. Second, it gives notice of dishonor to all interested parties, inasmuch as the notary who has protested the bill will also send out the required notices. Presumably, when the Negotiable Instruments Law was drafted many years ago it was felt that protest was not necessary for the accomplishment of these two purposes in connection with inland bills and was made applicable to foreign bills only. Let us remember that a bill of exchange is said to be an inland bill when it is both drawn and payable within the same state. All other bills are foreign bills within our protest laws. Years ago, when commercial laws and customs were taking form, it must have been felt that the dishonor of an inland bill would promptly become a matter of general knowledge and, consequently, the necessity for protest and for giving notice of dishonor, were confined to foreign bills. But nowadays, with our improved means of communications, protest should not be required even in the case of foreign bills if its sole purpose is to obtain prompt notice of dishonor. The drawer or any endorser who has a financial interest in the bill may request the ultimate collecting bank abroad to advise the possible dishonor of the bill by air mail or by cable and such advice will be received by the interested parties in the United States much sooner than the notices of dishonor mailed by the protesting notary. Notaries invariably use the ordinary mails.

Let us consider a hypothetical case. A in Canton, Ohio, draws a 60 days sight bill on B in Buenos Aires. A discounts the bill with X Bank in Canton and instructs the Canton bank to have the advice of possible non-acceptance and/or the advice of possible non-payment sent by cable. X Bank, not having facilities for collecting foreign bills, may rediscount the bill with its New York correspondent, the Y Bank. Y Bank, in turn, will forward the bill to its correspondent bank in Buenos Aires, the Z Bank. The bill will be accompanied with the instructions of the drawer requiring advices of dishonor by cable. B, the drawee, dishonors the bill by non-acceptance, and Z Bank immediately cables that fact to Y Bank in New York. Y Bank thereupon reimburses itself by debiting the account of X Bank on its books and relays the context of the cable to X Bank either by

telegraph or by air mail. Upon receipt of the advice of dishonor, X Bank reimburses itself by debiting the account of the drawer, A, on its books, and informs A of the dishonor of the bill. It will be noted that all parties have been notified promptly of the non-acceptance of the bill, and the two holders for value, X and Y banks, have been promptly reimbursed. A, the drawer, continues to have a claim against B, the drawee.

**Consequences of Protest from the Drawer's Point of View.**—The drawer of a bill has a claim against the drawee, which claim is discharged when the draft is paid by the drawee. If the drawer enters his bill with a bank for collection, the bank becomes his collecting agent. If the bill is paid, the agent pays its proceeds to his principal, the drawer. If it is not paid, the agent returns the bill to the drawer, who must then decide what further and other steps he is to take to collect from the drawee. If the drawer has sold the bill to a bank, he may accompany the bill with instructions that it is to be protested for dishonor, either by way of non-acceptance or by way of non-payment. The purchasing bank purchases the bill subject to this condition, and if the bill is not protested for dishonor by the purchasing bank, it loses its right of recourse against the drawer, and the law states that the drawer need not reimburse the purchasing bank now holding the dishonored bill. The same situation prevails when the drawer has issued no protest instructions whatsoever. The law states quite definitely that the drawer of a foreign bill of exchange is discharged, if the bill has not been protested for dishonor, unless, of course, the drawer has definitely and affirmatively waived protest by accompanying the bill with instructions that it need not be protested for dishonor. Such a waiver upon the part of the drawer makes his discharge under the law inoperative, and he is obliged to reimburse the purchaser of the bill even though it is not protested for dishonor. No decent drawer hopes that, through inadvertence or otherwise, the purchaser of his bill will not protest it in the event the drawee does not pay so that he, the drawer, may be discharged. Barring this evil thought from consideration, the honest drawer, when faced with the necessity for giving protest instructions will ask himself the question: "What, if anything, will I gain by protesting?"

Sight bills can be dishonored by non-payment only, and may or may not be protested for non-payment. Time bills can be dishonored either by non-acceptance or by non-payment and may or may not be protested under either or both circumstances. If the bill in connection with which the subject of protest is being considered is drawn "at sight" or "on demand," the drawer must take into consideration the advantages and disadvantages to himself if such a bill is protested for non-payment. The only advantage he obtains is the proof in the form of the certificate of protest which the notary has attached to the unpaid bill that, on the date specified in the certificate, formal demand for payment was made upon the drawee and that the drawee did not pay. But this piece of evidence is not worth the cost of protest and its attending disadvantages, because the records and employees of the ultimate collecting bank located in the city of the drawee, wherein the lawsuit against the drawee is generally commenced, can readily enough prove that proper demand for payment was made but that payment was not made. The drawer of an unpaid sight bill cannot maintain any legal action against the drawee upon the unpaid sight bill even if it has been protested for non-payment. The action must be based upon the circumstances in connection with which the draft was drawn. If the draft represents the value of merchandise sold by the drawer to the drawee, the action is based upon "goods sold and delivered" or upon the breach of the contract of sale. We cannot prevent people from drawing bills on us. We ignore such bills when we do not owe their values to the drawers. An unwarranted drawing is not strengthened by the fact that it has been protested for non-payment.

Protesting sight bills for non-payment has disadvantages which far outweigh the one slight advantage mentioned above. In the first place, while the drawee's credit is not injured by the protest (he can claim that the drawing is unwarranted) he may feel that the drawer is too harsh and too technical and place his future orders with others. This is especially true if the sight draft is presented for payment prematurely, as when the presentment is made before the arrival of the merchandise and it was assumed by the drawee that he should be called upon to pay only

when he could obtain possession of the goods. Again, the drawer must take into consideration the cost of protest which is quite considerable, especially in the Latin-American countries. This cost is a useless expense because the drawee who is justified in his refusal to pay the draft on first presentment will not pay the protest expenses when he ultimately may honor the draft, while the protest has in no way strengthened or improved the drawer's claim against the drawee. It would seem to follow, therefore, that the drawer may properly waive protest for the non-payment of his bills payable at sight.

We now come to time bills which may be protested for non-acceptance or for non-payment. As to time bills dishonored by non-acceptance, the drawer's position is exactly the same as in the case of the bill drawn at sight and dishonored by non-payment. The drawee may decline to accept the time bill because the drawing is unwarranted or because the presentment for acceptance has been made prematurely. The drawer's claim against the drawee will not be strengthened or improved when the time bill has been protested for non-acceptance, as any lawsuit to compel the drawee to meet the obligation must be based upon the circumstances or contract in connection with which the time draft has been drawn. The disadvantages are also the same as when sight drafts are protested for non-payment. It would seem to follow, therefore, that the drawer may properly waive protest for the non-acceptance of his bills payable so many days after sight or after date.

The situation is quite different, however, when the drawer is considering the protest of a time bill for non-payment when such bill bears the formal acceptance of the drawee. The draft, formally accepted, takes the place of the contract of sale or other similar circumstances in connection with which the draft was drawn, and the drawer may now sue the drawee upon the unpaid draft. The reason for this is that the drawee had an opportunity to disclaim liability, when the bill was presented to him for acceptance. Once he elected to accept, he impliedly agreed that he was lawfully indebted to the drawer for the amount involved and unconditionally agreed to discharge his obligation upon the date fixed by the formal acceptance. It should be borne in mind,

moreover, that the blame for the dishonor of a time draft by non-payment lies squarely upon the shoulders of the drawee. If he felt he might not have the ready cash for the payment of the bill, he should not have accepted it. Moreover, he may have requested the drawer to grant him a short extension, in which event the instrument giving effect to the extended maturity would take the place of the maturing acceptance and the maturing acceptance would not be considered as having been dishonored. Drawees, especially in the Latin-American countries, make every effort promptly to pay time drafts which they have previously accepted, if they realize that the ultimate collecting banks have been instructed to protest such drafts for non-payment. In many foreign countries the protest of bills is regarded as commercial information and is published and when the published protest covers the non-payment of an acceptance, the credit standing of the drawee is injured. To avoid all this, the drawee will make strenuous efforts to honor his acceptance. Again, it often happens that the drawee may have several acceptances payable by him on the same given day and can get together only enough cash to pay one or two of the bills. Under such circumstances, the acceptances which are to be protested will be paid while those which are not to be protested will become dishonored. But the greatest advantage which the drawer obtains by protesting his time bills is the right of Executive Action, available in most of the Latin-American countries to the holder of an acceptance, including the drawer, when the acceptance has been protested for non-payment.

**Executive Action.**—Executive Action (sometime called Executory Action) is a legal proceeding which permits the plaintiff in an action at law to attach the personal property of the defendant at the *commencement* of the action. In most Latin-American countries this remedy is available to the plaintiff when the action is based upon a time draft, duly accepted, but dishonored by non-payment, providing the dishonored acceptance has been duly protested. It is not available if the action is based upon a sight draft protested for non-payment or upon a time draft protested for non-acceptance. In these Latin-American jurisdictions it is held that the drawee of the time draft should

not have formally accepted it if, for any reason, he felt that he should not have obligated himself by his formal acceptance. But once he has elected to accept the draft he really has no good defense for dishonoring it.

As a general rule, the plaintiff in an action at law is not permitted to attach the personal property of the defendant until judgment has been rendered by the court in favor of the plaintiff and against the defendant. It can be readily appreciated, therefore, that this normal procedure gives an unscrupulous defendant opportunity to make himself judgment-proof between the time when an action has been commenced against him and the time when judgment has been entered against him. The possibility of accomplishing such a fraud is much lessened when the plaintiff is permitted to commence his action by attaching the property of the defendant. This practice is not particularly onerous upon the defendant because he is permitted to have the attachment vacated by depositing with the court a surety bond or other good guaranties which will insure the prompt payment of any judgment which may be rendered against him.

Under American and English law, attachments at the commencement of a legal action are granted under certain circumstances and conditions. They are not available, however, to the plaintiff in an action to collect the value of a dishonored acceptance, be it protested or not.

It would seem to follow, therefore, that it is in the best interests of a drawer to require the protest of his time drafts for non-payment, providing the same have been previously duly accepted.

**Consequences of Protest from the Endorser's Point of View.**—By the endorser we mean the person or bank which has purchased the bill from the drawer, or which has discounted it. Bills drawn in foreign currencies are bought and sold, while bills drawn in U. S. dollars are discounted. The law states that when a foreign bill is dishonored by non-acceptance or by non-payment it must be protested for dishonor if the holder wishes to preserve his right of recourse against the drawer and prior endorsers, unless, of course, they have waived protest. The endorser of a bill is not so much interested in the standing of the drawee as is the drawer. Rather, the endorser is more interested

in his right of recourse against the drawer or against a prior endorser from whom he has purchased the bill. If the drawee does not pay, he demands and receives reimbursement from the party from whom he purchased the bill. Only in the event the drawer and prior endorsers have failed between the time when the bill has been sold to the holder and the time of its dishonor, will the holder look to the drawee for redress. If this happens, his position becomes very similar to that of the drawer when the drawer seeks to obtain compliance by the drawee. Such an occurrence, however, is exceptional and we must confine our remarks largely to the situations created when the drawer and prior endorsers remain solvent and the default is upon the part of the drawee only.

Let us again consider the hypothetical case mentioned under the heading "The Purposes of Protest." A in Canton, Ohio, draws a 60 days sight bill on B in Buenos Aires. A discounts the bill with X Bank in Canton and gives no instructions whatsoever as to protest to X Bank. X Bank in Canton rediscounts the bill with its New York correspondent, the Y Bank, and says nothing about protest. Y Bank will send the bill to its correspondent bank in Buenos Aires, the Z Bank, for collection. Assuming time will not permit the obtaining of protest instructions from X Bank, how should the Y Bank instruct the ultimate collecting bank, the Z Bank?

Before answering this question let us clear up two collateral points. First, the omission of protest instructions is not and cannot be construed to be a waiver. To be legally effective, the waiver must be definitely and affirmatively made, and preferably in writing. Second, an intermediary bank, such as Y Bank, should not forward a bill to the ultimate collecting bank abroad without accompanying it with definite instructions as to protest. If the wishes of the drawers and of prior endorsers are to be guessed, the Y Bank in New York is in a much better position than the Z Bank in Buenos Aires to do the guessing.

This brings us to the answer of the above question. Y Bank is not only an endorser of the bill but is also a holder for value and must use care so that its right of recourse against the X Bank is not lost. This means that Y Bank must instruct the Z

Bank to protest the bill not only for non-payment but also for non-acceptance, even though no one obtains any benefit in a subsequent action against the drawee when a time bill is protested for non-acceptance. Y Bank has no choice in the matter, as the law definitely states that the drawer and endorsers of a foreign bill are discharged if they have not definitely waived protest and the holder for value has not had the bill protested for dishonor, meaning in the case of a time bill, protested for non-acceptance or protested for non-payment, as the case may be.

There is another point to bear in mind. X Bank and Y Bank enjoy reciprocal correspondent relationships. Y Bank does not know if the X Bank has discounted the bill for the drawer or is handling the bill for collection only. If X Bank has discounted it, its recourse against the drawer must be preserved and that cannot be done unless the bill is protested for dishonor, assuming, of course, the drawer has not waived protest. So in this case, protest not having been waived, the bill must be protested first, to preserve Y Bank's recourse against X Bank and second, to preserve X Bank's recourse against the drawer.

**Consequences of Protest from the Intermediary Collecting Bank's Point of View.**—Y Bank in the preceding paragraph is the typical intermediary collecting bank when it has not discounted the bill for account of X Bank but is handling the same for collection only. Under these circumstances, Y Bank is not concerned with protest but will wish to preserve X Bank's recourse to the drawer, not knowing if X Bank has discounted the item or is handling it for collection. Therefore, Y Bank will instruct the ultimate collecting bank in Buenos Aires to protest both for non-acceptance and for non-payment. On the other hand, if Y Bank knows that X Bank has no financial interest in the bill, or if Y Bank is handling the bill as a simple collection for account of the drawer direct, and without the intervention of X Bank, it should instruct the ultimate collecting bank to protest for the non-payment of the time bill which has been previously duly accepted and not to protest for the non-acceptance of the time bill. All this uncertainty would be eliminated if the interested drawer gives definite instructions as to protest when he first delivers his bill to the X Bank.

**Consequences of Protest from the Ultimate Collecting Bank's Point of View.**—The ultimate collecting bank in a foreign country very seldom acquires a financial interest in the bills sent to it for collection, unless it happens to be a branch of the American intermediary bank, when there is the possibility that its Head Office may have discounted it. In the majority of instances, however, the ultimate collecting bank is merely a collecting agent for the remitter, who may be the drawer or another bank. A good agent always extends to his principal a full measure of service and loyalty so that the principal's interests may not suffer. But it is common sense to realize that the agent must also take care of his own interests. If a bill is accompanied with definite protest instructions, the agent bank will either follow them or notify the remitter that it cannot endeavor to collect the bill subject to the given protest instructions as it prefers not to protest bills drawn on that particular drawee. If this happens, the remitter must either waive protest or place the collection with another bank in the city of the drawee.

But suppose the remitter has not accompanied the bill with protest instructions. No one can safely predict just what the ultimate collecting bank will do should the bill be dishonored either by non-acceptance or by non-payment. If the remitter is a bank and has discounted the time bill for the drawer, the bank loses its recourse against the drawer if the bill is not protested for non-acceptance or is not protested for non-payment. This is also true if the bill is drawn at sight and is not protested for non-payment. The ultimate collecting bank may not know this provision of our own laws and consider only the fact that the claim of the drawer against the drawee is not strengthened when a bill drawn at sight is protested for non-payment or when a time bill is protested for non-acceptance. The remitting bank, which has lost its recourse to the drawer under these circumstances, cannot very well charge the ultimate collecting bank with negligence because the remitting bank's hands are not clean. The remitting bank was negligent when it did not give the ultimate collecting bank instructions as to protest. The drawer who sends his bills to a foreign bank direct cannot complain because he is not injured under these circumstances and,

moreover, he is not in a position to take any action against the foreign collecting bank which, as is usually the case, has not solicited the collections of the drawer.

The situation becomes decidedly more awkward when an acceptance is dishonored by non-payment and has not been protested. The ultimate collecting bank, which is usually much closer to the drawee than to the drawer, may sympathize with the drawee's refusal to pay. Indeed, the drawee may be a borrowing client of the foreign bank and it is only natural for the foreign bank not to take any action voluntarily which is apt to injure the drawee's credit. This is so even when the remitter—bank or drawer—may lose a substantial benefit, such as Executive Action. The protesting of a bill should never be left to the discretion of the ultimate collecting bank. Rather, the bill should always be accompanied by definite instructions emanating either from the drawer or from the American remitting bank.

**Consequences of Protest from the Drawee's Point of View.**—While it is the duty of a good drawee promptly to honor bills drawn on him by his suppliers, there are times when he is quite justified in declining to honor such bills. When a drawee has asked for and has been granted 60 days sight terms, he undoubtedly had in mind the fact that he would not be called upon to pay the bill until some 60 days after the arrival of the corresponding merchandise. He may have had reason to believe that he could resell the merchandise within a period of 60 days and would then have the ready cash with which to retire his suppliers' bill. Many drawers overlook this fact and, instead of forwarding the bills and shipping documents by the steamer which carries the merchandise, they instruct the collecting banks to utilize the air mail, thus cutting the drawee's time by as much as 30 days.

Sight draft terms are in the nature of C.O.D. operations. The buyer has agreed to pay immediately upon the arrival of the merchandise but he is denied this right whenever the documentary sight draft is sent out to the ultimate collecting bank by air mail instead of by the steamer carrying the corresponding merchandise. It is quite proper to forward such documents by

air mail if there has been a definite understanding between the drawer and drawee on the point. In the absence of a definite understanding, the ultimate collecting bank should be instructed to defer the presentment of sight drafts for payment and time drafts for acceptance until the arrival of the corresponding merchandise.

Many foreign bills are dishonored because the drawees feel their suppliers are attempting to "put something over on them." Many drawers, when quoting prices, fail to obtain an understanding as to what interest or collection charges, if any, the buyer is to pay. The drawees, on the other hand, rightfully feel that their only obligation is to pay the bill at its proper maturity date in New York funds, assuming the quotations are in New York funds. The drawee can pay the obligation in New York funds by offering to the ultimate collecting bank a banker's check on New York or the equivalent of such a check, and when he makes payment in this manner all exchange, bill stamp, and other possible taxes incident to dollar checks drawn on and payable in New York, are for his, the drawee's, account.

Many drawers attempt to pass on to their drawees the charges which, in the absence of a definite understanding to the contrary, should be paid by themselves. Certainly, a drawee should not be called upon to pay interest when nothing was said about it at the time when the contract of sale was closed. If the drawer cannot afford to wait for his money and prefers to discount his foreign bills, the discount charges should be borne by him. Similarly, the drawee should not be called upon to pay the collecting charges of the collecting banks, which are the drawer's collecting agents, nor the cost of any bill stamps which must be affixed to the bill before a proper and legal presentment of it can be made. To be sure, the contract of sale may properly stipulate that the buyer (drawee) is to pay interest for a given number of days at a definite rate per annum, and also all collection charges both here and abroad, as well as all stamp charges, exchange and taxes. But, as pointed out above, in the absence of a definite understanding on these points, it is unfair for the drawer to make the attempt to collect all these expenses from the drawee, and when he orders the protest of a bill because the drawee

properly refuses to pay these incidental expenses, fuel will be added to the fire.

The protest of sight bills for non-payment and time bills for non-acceptance neither helps the drawer nor legally injures the drawee, who can always take the position that the drawing is unwarranted. The situation is entirely different, however, if the protest covers a time bill dishonored by non-payment. When the drawee accepted the time bill he served notice to all concerned that he owed the amount involved to the order of the drawer, and that he would honor his acceptance by paying it at maturity. If he fails to pay, his credit is injured, especially if the protest is published. He subjects himself to Executive Action by the holder of the bill. If the legal action against him is undertaken by a holder for value, such as a discounting bank, he cannot even justify his refusal to pay by alleged shortcomings upon the part of the drawer or by reason of the fact that the drawer may be owing him a larger amount and refuses to pay it. This is because the holder for value of a negotiable instrument holds the instrument free from any claims which the drawee may have as against the drawer.

Because of all these circumstances, the drawee of a foreign bill which has been duly accepted by him will make every effort to pay the acceptance at its maturity, especially when he realizes that the acceptance is to be protested for non-payment. The drawer should accompany his bills with instructions to that effect.

Some drawers deliberately do not give protest instructions, believing that their position with the drawee will be in a better light if the protest is made by the collecting banks on their own initiative. They wish to be in position to tell their drawees who are offended by the protest, "We, ourselves, did not instruct the collecting banks to protest but the collecting banks ordered the protest on their own initiative." This is absolutely wrong and places the collecting banks in an awkward position with the drawees. The collecting banks should be shielded by the drawers as much as possible. They are the collecting agents of the drawers and are anxious to serve their principals both loyally and efficiently. Their usefulness to the drawers is largely de-

stroyed, however, when their relations with the drawees become strained. They have a hard enough time to pacify drawees when the drawers assume responsibility for the protests made. For instance, a drawee never takes into consideration that the protest may be made simply to preserve recourse to endorsers, especially when sight bills are protested for non-payment or time bills are protested for non-acceptance. The drawee cannot understand why bills should be protested under these two circumstances, when the drawer acquires no advantage against the drawee. Some drawees even resent the protest of their acceptances for non-payment and instruct the drawer to use another collecting medium for future bills, which medium may not be so apt to protest. Now, it is only common sense to realize that no ultimate collecting bank is apt to present a bill to a drawee and immediately disclose to the drawee the protest and other instructions which accompany the bill. It is only when the drawee intimates that he may be unable to pay his acceptance that the collecting bank warns him that it is obliged to protest.

**Conclusion.**—The drawer of a bill may waive protest, depending upon his relations with the drawee.

The drawer acquires no substantial advantage against the drawee by protesting sight bills for non-payment and time bills for non-acceptance, but his claim against the drawee is much improved if he orders the protest of his time bills for non-payment.

A bank which is handling a bill for collection only is not concerned with recourse and may properly order the protest of only time bills for non-payment, thus protecting the best interests of its client. But if it is handling the bill for collection for account of another bank, protest must be ordered in every instance (sight bills for non-payment, time bills for non-acceptance, and time bills for non-payment) as the other bank may have purchased or discounted the bill and its recourse to the drawer must be preserved.

A bank which has discounted or purchased a bill must protest it under all circumstances, in order to preserve its recourse to its client, be he the drawer or an endorser, unless, of course, protest has been waived.

The drawer should always accompany his bills with full and definite protest instructions.

**The Drawer Must Instruct if the Dishonor of the Bill is to Be Reported by Cable.**—The collection letter form endeavors to draw from the merchant definite instructions with respect to this question. Some drawers solve the problem by marking the instructions reading "Incur no cable expense on this bill." But this solution may be satisfactory only with respect to clean bills which are being handled by the bank for collection only. However, it indicates a lack of understanding upon the part of drawers when documentary bills are involved, or when the bank has acquired a financial interest by way of purchase or discount.

In the case of clean bills which do not cover goods actually in transit and which have not been purchased or discounted by the bank, it may be well not to incur cable expenses. The advice of dishonor may come by regular or air mail. The presumption is that the drawee has owed the amount involved to the drawer for some time and a delay of thirty days or more in the receipt of the advice of dishonor of the bill drawn in cover of the indebtedness may not mean much to the drawer. But if the drawer is depending upon the prompt payment of the bill, it would seem that he would require the advice of dishonor by cable so that he may not be misled. As the bank has not acquired an interest in the bill, it is not concerned with the prompt payment, nor with the dishonor of the bill, nor in the means used to convey the knowledge of dishonor to the drawer. At times, however, the making of a new shipment to a foreign buyer may depend upon his honoring an outstanding bill drawn in cover of a previous shipment. Certainly, under such circumstances the drawer will wish to be advised by cable of the dishonor of the outstanding bill. The cable expense is small when compared to the losses which might result were the new shipment made upon the false assumption that the outstanding collection had been already duly honored. If the bank has purchased or discounted the clean bill and is extending credit facilities to the drawer sparingly and within definite limits, it is only natural that the bank should wish to receive

the advice of dishonor in the quickest possible manner, that is, by cable.

The bank may also wish to receive by cable the advice of dishonor of a documentary bill for the same credit reasons, but the drawer, for his own protection, should always insist upon cabled advices of dishonor whenever the draft is documentary and covers a shipment currently made. No one knows definitely what may happen to the relative merchandise when a sight draft has been dishonored by non-payment or when a time draft has been dishonored by non-acceptance. The drawer may wish to extend the insurance on the refused shipment. He may wish to have the goods returned to him promptly, or sold to others in the same locality of the original buyer. The goods may be of a perishable character and may require prompt clearance from customs and storage at a place more suitable than a steamship dock. If a time draft has been duly accepted, the merchandise surrendered to the drawee against his acceptance, and the acceptance dishonored by non-payment, it would still seem to be in the best interests of both the shipper and of the American bank to receive the advice of non-payment by cable.

Some drawers seem to feel that their local agents can protect their interests whenever their drafts are dishonored by non-acceptance or by non-payment. Such a procedure, however, keeps both the drawer and the American bank in the dark as to the real situation, unless the agent cables his principals. The agent may hesitate to do this as the dishonor is a reflection upon the agent, too, because it was he who took the order from the defaulting buyer. Other drawers take the position that their bills will not become dishonored but forget the fact that if the bills are not dishonored there will be no cable expenses incurred. A prudent drawer will always wish to keep in the closest possible touch with every phase of his business and will much prefer to receive the advices of dishonor by cable. The expense is more than offset by the advantages of prompt knowledge.

**The Drawer Must Instruct if the Payment of the Bill is to Be Reported by Cable.**—If the drawer has instructed that the dishonor of the bill for non-acceptance and/or for non-

payment is to be reported by cable and such a cable is not received at the approximate dates, both he and the American bank may safely assume that the bill has met with no difficulties and has been honored in due course. Some drawers, largely for credit considerations, prefer to be definitely advised by cable of the actual payment of their bills. Other drawers, who are not situated well enough to be able to obtain discounting facilities from the bank, will request the bank to make an advance against the paid collection until its proceeds are received by the American bank in America. The bank will do this readily enough because the cable advising the actual payment of the bill abroad has been received from its own foreign collecting bank, and hence no credit extension is involved.

Still other drawers request cable advice of payment under the mistaken idea that as soon as the American bank has received the cable advice, it will pay the drawer the proceeds of the collection. As we have pointed out previously, dollar drafts payable abroad are paid by the drawees by means of bankers' checks on New York, purchased by them from the collecting banks, or at the collecting bank's selling rates for checks on New York. The collecting bank in America does not receive the proceeds of a collection until it has received from the foreign collecting bank the bankers' check purchased and offered by the drawee in payment of the collection and until the check received by the American bank is actually collected through the American clearing houses. If the drawee has paid the dollar draft at the collecting bank's selling rate for checks on New York, the American bank cannot debit the dollar account of the collecting bank on its books until it has received the foreign bank's advice of payment and instructions to the effect that the proceeds due to the American bank may be debited to the dollar account of the foreign bank on the books of the American bank.

At times, Americans sell merchandise to foreigners with the definite understanding that the drawee is to make payment not by means of a banker's check on New York or at the collecting bank's selling rate for checks on New York, but by means of a cable transfer on New York or at the collecting bank's selling rate for cable transfers on New York. The cable

received from the foreign collecting bank is not only an advice of payment but also represents the actual proceeds of the collection. The cable received will read somewhat like this: "Your collection No. — paid. Debit our account \$—." The amount mentioned in the cable represents the face amount of the collection, less the collection charges of the foreign bank and its out-of-pocket expenses for bill stamps placed on the draft which has been collected. When the American bank receives such a cable it is prepared to make the proceeds of the collection available to the drawer immediately. But we must not forget that a foreign drawee will not pay a draft at the cable rate unless he has agreed to do so in the sale contract. The cable rate is more expensive to the drawee than the check rate.

**If Drawer Designates a "Case of Need" (Abbreviated as C/Need), He Must Instruct as to the Scope of His Authority.**—The "Case of Need," under the Negotiable Instruments Law, is a person entirely different from the Case of Need designated nowadays in connection with foreign drafts. Under the Negotiable Instruments Law the Case of Need is in the nature of an alternate drawee, the theory being that if the real drawee should refuse to honor the bill, it should be presented to the Case of Need mentioned on the face of the draft who is to honor the bill in place and stead of the drawee and adjust the payment with the drawer at a future time.

That type of Case of Need served a very useful purpose, especially in connection with bills in foreign currency, as will be noted by the following common procedure. An American exporter makes a sale to an Australian importer and agrees to draw on the importer at 90 days sight, in sterling. The exporter sells the sterling bill to the American trader. The trader sells it to an Australian bank in London because he can utilize London sterling more advantageously than Australian sterling. The bill is then sent by the London bank to its branch in Australia for acceptance and payment by the Australian drawee. Should the bill be dishonored, the Australian bank would be required to return it to the London bank and the London bank would then return it to the American bank and request reimbursement for the value of the dishonored bill, now

increased by charges for exchange as between London and Australia, as well as interest and bill stamp charges. The American bank would then demand from the exporter the sterling value of the dishonored bill at the then current rate in order to correct his sterling position because, after reimbursing the London bank, the American bank is short in sterling. When the American trader sold the bill to the London bank and received London sterling for it, the trader theoretically sold the sterling thus acquired. His sterling position becomes short when he reimburses the London bank. If, in the meantime, the sterling rate has advanced, the American exporter is apt to face a bad exchange loss, not mentioning the other accrued charges for interest and bill stamps. All this would have been eliminated had the drawer placed on the draft the name of a Case of Need, usually the drawer's representative or a very friendly concern, who would pay the bill in place of the original drawee and subsequently adjust the payment with the American exporter. By this alternate payment, the intervening banks' positions are exactly the same as if the bill had been paid by the original drawee. No adjustments or charge-backs are involved.

When the functions of the Case of Need were those contemplated by the Negotiable Instruments Law, the drawer placed on the draft, usually just below the name and address of the drawee, a phrase reading "In Case of Need refer to A & Co. \_\_\_\_\_ (address)." If the original drawee declined to pay a sight draft it would be presented to A & Co. for payment and A & Co. would pay it and receive the documents, if any, attached to the draft. Were the draft a time item and the original drawee declined to accept, it would be presented to A & Co. for acceptance and A & Co. would duly accept it and pay it at maturity. And, finally, if the dishonor upon the part of the original drawee consisted of his refusal to pay a time draft which he had previously accepted, the unpaid acceptance would have been presented to the Case of Need, A & Co., for payment and A & Co. would have paid it.

**The Case of Need as We Know Him Today.**—The Case of Need as we know him today is a person with functions entirely different from the functions exercised by the old fashioned

Case of Need mentioned in the Negotiable Instruments Law. The reason for this difference is understandable when we recall that some fifty years ago our export trade was in the hands of a small group of strictly export firms who had at all important foreign points either their own branch offices or well established local concerns acting as the representatives of the American export firms. These representatives operated like partners of the American firms, sharing the profits and losses of the orders taken by them and forwarded to their American principals for execution. American manufacturers, with very few exceptions, did not have their own export departments but sold for export through the established exporting concerns.

Today, however, the old line of export houses are largely out of business and manufacturers do their own exporting through the facilities of their own export departments. The average factory is not large enough to maintain foreign branches and is obliged to work through agents who may represent a large number of manufacturers both in America and in other foreign countries. Some of these agents may be good salesmen but poor in financial ability and sometimes also poor in business ethics. The smaller factories are apt to have a poor lot of agents while the agents of the larger manufacturers, because of the volume of sales and of the importance of the lines manufactured, may have agents who are good both morally and financially.

Because of this mixed situation, most manufacturers prefer not to extend credit to their foreign agents, nor to place their merchandise within their reach. The agent secures an order from a buyer in his territory and forwards it to his principal, the American manufacturing exporter. The exporter checks with his bank and with other credit agencies the standing of the buyer. If he is satisfied to give the buyer the terms suggested by the agent, the order is filled and the agent will receive a specified commission after the buyer has paid the seller's draft. This is the usual procedure. You will note that the agent's standing plays no part in the transaction.

And so the expression "In Case of Need refer to" has acquired a new meaning in modern foreign trade. The

American seller calculates, and correctly, that the agent has an interest—his commission—in the orderly liquidation of the sale which the agent has made, and concludes that in case the relevant draft meets with difficulties such difficulties are to be made known to the agent who, presumably, is to resolve them. With this thought in mind the American exporter instructs the bank which is to collect his foreign draft, "In Case of Need, refer to B— address—," B being the agent who obtained the order which the draft covers.

It used to be the custom of New York banks to transmit these instructions verbatim to their foreign correspondents to whom the given bill was sent for collection. Each correspondent bank would interpret these instructions as it saw fit. One bank would advise the agent of the dishonor and expect the agent to induce the drawee to honor the bill promptly as drawn by the drawer. Another agent would authorize a discount of say, 10% to 20%. Still another agent would instruct a change in terms, say from sight D/P to 90 days sight D/A. Still another agent would instruct the surrender of the documents to the drawee without any payment while still another agent would instruct that the foreign bank release the documents to himself and to return the unpaid draft to the American bank. Such a situation had two distinct disadvantages. In the first place, the action which the foreign bank took would not be satisfactory to the shipper. In the second place, assuming the American bank had acquired an interest in the bill by way of purchase or discount, it would oftentimes lose the merchandise which collateralized the operation.

In order to bring order out of this chaos, American banks now decline to indicate a Case of Need, in the new sense, unless the drawer also indicates the extent of his powers. The collection letter form gives the drawer this opportunity. If the agent is to be accorded full powers, the drawer is required to mark the phrase reading "whose instructions with respect to this draft (and the documents, if any) you are authorized to follow. He may also change any of our instructions." (See National City Bank form—page 216. Under these instructions, the agent may change the terms, allow rebates, or indeed,

authorize the delivery of documents to the drawee free of payment. If the bank is offered for discount a bill giving the agent such unlimited authority, it may or may not make the discount, depending entirely upon the standing of the drawer, for the bank is on notice that the agent has authority to give away the goods. When the agent is not to be allowed any discretionary powers whatsoever, but is to use his efforts to induce the drawee to honor the draft exactly as drawn by the shipper, the drawer may indicate this understanding by marking the phrase reading "who will endeavor to obtain the honoring of this draft as drawn." The third phrase in the form is to be utilized whenever the agent is to be accorded limited powers and if the drawer wishes to place other conditions to the instructions to be issued by the agent, they may be noted in the ample space reserved for Special Instructions.

By clearly indicating the scope of the powers to be exercised with respect to a given draft, the drawer is protected, the banks are protected, and the agent knows exactly where he stands. Let us assume we have a case involving a bill for \$1,000. and the drawee, for reasons which seem good and sufficient to himself, refuses to pay the bill unless he is allowed a rebate of 10% or \$100. Assuming, moreover, that the agent is to use his good offices to obtain the honoring of the bill as drawn, he may allow the rebate out of his own pocket and thus permit the collecting bank to obtain the necessary full payment of the bill and subsequently seek reimbursement from the drawer after he has satisfied the drawer of the justice of the rebate. If this is not done, several cables must be exchanged by the collecting bank and by the agent with the American remitting bank and with the drawer, before a satisfactory adjustment can be made. But cables are expensive.

**The Drawer Must Instruct if the Acceptance and/or Payment of Bills on Latin America May Be Deferred Until the Arrival of the Carrying Vessel.**—The collection letter form alleges that the drawee is not to be compelled to honor the draft until the arrival of the vessel carrying the corresponding merchandise. If the drawer is not in accord with this custom which prevails in Latin America, he should indicate that fact by giving

special appropriate instructions. It will be noted that this condition applies to bills on Latin America only and not to bills payable in other foreign countries. The reason for this is that mail intended for Latin-American countries invariably is carried by the same vessels which carry the merchandise. Mails for Europe, Asia, and Africa usually are carried on fast mail and passenger vessels while, as a rule, cargo intended for these points is shipped on slower cargo vessels. Consequently, buyers at foreign points outside of Latin America have always received the drafts and shipping documents intended for them prior to the arrival of the merchandise and they honor the drafts as soon as received and presented by the local collecting banks. This fact is taken into consideration when terms of payment are discussed.

In trade with Latin America, as previously stated, the drafts, documents, and cargo almost always arrive by the same steamer and our Latin friends south of us base their request for terms on this situation. If a merchant in Buenos Aires requests 90 days sight terms he has in mind that he shall not be called upon to accept the draft until the merchandise purchased by him has arrived, thus giving him full ninety days before being required to pay the draft. He may require the full time for making the merchandise turnover. While the giving of generous terms is within the discretion of the seller, he cannot and should not attempt to shorten by "sharp practices" the terms which he has already granted. This problem becomes increasingly important by each extension of air mail service and, in the absence of a definite understanding, it is wrong upon the part of the drawer to have the drafts and documents forwarded to the drawee by air mail when the corresponding merchandise will not arrive at his port until some twenty or thirty days later. If the drawee is advised that the drawer will forward the draft and documents by air mail, the probabilities are that he will request still longer terms so that the accelerated maturity of the draft will not shorten his required time for the resale of the imported goods to his own local buyers. Neither the American seller nor the Latin-American buyer is prejudiced if both understand that the resulting draft is not to be honored

by acceptance or by payment until the arrival of the carrying vessel.

**The Drawer Should Instruct if the Collecting Banks Are to Insure Refused Merchandise Against Fire for His Account.—**

The collection letter form places the drawer on notice that this may be done but does not say that it will be done in every instance. At some foreign points, due to the scarcity of proper storage facilities, rates for fire insurance are apt to be high and the bank may not wish to incur this expense when it may have no financial interest in the shipment and when, perhaps, it is not sure that it can collect the premium from the shipper. Despite all this, the foreign collecting bank—which has no way of knowing if the bill has been discounted by the American bank or is being handled for collection only—may cover refused merchandise with fire insurance, fearing that its correspondent American bank may be financially interested in the shipment, especially when the shipper does not have an agent at the foreign point, or when the foreign bank has been instructed to advise the dishonor of the bill by letter and not by cable. If a cable has been received to the effect that the buyer has refused the shipment, the probabilities are that the seller will take care of the insurance at this end. Some foreign banks will not insure under any circumstances unless they have been definitely advised to do so. There is no definite general rule on this point.

Drawers are not compelled to use the instruction forms prepared and supplied by banks. Many drawers utilize forms printed for them but patterned after the bank forms. Still other drawers accompany their bills with especially typed letters. The drawer must carefully consider the various points covered by the letter of instructions and accompany his bills with adequate instructions if he is to protect his own best interests, maintain his good relations with his bank, and also bear in mind the best interests of his foreign buyers.

**Collection Instructions Must Be Given by Endorser When Bank Handles Bill for His Account.—**Many foreign bills are offered to the Outward Bills Department, not by their respective

drawers, but by intermediary endorsers. Such endorsers may be smaller local banks, country banks with no foreign facilities, factors who conduct a private banking business in some trades, or other concerns which are financially strong and at times are willing to extend their available credit facilities to weaker friendly exporters by endorsing and discounting with their own banks the export bills of such drawers.

Whenever a bill has been received by a bank from an endorser for purchase, discount, or collection, such endorser becomes the client of the bank. Indeed, the bank handling the bill may have no knowledge of the drawer but undertakes the business relying largely, if not entirely, upon the security represented by the endorsement of the endorser.

Under such circumstances, the bank which is to buy, discount, or collect the bill must look to the endorser for the instructions which are to govern the collection of the bill. The bank is not much concerned with the nature of the instructions which the drawer may have given the endorser. Assuming the endorser remains solvent, and the endorsed bill has become dishonored, the negotiating bank will look to the endorser, and not to the drawer, for reimbursement. The endorser takes the place of the drawer and it becomes his duty to accompany the bill with proper collection instructions. The instructions may or may not follow the wishes of the drawer as communicated to the endorser.

**When the Drawee Designates the Foreign Collecting Bank.**—A foreign buyer may instruct the American seller that the draft covering the sale is to be collected through the facilities of Banco Comercial, assuming the said bank is established and operates in the buyer's city. Another buyer may request the collection of the draft through X Bank of New York, the X Bank being the New York correspondent of Banco Comercial. Such requests may be readily followed if the designated native bank is favorably known to the seller and the seller is in the habit of sending his collections to native banks direct and without the intervention of American banks. The seller may also use the facilities of the designated American bank if the American bank will buy or discount his bills or if it normally

handles a portion of the foreign collections of the particular seller. The problem becomes involved, however, if the banks designated by the buyer are unknown to the seller and, consequently, the seller has no relations whatsoever with them.

Let us consider, first of all, the motives of the buyer in making such requests. He may be quite friendly with the management of the designated native bank. Indeed, he may have his own account at that bank. Collections are most profitable to the ultimate native collecting banks because they not only obtain from this business handsome commissions for their services but they also, as a rule, sell the required dollar exchange to the drawees for the payment of the collections, although drawees are privileged to offer in payment of dollar collections dollar checks purchased from good banks other than the ones holding the collections. It is possible, therefore, that the buyer, in designating his own bank as the ultimate collecting medium, may only wish to direct desirable business to his own bank in reciprocation of the courtesies received by him from that bank.

It may be, however, that the buyer designates the collecting bank because he does not wish the seller to use the particular bank which the seller has been using. Why? Is it because the bank regularly used by the seller has offended the buyer? How could any bank offend the drawee of a draft in its hands for collection? Has it refused to delay the presentment of drafts without notice to the American bank and to the drawer until such time when the drawee finds it convenient to honor such drafts by acceptance or by payment, as the case may be? Has it refused to delay the protest of bills for dishonor for a few days at the end of which period the drawee expects to be in a position to pay? If the offensive action on the part of the bank usually used by the seller is the zeal exhibited by that bank to protect the best interest of the American remitting bank and of the drawer, surely the business should not be turned over to another bank which is apt to ignore these interests and be more concerned with the interests of the drawee.

Some may say that the drawee designates a particular bank as the collecting medium because he has purchased from that bank the required dollars in the form of a future contract and

will naturally wish the bill to be handled through the bank which is to supply the dollars. This cannot be true. In the first place, the future contract has nothing to do with the collection of the bill. If the contract is with Bank A, the buyer may take the delivery of the dollar exchange in the form of a dollar check drawn by Bank A on its New York correspondent and deliver the check to Bank B, which holds the matured draft. In the second place, many drawees, especially in Latin American countries, do not purchase dollars for future delivery but prefer to buy the dollars on the due dates of their acceptances. They prefer to take chances with exchange rates. If the rate for dollars has gone against them, they ask for extensions, hoping that the rate may be in their favor at the new maturities.

When the buyer goes so far as to designate the American bank to be entrusted with the collection of the bill—usually the correspondent of the buyer's friendly native bank—he is apt to place his supplier in an awkward position. If the supplier has no relations with the designated bank he may not be able to obtain discounting facilities from that bank while he may enjoy a good line of credit at his own bank.

The collection charges of the banks designated by the foreign buyer may be considerably higher than the charges of the banks normally used by seller. This becomes important whenever the seller has agreed to absorb the collection charges and expenses.

Finally, whenever the drawer offers a bill to his own bank, either for discount or for collection, and instructs his bank to collect the bill through a bank at the foreign point suggested by the drawee, the foreign bank, irrespective of its size, standing, or reputation, becomes the direct agent of the drawer and the drawer cannot complain to his own bank with respect to the errors and omissions of the designated foreign bank. While it is true that American collecting banks are now relieved from liability for the neglect, misconduct, mistakes, or defaults of the foreign collecting banks selected by themselves, providing they exercise ordinary care in selecting their collecting correspondents in foreign countries, they have no responsibility whatsoever whenever the drawer designates the foreign collecting bank.

The selection of the American collecting banks is a matter

which should be left to the drawer and the selection of the foreign collecting banks should be left to the drawer's bank. After all, the drawer is the creditor and has extended credit to the buyer by making the shipment before receiving its value. Having made the shipment, he must collect the draft drawn on his foreign buyer. Why deny him the privilege of selecting his own collecting agents?

**When the Drawer Designates the Foreign Collecting Bank.**

—Whenever the drawer, either upon the request of the drawee or for reasons of his own, designates the ultimate foreign collecting bank, the American bank will utilize the services of such a bank, providing it actually exists and also providing the American bank has no information of a derogatory nature on the designated bank. If the American bank prefers not to have relations with the designated collecting foreign bank, it is at liberty to refuse to buy the bill, discount it, or handle it as a simple collection. The drawer must either withdraw the designation or offer the bill to another American bank. The fact remains, however, that the American bank cannot ignore the wishes of the drawer, because the designation is one of the conditions of the collection and its disregard may even destroy the American bank's right of recourse against the person who has negotiated the bill to the bank.

American exporters should obtain credit information on the banks requested by their foreign buyers as the ultimate collection media, before actually instructing their American banks to utilize the services of such banks. Many times American exporters blindly follow blanket instructions received from their buyers some years back. It may be that the bank then designated is now out of business, or is on the verge of insolvency. These facts may not be known to the American bank. The suggested bank may be still listed in the Bankers' Almanac. In order to protect its interests and the interests of its American client, the American bank may go so far as to send the bill to its own branch or correspondent nearest to the bank designated by the drawer and request it to make the presentment of the bill through the specified local bank. This practice should be encouraged

and not condemned, especially when the designated bank is quite small and of questionable standing, because the American bank's regular correspondent is in the closest touch with the actual situation of the bank indicated by the drawer as the ultimate collecting medium.

Whenever the American exporter sells to the foreign exchange trader a bill of exchange drawn in a foreign currency or discounts with his bank a dollar bill payable abroad and does not designate the foreign bank through which the ultimate collection is to be made, he is freed from responsibility for the neglect, misconduct, mistakes, or defaults of the ultimate collecting bank. Under these circumstances, the foreign bank becomes the direct and exclusive agent of the American bank, the owner of the bill.

But when the drawer, after selling to or discounting the bill with his bank in America, instructs his bank to effect the collection of the bill through a bank designated by himself, the designated bank becomes his (the drawer's) agent and the drawer must be responsible for the negligence and default of his own agent. As indicated above, the rule is different when the American bank is handling the bill for the drawer as a simple collection and the drawer has not designated the ultimate collecting bank. Here the American bank does not own the bill and acts only as a collecting agent for the drawer. If the bank uses good care and judgment in selecting a sub-agent—the collecting bank abroad—the law absolves the American bank from responsibility as to the neglect, misconduct, mistakes or defaults of the sub-agent. But it is incumbent upon the American bank to use good judgment in making the selection.

**When the American Bank Selects the Foreign Collecting Bank.**—It should be reassuring to the American exporter to know that his bank uses extreme care in selecting its collecting banks in foreign countries and that, as a rule, his rights are better protected when he does not indicate the foreign bank. As to foreign currency items sold to the American bank, the foreign exchange trader designates the bank abroad, as the proceeds must be held by the designated foreign bank in the ac-

count on its books in the name of the New York bank—the New York bank's "Our Account" with the foreign bank. The trader may have sterling accounts with three or more banks in London and may wish to operate the one account more actively than the others. His "Our Accounts" are invariably maintained with the leading banks in foreign countries, hence it would be difficult to select better collecting media for foreign currency bills.

The selection of foreign banks for the collection of bills drawn in United States dollars is not so simple, because such bills are drawn on every conceivable foreign point, some of which are served by one bank only while still other points may be too small and too unimportant to support a regularly established bank. If the American bank has a branch at the foreign point where the bill at hand is payable, it will always send the bill to its branch for collection. If no branch is maintained at the foreign point, the bill will be sent for collection to the native bank at that point, which carries a dollar account on the books of the American bank. The established depository relationship of the two banks commands the best reciprocal services of the two banks. The assets of the native bank in the hands of the American bank in the form of deposits and pending collections payable within the United States, serve as collateral for the ultimate proper liquidation of the collections entrusted by the American bank to the native bank. This becomes highly important in the possible event the foreign bank becomes insolvent.

If the bill at hand is drawn on a point where the American bank has neither a branch nor a correspondent maintaining a dollar account on the books of the American bank, the bill will be forwarded to the best available bank at that point and preferably to a bank which has an agency in New York. For instance, the Canadian banks have branches at many points in the West Indies. They also have agencies in New York and in other large American business centers. While these Canadian banks are direct competitors of the American banks for foreign collection business, it is well to use the facilities of their branches at the small foreign points instead of the facilities of a small native bank which may have no relations whatsoever with the American bank. If the service is faulty and satisfaction can-

not be obtained by correspondence, the American bank may appeal to the nearest American agency of the same Canadian bank and the difficulty will be promptly and satisfactorily adjusted. In some instances, when the available banking facilities at a given foreign point are not satisfactory to the American bank, it may send the collection to its branch or established correspondent in the city nearest to the drawee's town, thus enabling the branch or correspondent to select the ultimate collecting medium in the drawee's town. The probabilities are that there is a closer relationship between the branch or correspondent and the collection medium selected by them in the drawee's own town, than between the American bank and such ultimate collecting medium.

### Advances Against Collections

At times, advances are made against dollar bills payable abroad instead of discounting such bills at flat discount rates. These advances take three forms :

1. 100% advance against each individual bill
2. Partial advance against each individual bill
3. An advance against all pending collections

The principal difference between a discount operation and an advance operation is a legal one. When the bank discounts a bill, it becomes the owner of the bill and assumes the responsibility for the neglect, misconduct, mistakes, or defaults of the foreign collecting bank selected by the American bank as collecting agent at the foreign point where the bill is payable. When the bank makes an advance against a bill, the bill remains the property of the drawer and serves as collateral for the advance. Consequently, the foreign collecting bank selected by the American bank becomes the agent of the owner of the bill—the drawer—and the American bank is absolved from responsibility for the wrongful acts and omissions of the foreign bank, providing it has used good care and judgment in making the selection.

The second difference, also a legal one, is that when the bank buys or discounts a bill it has the right of recourse against the drawer. If the bill has been sold to or discounted with the

bank by an endorser, the bank has the right of recourse against the endorser. But this recourse may be lost through negligence, as, for instance, when the bill is not protested for dishonor, and protest has not been waived. When an advance has been made against a bill, or against a number of bills, the loan is often evidenced by a separate note, payable on demand, and the bills in process of collection become the collateral for the advance. Recourse is not involved and the failure to protest may make the bank liable for negligence but the drawer or endorser, as the case may be, must prove that he has suffered a loss as a direct result of the bank's negligence. He is still liable for the payment of the demand note in favor of the bank.

As will be seen from the following comments, the form of the advance depends upon world conditions, the wishes of the drawer and upon the wishes of the bank.

**The 100% Advance Against Each Bill.**—If a bill has been drawn with a clause which obligates the drawee to pay not only the face amount of the bill but also all interest, collection, and bill stamp charges and is offered to the bank for discount, the bank makes the discount by advancing to the drawer the full face value of the bill and looks to the drawee for the payment of the discount charges. A different situation arises when the discount charges are to be paid to the bank by the drawer, the payment of these charges being deferred until the proceeds of the bill have been returned to the drawer's bank, the full face amount of the bill having been advanced to the drawer during the time the bill is in process of collection. Whenever the mails are irregular due to wartime conditions, maritime strikes, etc., it is impossible to apply flat rates of discount, as the element of time becomes too uncertain. Under such conditions it is better both for the bank and for the drawer if the bank advances the drawer the full face amount of the bill offered for discount and charges the drawer the collection expenses and the interest after the bill has been collected. By doing this no one need guess the time for which interest is to be charged.

Some drawers prefer this method even when mails are regular and when the bank is quite willing to quote flat discount rates.

These drawers feel that the discount expense will be less when applied after the bill has been paid as the discounting bank need not estimate any of the factors which enter into the flat rate. They overlook the fact, however, that the estimate of these factors in the flat rate may also turn out to be against the bank. The bill may be in process of collection for a longer time than estimated by the bank, due to carelessness upon the part of its foreign correspondent, or due to unforeseen delays in the mails. The drawer assumes no responsibility for the bank's losses due to such events and will only agree to adjust the interest charged in the flat rate if the delay is attributable to the drawee.

Other drawers prefer this method because of a feeling on their part that they will receive more promptly from the bank the advice that the bill has been duly paid by the drawee, as the bank will wish to collect its charges as promptly as possible. These drawers are good credit men. They do not wish to extend more credit to a drawee unless the drawee has already taken care of other obligations which may be pending. While the bank always reports to the drawer the payment of his bills discounted at flat rates, the drawer feels that the bank may delay giving this information unless the information is accompanied by a debit memorandum or by an invoice indicating the drawer's indebtedness to the bank for the interest and collection expenses.

**The Partial Advance Against Each Individual Bill.**—More often, however, the bank will advance against each bill its 60%, 70%, or 80% value, and will charge interest only on the percentage advanced. The interest and collection expenses are calculated as soon as the proceeds of the bill are received in America and deducted from the percentage not advanced. The resulting difference is then made available to the drawer in the form of a cashier's check or of a credit memorandum.

This form of advance is of advantage to the bank if the credit standing of the drawer is not of the highest. The percentages not advanced build up a credit cushion on the books of the bank. For instance, if the total value of the bills in process of collection is some \$50,000, and the bank has advanced 80% against each bill, the cushion will amount to some \$10,000, and the bank may reimburse itself from these funds should the

drawer be unable to reimburse the bank promptly upon the dishonor of any one of the pending collections. Should the drawer become bankrupt, in all probability several of his foreign buyers will refuse to meet their obligations, as represented by their outstanding acceptances drawn by the bankrupt, because of some real or fancied counterclaims which they may have against him. In such cases the bank is well protected by the unadvanced percentages in the cushion and need not make any funds available to the bankrupt's receiver until the bank has been fully reimbursed for all advances made to the drawer before his bankruptcy, plus all accrued interest and collection expenses. It must be noted, however, that this form of advance cuts down the interest earnings of the bank, as interest is charged on the percentage advanced and not on the full face amounts of the bills.

Some drawers prefer partial advances because the interest expense is reduced, all guesswork as to the length of time a bill is to be in process of collection is eliminated, and because it is felt that the bank will be more prompt in giving them the advices of payment when, immediately upon receiving the proceeds from abroad, the bank will wish to collect from the drawers the interest and collection expenses. Should the bank delay the liquidation of the percentage not advanced, the drawer is entitled to interest on the amount due it and at the same rate as the bank charges on the percentage advanced.

**The Advance Against All Pending Collections.**—Assuming the drawer is in an easy cash position and may be short of cash only here and there, the best method for obtaining funds from foreign bills in process of collection is for the drawer to borrow from the bank on his note, payable on demand, pledging all of the pending collections as collateral. The demand loan may be reduced and ultimately paid by the proceeds of the outstanding collections, as received from abroad. Or, these proceeds may be paid to the drawer, providing the total of the outstanding bills is being constantly augmented by new bills, thus keeping the value of the collateral up to the amount outstanding at the time the loan was made. Most drawers prefer to have the demand loans reduced and ultimately paid by the proceeds of each bill as received by the bank.

This form of advance gives the bank the maximum of credit protection because the value of the pending collections is usually considerably higher than the total value of the demand loans outstanding. The bank is always the master of the situation and can limit the size of the loans or demand repayment at its pleasure. The bank must not be misled, however, by the real value of the outstanding collections, as compared with their apparent value. Many collections may be pending upon the books of the bank which will never be paid in whole or in part. Over a period of years, many bills of a given drawer will remain on the books of the bank simply because the drawer has neglected to request their return. Neither the American nor the foreign collecting banks are particularly interested, since they have no financial interest in such collections. Because of all this, it is important for the American bank from which an advance is requested against all pending collections to make sure that the collections are currently good and not just a conglomeration of dishonored and extended old bills.

As indicated above, this form of advance is particularly attractive to the drawer who may need some extra funds only on special occasions. The American Export Company may have pending good foreign collections with the bank, aggregating some \$240,000. The Company, due to an unusually sudden operation in its business, discovers that it could use very conveniently additional ready funds in the amount of \$100,000. It borrows the \$100,000. from the bank against a demand note, pledging the \$240,000. worth of collections as the collateral for the advance. Let us say that the advance is made at 10:00 A.M. of a given day. By the end of that day the Outward Bills Department of the foreign department will reduce the \$100,000. advance by the proceeds of the collections of the Company received during the day and if these proceeds amount to \$5,000., the advance is reduced on the very day it is made from \$100,000. to \$95,000. And so the advance is reduced by the proceeds of collections received each succeeding day until completely liquidated. Interest is charged the borrower, not on the amount of the original advance, but on the net balance due the bank each day, after the proceeds of the paid collections are credited to

the advance. Such advances are sometimes entirely liquidated within a matter of days. In the meantime, the borrower has profitably utilized the \$100,000. advance and may repeat the operation when he again has use for an extra sum of money for a special operation.

**Acceptances Created Against Export Collections.**—The Federal Reserve Act permits a member bank to accept bills drawn on it, having not more than six months sight to run, exclusive of days of grace, which bills grow out of transactions involving the exportation of goods. The pending foreign collections of American drawers almost invariably represent the value of American goods exported and consequently may be financed by acceptances. As a rule, money borrowed from a bank in the form of acceptances costs less than when export bills are discounted, or when advances are made against outstanding collections. In the case of acceptances, the borrower, who is also the drawer of the acceptance, pays the bank an acceptance commission. The accepted time bill—the acceptance—is then delivered to the drawer, who may discount it either with the accepting bank or in the open discount market. The rate of discount is fixed by the market, so it really makes no difference to the borrower if the acceptance is discounted by the accepting bank or by another financial institution. As paper of this character is considered “prime,” being a primary obligation of the accepting bank, and as it is short paper, having a maturity of not more than six months sight and usually payable at ninety days sight, the discount rate is very low. The acceptance commission paid to the accepting bank plus the discount represents the total expense to the borrower and, generally speaking, this combined expense is less than the rate charged by banks for discounting export bills or for full or partial advances, secured by export bills.

Despite its lower cost, neither American exporters nor American banks resort to this method of financing export shipments, if the other more usual methods are available. The reason for this is that acceptances are discounted and rediscounted in the open discount market and the institutions making up the discount market are apt to become skeptical if too large a volume

of acceptances of a given commercial house, as drawer, and of a given bank, as acceptor, enter the market, thus tarnishing, if not destroying, the desirability of such acceptances in the market.

Just before the financial crash of 1929, money in New York was both scarce and expensive. The rate for loans to stock exchange houses had advanced to fantastic figures and the banks, naturally enough, preferred to make loans to the groups able and willing to pay the highest rates. But the banks were obliged to take care of their commercial clients also, especially those engaged in exporting. The interest charged to individual exporters could not exceed the legal limit of 6% set by our usury laws. They overcame this difficulty in some instances by raising the collection commission so that the commission, plus interest at 6%, would give the banks an over-all return of from 8% to 10%. This was only about one-half the rate then applied to call loans made to stock exchange houses.

In such a market some banks, shorter of cash than others, suggested to their exporting clients the acceptance form of financing their foreign sales. The pending collections were pledged to the banks as collateral. Bills payable at 90 days sight were drawn against the American banks holding the bills for collection. The eligibility of the acceptances by the Federal Reserve Act was indicated by a phrase on them reading "This acceptance grows out of a transaction involving the exportation of goods." The drawee banks accepted the drafts and delivered them to the exporters who, in turn, discounted them in the market. The accepting banks loaned their credit but not their cash. Should we experience another tight money market such as we had in 1928-1929, this form of financing foreign sales will no doubt again be utilized. But it has no place in the easy money market which we have had in more recent years.

**Instructions to the Foreign Collecting Bank.**—The instructions to the foreign collecting bank are given by the American bank which has purchased or discounted the bill, or is handling it as a simple collection. The form letter which accompanies the bill and which contains these instructions is called the transmittal letter. Some bills are enfaced with clauses which are in

effect instructions from the drawers and intended for the guidance of the collecting banks both here and abroad. We shall discuss these clauses in detail a little later.

It may be well to digress a little and examine another phase of the relationship between the American bank and the collecting bank abroad. The foreign bank always regards the American bank as its principal and will not consult with or accept instructions from the drawer. If a Case of Need has been designated it will consult him and accept his instructions, in keeping with the scope of authority granted to the Case of Need by the American bank. These rules are the same, also, whenever the drawer designates the foreign collecting bank. Moreover, the foreign collecting bank always regards the remitting American bank as the actual owner of the bill, because it has no way of determining accurately what financial interest, if any, the American bank may have in a bill. While some American banks usually assign one series of numbers to bills which have been bought or discounted and another series of numbers to bills which are being handled as simple collections, the foreign bank cannot depend upon these numbers in determining the financial interest of the remitting bank in a given bill. Oftentimes, a bill is entered as a simple collection and several days later is either discounted or made to serve as collateral for a loan.

Foreign currency bills are accompanied by general instructions calling upon the collecting foreign bank to collect checks and sight bills and credit their proceeds to the account which the American bank maintains with the foreign bank. If no "Our Account" is maintained with the foreign bank, it is requested that the collection be made and the proceeds paid to another foreign bank in the city or country of the foreign collecting bank for the credit of the account of the American bank on the books of such other foreign bank. Time bills which require acceptance first, and payment at maturity, must be accompanied by instructions as to what action is to be taken with the accepted bills. Are they to be discounted, or held in depot, or perhaps turned over to another foreign bank? A foreign collecting bank is seldom requested to collect a foreign currency bill and convert the proceeds into dollars and return the dollars

to the American bank. This would involve the sale of dollars by the foreign bank. The trader attached to the American bank would much prefer to buy the foreign currency involved for his own account. This is his business.

As to dollar bills, the foreign collecting bank is instructed generally to collect them in a manner and at rates of exchange which will permit it to remit the proceeds to the American bank either in the form of good bankers' checks on New York or to authorize the American bank to debit the dollar account which the foreign bank may have with the American bank, the entry to be passed as of the date when the advice of the foreign bank reaches the American bank. In either event, it is understood that the foreign bank will deduct from the proceeds its own collection charges and out-of-pocket expenses for bill stamps, cables, etc. incurred by it in connection with the particular bill.

The special instructions accompanying all bills are the same as those addressed by the drawer to the American bank in the instruction letter form. They cover the delivery of documents against acceptance or payment, protest, cable advices, possible rebates for payments before maturity, the Case of Need and his powers, and any other wishes as expressed by the drawer in the instruction letter addressed to the American bank. As a matter of fact, the form of the transmittal letter is quite similar to the form of the instruction letter of the drawer and the typist preparing the transmittal letter simply transfers the drawer's special instructions to the form addressed to the foreign collecting bank. Unusual conditions, at times, make necessary other special instructions to meet a given situation. These are supplied by the American bank, based upon its knowledge of the special situation and the best means of meeting it.

**Special Clauses on Dollar Drafts.**—We have mentioned several times that a bill of exchange should not be covered with instructions because such a practice may affect the negotiability of the bill. The bill should always be a true bill of exchange as defined by the Negotiable Instruments Law. The instructions covering the collection of a bill should be indicated in the drawer's letter addressed to the American bank and in the letter

of the American bank addressed to the foreign collecting bank. But commercial usage and practice have given us a number of clauses which are generally stamped on bills of exchange as well as being included in the accompanying instruction letters addressed to the collecting banks. These are: 1. The Colonial Clause, 2. The African Clause, and 3. The Far East Clause.

### The Colonial Clause

**Its Wording and Purpose.**—This clause reads substantially as follows:

Payable with exchange and English and Colonial stamps at the current rate in London for negotiating bills on the Colonies.

It is placed on drafts drawn by American exporters to Australia (including Tasmania) and New Zealand, these political entities being considered as the "colonies." Some years back, they were colonies of Great Britain instead of members of the British Commonwealth of Nations, as now. The clause may be used also in connection with bills drawn on Australasian importers by exporters in Canada and in the Latin countries of the Western Hemisphere, but is never used in connection with the drafts of British exporters to Australasia.

The primary purpose of the clause is to facilitate the payment for goods sold and shipped to merchants in Australasia (Australia and New Zealand) by exporters of countries other than Great Britain. To the author's personal knowledge, the clause was in use over fifty years ago when Britain was the undoubted merchant prince of the world, when London was the recognized financial center of the world, and when most foreign trade, including the foreign trade of the United States, was carried on in sterling. Moreover, mail time between Australasia and supplier countries to Australasia was both long and uncertain, even though slow steamers were beginning to supplant the still slower schooners. Australia (and what we say about Australia applies also to New Zealand) has always been keen for American manufactures. To buy American goods and to pay for them with the minimum of delay and exchange risk was the problem. The Colonial Clause was its solution.

**Colonial Clause Gives Seller Prompt Payment and May Entitle the Buyer to the Cash Discount.**—Whenever an Australian importer has specified that his American supplier is to draw on him and enface the draft with this clause, he places the American exporter on notice that the exporter is to receive the full cost of the merchandise and incidental shipping charges as soon as the shipment has been made and that all charges incident to the draft, such as interest, collection commissions, bill stamp charges, and exchange charges, are to be paid by the importer in Australia. Such an arrangement is equivalent to cash payment to the seller as soon as he has made the shipment. While the seller, as the drawer of the bill, remains liable on the bill until discharged by the payment of the bill by the Australian drawee, neither the seller nor the buyer attaches much importance to this contingent liability of the drawer-seller. Australian importers are excellent credit risks. The author, who has handled thousands of bills drawn on Australia by American exporters, recalls but one bill which became dishonored by the Australian drawee. Because of this, the Australian buyer at times demands and receives from the American seller the 2% discount usually allowed when a domestic buyer pays within 10 days after the date of the invoice. This discount compensates, in a measure, the interest, collection commissions, bill stamp charges, and exchange to be paid by the buyer-drawee as contemplated by the clause. The American seller may allow the 2% cash discount because the clause enables him to receive payment for his goods the moment the shipment is made and without any deductions in the form of banking charges. He is selling for cash and, as a rule, will quote to his Australian buyer his best prices for cash sales.

**Colonial Clause Enables Buyer to Predetermine Promptly the Landed Cost of His Purchases.**—The clause also enables the Australian buyer to predetermine the landed cost of his imports. As we shall see later, the dollar draft of the American seller is converted into London sterling the moment he negotiates the draft to his American bank. From that moment, the Australian buyer can quite accurately determine the Australian

sterling amount of the draft and the amount of banking expenses which will be added to the face amount of the draft. He is not much worried about the rate of conversion because he understands sterling better than dollars, and can follow the movements of the sterling rate more easily. When the clause is used, he is able to determine quite accurately the landed cost of his imports. When the clause is not used and the American seller's draft is presented to him as a dollar item, he may find that the rate for dollars on the payment day of the draft may be considerably higher than the rate prevailing at the time when he ordered the merchandise. It may not be possible for him to buy dollars for future delivery. Moreover, the rates quoted by Australian banks for dollar exchange are not apt to be so fine or close because of the fact that, until recent years, very little of Australia's foreign business was conducted in dollars.

**British Exporters to Australia Do Not Use the Clause.—**

The clause is never used in connection with the bills of British exporters to Australia. Before the freezing of monetary gold, the London pound sterling and the Australian pound sterling were equal in value. Both pounds contained 113 grains of pure gold. In those days of freely obtainable gold the English exporter to Australia was not obliged to indicate if his quotations for his merchandise were in terms of London pounds or Australian pounds. Both the London seller and the Australian buyer understood, however, that the resulting sterling bill, drawn in London and presumably in London sterling, would be negotiated by the London seller to one of the Australian banks doing business in London at the then going rate for negotiating such bills. Sometimes the London exporter would receive as the proceeds of these bills the respective full face amounts of such bills and a premium as well. The Australian banks in London were so anxious at the time to negotiate bills payable in Australia that they were willing to pay a premium for them. At other times, the London exporter would receive the face amounts of his bills, which meant that the Australian banks operating in London were negotiating bills on Australia at par. At still other times, the negotiating Australian banks in London

would make a deduction from the proceeds, and it was said, at the time, that the Australian banks operating in London were negotiating bills on Australia at a discount.

To be sure, the negotiation rate for a particular bill is based upon the usance of the bill. Once the negotiating rate for sight bills has been determined, the rates for long bills follow in arithmetical certainty. Assuming the interest included in the negotiating rate has been calculated at 6% per annum, when the negotiating rate for a sight bill is par, the rate for a 30 days sight bill will be  $\frac{1}{2}\%$  discount, representing interest for thirty days at 6% per annum; the rate for a 90 days sight bill will be  $1\frac{1}{2}\%$  discount, representing interest for ninety days at 6% per annum.

Now that the London pound and the Australian pound have different pegged values, the Australian pound being some twenty per cent less in value than the London pound,—Australian £5. = London £4.—the British exporter to Australia must quote and sell either in terms of Australian pounds or London pounds. In order to avoid confusion, sales to Australia by British exporters are now generally made in terms of London pounds with the understanding that the British exporter is to receive the full cost of the goods, plus shipping expenses, as represented by the exporter's draft on the Australian importer, while the Australian importer will meet all exchange, interest, collection, and bill stamp charges in addition to the face value of the draft drawn by the exporter in London pounds. This understanding is evidenced by a notation placed on the draft by the exporter, which may read:

Payable with exchange, stamps  
and all charges for collection.

**The Wording of the Clause Analyzed.**—The clause serves notice on the seller that the Australian buyer will pay the sterling value of the shipment, plus the exchange charge made by bankers in London for negotiating bills on the colonies. The clause reads "payable with exchange." This means "payable *plus* exchange." It also obligates the buyer to pay the British stamp tax (2d or  $\frac{1}{2}$  per mil, depending upon the usance of the

bill) and the Australian stamp tax, which varies in the different Australian states. The dollar bill drawn in America must be converted into London sterling so that it will become similar to the sterling bill which the British exporter draws on Australia. The conversion from dollars to sterling is made by the seller or by his American bank at the American bank's buying rate for sight drafts on London. The bill may be drawn at 90 days sight but the conversion is made, nevertheless, at the American bank's buying rate for sight drafts. The usance of the bill is considered only at the time when the "exchange current in London" is to be added to the bill. The longer the bill may be, the larger will become the added exchange.

The "exchange current in London for negotiating bills on the Colonies" is fixed, from time to time, by the Associated Australasian Banks in London, of which the banks operating in Australasia are members. All these banks have branches or head offices in London, depending upon their places of establishment or incorporation. Between their offices in London and Australasia, they control all the available banking business with Australasia.

In determining the "exchange current," the Associated Banks take into consideration the difference between the pegged values of the London and Australian pounds, the normal expense of moving gold in order to reduce or increase their holdings of cash in London or in Australia, interest for the length of time the negotiated bill will be in the collection process, and the collection charge of  $\frac{3}{8}\%$  made by Australian banks for collecting bills of exchange. They give due consideration, moreover, to the wishes of their respective governments and to the best interests of their own peoples.

British exporters to Australia may sell either in London pounds or in Australian pounds. If the sale has been made in London pounds and the seller is to absorb the charges incident to the negotiation of the resulting bill of exchange, the negotiation takes the form of a discount operation. The negotiating bank in London receives from the exporter-drawer a bill calling for the payment of London pounds. The drawee in Australia must purchase in Australia a check on London, payable in

London pounds, which check he will offer to the Australian office of the Australian bank in London which negotiated the exporter's draft and forwarded it to its Australian office for collection. Since the drawer is assuming the discount charges, he will pay interest, at an agreed rate, to the discounting bank in London from the date of the negotiation to the approximate date when the proceeds of the bill will arrive back in London, and the usual collection expenses.

Should the London exporter quote and sell to Australia in terms of Australian pounds,—and this is now rarely done—the bill which the London exporter will draw on the Australian buyer will call for the payment of Australian pounds. When the bill is negotiated to an Australian bank in London, the negotiation becomes a sale and not a discount operation. The negotiating bank buys Australian pounds with London pounds. The proceeds of the bought bill, representing Australian pounds, may be held in Australia for account of the London office of the Australian bank. The rate applied in London for negotiating (buying) such a bill is the "exchange current in London for negotiating bills on the Colonies." If, when negotiating a sight bill on Australia calling for the payment of Australian pounds 100, and the drawer receives as the proceeds of the bill London pounds 75, it is apparent that the negotiation rate is some 25% discount. This abnormal discount represents largely the difference between the pegged values of the two pounds but does include, nevertheless, the factors of pure exchange (the expense incident to moving actual funds or gold from one point to the other), interest, and collection charges.

Australian importers feel that their interests are best protected if, by some device, their British and American suppliers could receive the full face values of their bills, leaving all exchange, interest, collection, and bill stamp charges to be paid by the importers in Australia. The British exporter to Australia is now requested to quote and to draw in London pounds. The resulting bill, drawn in London pounds, is negotiated to the London office of the Australian bank. As the bill will be marked "Payable with Exchange," the drawer will receive the full face amount of the bill in London pounds. The negotiating bank in

London will then add to the face amount of the bill the "exchange current," which addition will change the currency of the bill from London to Australian pounds. The amount of Australian pounds which the drawee is to pay will be:

London pounds + exchange = Australian pounds, or  
 London £100. +\* exchange 25% = (Australian) £125.

\* Assuming the "exchange current" is 25%.

When buying from American suppliers with the understanding that the resulting bills are to bear the Colonial Clause, the Australian importer assures his suppliers that they are to receive the full face amounts of their bills representing the cost of the goods and shipping charges just as soon as the shipments have been made, when the bills may be negotiated to American banks, and that all the negotiating expenses representing exchange, interest, collection, and bill stamp charges will be borne by him, the Australian importer. In other words, the importer wishes to place the American exporter in exactly the same position as the British exporter to Australia when the British sale has been made in terms of London pounds. The Colonial Clause accomplishes this purpose.

**The Mechanics of the Clause as Affecting the American Seller.**—The American seller to Australia converts his dollar bills on his Australian buyers into sterling at his American bank's buying rate for checks on London. Irrespective of the usance of the bill, the conversion from dollars to sterling is invariably made at the check rate. As the clause obligates the drawee to pay all banking charges, the amount of these charges is determined in accordance with the usance of the bill. Bills on Australia enfacéd with the clause are payable "with exchange at the current rate in London for negotiating bills on the Colonies," the term "with exchange" meaning *plus* exchange. There is a current rate for sight bills and current rates for time bills. The longer the usance may be, the higher the "current rate" becomes.

A New York bank here and there, and especially the New York agency of an English or Canadian bank, in its eagerness to negotiate bills of this type, will at times offer to have the

conversion made at its buying rate for cable transfers on London. But this more favorable rate is of direct advantage to the Australian buyer only, because the higher the rate the less sterling results when the conversion is made from dollars to sterling and the draft is drawn for a lesser amount of sterling than when the buying rate for checks on London is used. The American exporter benefits indirectly when the cable rate is used, as the higher cable rate reduces the cost of his merchandise to his Australian buyer.

In order not to confuse the reader, we shall assume that the conversion is always made at the American bank's buying rate for checks on London. The American exporter obtains the rate from his American bank and makes the conversion himself, draws the bill on the Australian buyer in sterling, and sells the bill to the American bank. The American bank which has supplied the rate buys the bill at that same rate, thus giving the exporter the exact amount of dollars and cents to which he is entitled. Other American sellers to Australia draw the bills in dollars but inform the bank that the bill is to bear the Colonial Clause. The American bank will then indicate on the bill its sterling equivalent converted at its buying rate for checks on London and will stamp the bill with the clause. It will then buy the resulting sterling at the same rate, thus giving the drawer the full dollar value of the bill. Having received from the negotiating American bank the full selling price of his merchandise and the incidental shipping expenses, the American seller is out of the picture except in the very remote event of the dishonor of the bill, in which event he, as the drawer, will be required to reimburse the American negotiating bank.

**The Mechanics of the Clause as They Affect the American Negotiating Bank.**—The American bank negotiating the bill on Australia with the Colonial Clause is not particularly concerned with the "current rate in London for negotiating bills on the Colonies." Irrespective of the usance of the bill, it is purchased by the American bank as so much demand sterling on London. The American bank splits the documentary draft into two sets and forwards the original draft and original documents

to an Australian bank in the city of the Australian drawee with the information that the American bank will negotiate to the London office of the same Australian bank the duplicate draft and documents and that the bank in Australia is to collect the bill and hold its proceeds at the disposal of its London office.

The American bank sends the duplicate draft and documents to the London office of the selected Australian bank and requests it to negotiate the bill and pay the proceeds of the negotiation to the depository London bank of the American bank, for the credit of the American bank. The London office of the Australian bank immediately pays to the designated London depository the full sterling value of the bill, plus a commission of  $\frac{1}{8}\%$ . The bill having been enfaced with the clause by the American bank, the London office of the Australian bank is on notice that the drawee in Australia is to pay the face amount of the bill, plus all charges for exchange, interest, collection fees, and bill stamps.

The  $\frac{1}{8}\%$  commission allowed by the negotiating bank in London is for the endorsement of the American bank on the bill. The bill is endorsed to the order of the Australian bank in London by the American bank. If it is dishonored, the Australian bank will look to the American bank for reimbursement, while the American bank can only look to the drawer. Obviously, the credit risk which the London negotiating bank takes is negligible, while the risk assumed by the American bank may be real. The bill in the hands of the London bank is bank paper, while the same bill in the hands of the American bank is commercial paper.

The profit which the American bank makes by negotiating an Australian bill with the Colonial Clause is made up of two elements, the one element being that of exchange (from the purchase and sale of sterling) and the other element is the  $\frac{1}{8}\%$  commission allowed by the negotiating bank in London for the endorsement of the American bank. From this point, the American bank is also out of the picture unless, of course, the bill becomes dishonored by the drawee, in which event the negotiating bank in London will seek reimbursement from the American bank.

**The Mechanics of the Clause, as They Affect the Negotiating Bank in London.**—The negotiating bank in London is the bank most concerned with the Colonial Clause. It is this bank which applies the “exchange current in London for negotiating bills on the Colonies.” We are not particularly concerned with the operation beyond this point. When the London bank negotiates (buys) a bill on Australia bearing the clause, it has bought, in effect, Australian exchange or Australian pounds. The London bank may elect to use the Australian pounds thus purchased in making investments in Australia or the Australian office of the London bank may use the Australian pounds to negotiate (purchase) bills drawn in Australia on British merchants and payable in British pounds. This last operation would return the funds to London. The bank in London and the bank in Australia being offices of the same institution, they may use the funds as may seem best to the management of the institution.

As the American bank sends the original draft and documents to Australia direct, it follows that the amount to be paid by the drawee must be determined by the bank in Australia before it has received the duplicates from its London office. This involves no hardship for the Australian office of the Australian bank. The Australian office is well acquainted with the “exchange current” in London. As soon as the original draft and documents are received from the American bank, the bank in Australia fills out and attaches a slip to the bill containing the following data :

Amount of bill	£	—	—	—
Exchange London-Australia		—	—	—
English bill stamp		—	—	—
Colonial bill stamp		—	—	—
		<hr/>		
Total to be paid by drawee	£	—	—	—

**Selling to Australia in U. S. Dollars.**—Due to the repercussions of World War II on the political and economic life of Great Britain, Australian banks and merchants are working much more closely with American banks and merchants. The banks in Australia are now maintaining very substantial bal-

ances in America and are encouraging American banks to establish on their books accounts in Australian pounds. Australian merchants are buying and selling more and more in dollars instead of almost exclusively in sterling, as was the case some years ago. The dollar has become the monetary unit of the world and is now accorded more faith than any other currency. Most people throughout the world prefer to hold their cash in dollars. Because of this changed situation, Australian banks have become active buyers and sellers of dollar exchange. The Australian importer, purchasing goods from an American exporter in terms of dollars, may request that the resulting bills of exchange be drawn in dollars, negotiated to an American bank, and forwarded by the negotiating American bank direct to Australia for collection. The Colonial Clause will not be used in such an operation, since the dollar bills of the exporter will be handled exactly the same as his dollar bills on other foreign countries. The drawee pays at the collecting bank's selling rate on date of payment for sight drafts on New York. As a rule, the Australian drawee will also pay interest for the length of time the bill is in process of collection, at a rate specified by the American negotiating bank and, also, the collection and bill stamp charges. The American exporter-drawer receives the full face amount of his draft (representing the cost of the goods and shipping charges) from the negotiating American bank.

### The African Clause

The African Clause reads as follows :

Payable with exchange as per endorsement,  
bill stamp charges added.

This clause applies to American bills drawn on British South Africa, to be negotiated in London. Its purpose is exactly the same as the purpose of the Colonial Clause. No one knows why the wordings of the two clauses differ so much when their purpose and effect are exactly the same. Indeed, were we to paraphrase the African Clause by the use of words similar to those

used in the Colonial Clause, we would have an improved African Clause reading :

Payable with exchange and English and South African stamps at the current rate for negotiating bills in London on South Africa.

But our South African friends are economical, not only in the use of words but also in deeds. Instead of attaching to the bill a slip showing the exchange and the bill stamps, they just turn the bill over and imprint on its back a rubber stamp which has spaces for these expenses. And so, the South African drawee pays the charges "as per endorsement" or as indicated on the back of the draft.

The South African pound also has the same gold content as the British pound and the pegged values of the two pounds are exactly the same. The two rates being the same, the exchange in London applicable to South African bills may be at par, or at a premium, or at a discount. This rate is set from time to time and controlled by the two British-South African banks which operate both in London and in South Africa.

The African Clause is not used in the British-South African trade but, like the Colonial Clause, is almost exclusively used in the American-South African trade. If a British exporter makes a shipment to a South African importer he draws on the importer in sterling and offers his bill for negotiation to the London office of the South African bank.

The mechanics of handling American bills on South Africa to be en faced with the African Clause are exactly the same as the mechanics of the bills on Australia. The American exporter's bill is converted into sterling either by himself or by his American bank at the American bank's buying rate for checks on London, irrespective of the usance of the bill. The American bank buys the bill at the same rate, thus giving the exporter the full dollar value of his bill. The American bank places the African Clause across the face of the bill. It then sends to the South African office of the South African bank the original draft and documents and informs that office that the duplicate draft and documents have been sent to its London office for negotiation. In sending the duplicate papers to the London office, the American

bank instructs it to pay the face sterling amount of the bill, plus the usual  $\frac{1}{8}\%$  allowed for the endorsement of the American bank, to the London depository of the American bank, for account of the American bank. The London office of the South African bank indicates the exchange and bill stamp expenses on the back of the duplicate draft and forwards it, together with the duplicate documents, to its South African office.

In the meantime, the South African office has received the original draft and documents from the American bank, has indicated the exchange and bill stamp charges on the back of the draft, and has submitted the bill to the drawee for acceptance or for payment, as the usance may indicate. What the South African bank does with the South African sterling collected from the drawee is its own business and the business of its London office. It may hold it in South Africa or invest it in the purchase of South African bills on London, which operation, in effect, transfers the funds from South Africa to London.

### The Far East Clause

The Far East Clause reads as follows :

Payable at the collecting bank's selling rate for sight drafts on New York with interest at —% per annum from date to arrival of proceeds in New York, stamps and collection charges added.

This clause may be properly used in connection with any and all dollar drafts payable abroad, when the drawee is to pay all interest and collection expenses in addition to the full face amount of the draft. However, the clause as used in connection with Far East bills has two implied conditions which make it differ from the similar clause on a bill payable in other sections of the globe. In the first place, Far East bills are supposed to be negotiated with banking institutions in America which have their own branches or affiliates in the Far East, and the Far Eastern importer is expected to pay the bill at the collecting bank's rate rather than by means of dollar exchange purchased from another bank in his city. Both the negotiating bank in America and its affiliate or branch in the Far East expect to keep

within the "family" the profit resulting from the sale of dollars to the drawee. Several British banks operating in the Far East have agencies or offices in the larger American cities and they, too, are constantly on the alert for Far East business.

In the second place, the rate of interest to be indicated in the Far East Clause is not the rate which the bank in America usually obtains in connection with bills on other points when the drawee is required to pay interest but, rather, is the going rate for this type of business as set by the banks which operate in the Far East. The rate so fixed is invariably higher than the rate applied in America for discounting other foreign dollar bills, and may be as high as 9% or more per annum. The question of usury does not arise because the charge is not made to an individual in America but to the drawee in the Far East who, apparently, is not sheltered by such laws. Because of the higher interest rate obtainable, the banks in America which operate in the Far East are quite willing not to make a collection charge to the drawee nor to charge him with bill stamps, usually nominal in value, providing the bill is collected through the "family" and providing the drawee buys the dollar exchange required for the payment of the bill from the Far East member of the "family."

As a matter of fact, the banks in America which operate in the Far East through branches or affiliates usually negotiate the Far East bill with the clause not for their own account but for account of the Far East member of the "family." For example, should a bill on Shanghai for \$1,000., bearing the Far East Clause, be offered for negotiation to The National City Bank of New York, in all probability the negotiation will be made by the City Bank in New York for account of its Shanghai Branch. The drawer is paid \$1,000. and the payment so made is debited to the dollar account of the Shanghai Branch on the books of its Head Office in New York. The bill is then forwarded to Shanghai Branch with the information, "Here's a bill which we have negotiated (purchased) for you. We have debited its face amount to your account with us. Collect it and do with the proceeds as you see fit." Shanghai Branch should, and usually does, send an advice of payment to its Head Office for the information of the drawer. But no accounting is necessary, since

the bill was negotiated for, and with the funds of, Shanghai Branch.

While we shall discuss the Far Eastern Authority to Pay under the chapter devoted to Commercial Letters of Credit, it may be well to mention the Authority at this point, in passing. The Far Eastern Authority to Pay is a letter issued by a bank in the Far East or by its American connection, addressed to the American seller, informing him that the American connection is prepared to negotiate his (the drawer's) bill to be drawn on the Far Eastern buyer. The letter will also indicate the usance of the bill, the documents to be attached to the bill and other such details. Such a letter is of no value to the drawer if his own bank is ready and willing to extend him a line of credit for the negotiation or discount of his foreign bills, but it does indicate to the drawer that the Far Eastern importer is well regarded by the bank issuing the Authority—the importer's bank operating in the Far East. The drawer, if availing himself of the facilities of the Authority, remains liable on the bill as drawer until discharged upon the actual payment of the bill. The Authority does indicate the desirability of Far East bills as an investment for Far Eastern banks because no other types of bills are solicited by a device similar to the Authority to Purchase. Unfortunately, many American drawers are misled by the Authority and erroneously regard it as a form of commercial credit.

The Far East Clause is used in connection with bills on the Far East largely because the documents attached to bills of this type, irrespective of their usance, are deliverable against payment, and the drawees may wish to lift the documents prior to the maturities of the corresponding bills. The drawer is unable to estimate the actual date of payment, as distinguished from the maturity date, and cannot include the interest in the invoice and bill the same as he does with a D/A bill. A D/A bill is seldom retired before maturity because the interest charged by the drawer is, as a rule, at a lower rate than the rate prevailing in the country of the drawee. All guesswork is eliminated when the drawer of the Far East bill receives the full face amount of his bill from the negotiating bank in America and instructs the bank to collect interest from the drawee from the date of the bill

to the approximate date of the arrival of the proceeds of the bill back to the American city wherein the negotiating bank is located. If the bill has been negotiated by the bank in America for account of its affiliate, and the value of the bill has been debited to the American account of the affiliate on the day of negotiation, the affiliate is not required to return the proceeds of the bill to America. It is still entitled, however, to interest for the return transit time, Far East to America, the same as the drawer would be entitled to interest for the return transit time, were the bill entered by the drawer for collection only, and not negotiated.

**Trust Receipt Facilities in the Far East.**—Long D/P bills on the Far East are not particularly burdensome to Far Eastern drawees. These merchants in China, India, Japan, the Philippines, and the Netherlands Indies are accustomed to such terms and have evolved their own plan for meeting them. Almost all Far Eastern merchants who are large and important enough to buy from foreign suppliers direct enjoy the facilities of Trust Receipt lines from their local bankers. These lines may or may not be supported by collateral security, depending upon the standing of the individual merchant and the size of the line. Under such a line, the local bank will make available to the buyer, against a trust receipt signed by the buyer, the merchandise covered by a long D/P bill, and assume the responsibility for the ultimate payment of the D/P bill. The local bank deliberately ignores the D/P instructions accompanying the bill. It is, however, on the ground and can keep in closer touch with the standing of its client than could the supplier of the client in America or in Great Britain. The Far Eastern drawee of a D/P bill obtains what amounts to D/A terms. But the more liberal D/A terms are extended to him, not by the drawer (his foreign supplier), but by his local bank.

The existence of this form of trust receipt financing makes it highly desirable for American exporters to the Far East and for American banks to endeavor to meet the drawee's wishes as to the identity of the Far Eastern bank through which the bills on such drawees are to be collected. The drawees, naturally enough, designate banks in their localities which have accorded them trust receipt lines and they are apt to become embarrassed

should the bills be presented to them by other banks which have not and, perhaps, will not extend them the same facilities.

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We shall not enumerate all possible clauses which may be properly stamped upon a bill of exchange in order to have the bill collected within the understanding between seller and buyer as expressed in the sales contract. Conditions may arise in this or in that foreign country which must be covered. It is well to bear in mind, however, that the bill of exchange should not be made the letter of instructions as well. The collection instructions should accompany the draft. Many bills of exchange are made worthless in the light of the law when they contain instructions which violate one or more of the definite requirements of a bill, as defined by the Negotiable Instruments Law.

## CHAPTER 14

### COMMERCIAL LETTERS OF CREDIT

**Definition.**—A commercial letter of credit is an instrument or letter issued by a bank in behalf and for the account of a buyer of merchandise. By this instrument the bank agrees that the drafts of the seller may be drawn on the issuing bank or on another bank designated in the instrument instead of on the buyer, and when so drawn within the conditions indicated in the instrument, such drafts will be duly honored by acceptance and/or payment, depending upon the usances of the drafts. While a buyer of merchandise always agrees, impliedly or otherwise, to pay the seller, we have here a situation where a more responsible third party, a bank, tells the seller, "If you, Mr. Seller, will ship the merchandise ordered by Mr. Buyer, we, ourselves, will pay you for the merchandise." What induces the bank to make such a statement to the seller is something between the bank and the buyer, but the offer to make payment as contained in the instrument issued by the bank and addressed to the seller, is quite unconditional except as to the simple factors of amount, time of shipment, the nature of the merchandise and the documents which must evidence the shipment, all of which are clearly indicated in the instrument.

If the buyer is accorded a sufficiently large line of credit by the bank issuing the letter of credit, the instrument is issued as a matter of course, and its value is charged as an availment against the line of credit. If the buyer is not accorded such a line of credit, he may be required by the issuing bank to make a marginal deposit of cash or to deposit with the issuing bank the entire value of the commitment of the issuing bank as represented by the letter of credit. This is a credit matter between the bank and the buyer in which the seller has no interest whatsoever.

**The Necessary Contents of the Commercial Letter of Credit.**—The commercial letter of credit is a letter addressed to the seller and signed by the writer—the issuing bank. It is dated as any other letter. It discloses the name of the individual or concern for whose account it is issued. It indicates the approximate value of the goods to be shipped and the general nature of the goods. It indicates the usance of the drafts which the seller must draw and the name of the bank on which the drafts are to be drawn. It indicates the terms of sale (for full list of selling terms, see Revised American Foreign Trade Definitions, in Appendix II), such as F.O.B. or C.I.F., so that the banks which may negotiate the drafts of the seller may know if the shipping charges are for account of the seller or for account of the buyer. It may incorporate, by reference, the guiding provisions of The Uniform Customs and Practice for Commercial Documentary Credits fixed by the Seventh Congress of the International Chamber of Commerce, printed in full in Appendix I of this book. The forms used by Irving Trust Company do this. Furthermore, the commercial letter of credit indicates if the drafts are to be drawn for 100% of the cost of the merchandise or for a lesser percentage. It may indicate the shipping route. It always indicates the exact shipping and other documents which must be attached to the drafts of the seller. It indicates the outside date of shipment and the outside date by which the seller is to negotiate his drafts to which the specified documents are attached. And, finally, the commercial letter of credit contains a clear indication upon the part of the issuing bank that the seller's drafts, meeting the specifications mentioned in the letter of credit, will be duly honored.

While the wording of most commercial credits follows the above general pattern, we have several different types of commercial credits, each type being intended to meet certain requirements and using appropriate phraseology to give effect to the desired differences. The phraseology used is quite simple and understandable. The rights and liabilities of the issuing bank and of the seller, and in some cases of intervening banks which may negotiate the seller's drafts, are determined solely by the provisions of the commercial credit and never by any conflicting

provisions which may be in the contract of sale between the buyer and the seller.

**The Mechanics of Commercial Credits.**—Perhaps the functions of commercial credits will be more readily understood were we to follow through a typical operation. Let us assume Paterson Silk Company of Paterson, N. J. is corresponding with James Ling, a silk merchant of Shanghai, for the purchase of ten bales of raw silk of the approximate value of \$5,000. a bale. Ling, the seller, prefers cash with order or, in the alternative, sight draft terms. The Company, the buyer, much prefers 90 days sight terms. Both are satisfied as to terms when the buyer company offers to have established in favor of the seller a commercial credit calling for drafts of the seller, drawn on the issuing bank at 90 days sight. The seller knows that the banks in Shanghai will be quite willing to negotiate such drafts because of the protection afforded them by the commercial credit and need not be much concerned with his own (the seller's) financial standing.

To bring about this happy result, the Paterson Silk Company requests its New York bankers, say The Chase National Bank of the City of New York, to open a commercial credit in favor of James Ling of Shanghai for approximately \$50,000. covering the shipment of ten bales of raw silk, F.O.B. Shanghai, and available by Ling's drafts on Chase at 90 days sight. The request to open the commercial credit as well as other necessary details such as time of shipment, insurance, etc., are all contained in the "Application for Commercial Credit" supplied by Chase Bank, which the Paterson Silk Company fills out and signs. Assuming the Company is accorded a liberal line of credit at the Chase Bank, the credit is opened as a matter of course and without requiring either a marginal or full payment from the Company. We have illustrated this credit instrument by Form 15, which appears on page 287.

Now let us examine certain parts of this typical commercial credit, Form 15, somewhat more closely. In the first place, it is provided that the bills of lading are to consign the goods to the order of The Chase National Bank of the City of New York.

IRREVOCABLE  
COMMERCIAL  
LETTER OF CREDIT

# The Chase National Bank

CABLE ADDRESS  
CHASEBANK NEW YORK

OF THE CITY OF NEW YORK  
PINE STREET CORNER OF NASSAU

April 24, 1947

No 100

New York 15, N. Y.

Mr. James Ling  
184 Marshall Street  
Shanghai, China

GENTLEMEN:

WE HEREBY AUTHORIZE YOU TO DRAW ON US

BY ORDER OF Paterson Silk Co., Paterson, New Jersey

AND FOR ACCOUNT OF Paterson Silk Co.  
UP TO AN AGGREGATE AMOUNT OF Fifty thousand (\$50,000.) Dollars, U. S. Currency

AVAILABLE BY YOUR DRAFTS AT Ninety (90) days sight  
ACCOMPANIED BY

Consular Invoice

Full set On Board Bills of Lading drawn to the order of The Chase  
National Bank of the City of New York

Marine Insurance Policy or Certificates, including War Risk Coverage,  
endorsed in blank

Commercial invoice for 100% invoice cost evidencing shipment of raw  
silk F. O. B. Shanghai during July, 1947, from Shanghai to  
New York

DRAFTS MUST BE DRAWN AND NEGOTIATED NOT LATER THAN August 15, 1947

EACH DRAFT MUST STATE THAT IT IS "DRAWN UNDER LETTER OF CREDIT OF THE CHASE NATIONAL BANK NEW  
YORK, NO 100 DATED April 24, 1947", AND THE AMOUNT ENDORSED ON THIS LETTER OF  
CREDIT

WE HEREBY AGREE WITH THE DRAWERS ENDORSERS AND BONA FIDE HOLDERS OF ALL DRAFTS DRAWN  
UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT, THAT SUCH DRAFTS WILL BE DULY HONORED  
UPON PRESENTATION TO THE DRAWEE

YOURS VERY TRULY

SECOND VICE PRESIDENT  
ASSISTANT CASHIER

ASSISTANT MANAGER, FOREIGN DEPARTMENT

This is done for the protection of Chase Bank. By shipping the goods to the order of Chase Bank, that bank becomes the sole owner of the goods and will remain the sole owner until such time when it may be quite willing to endorse the ladings to the order of Paterson Silk Company or to the order of a nominee of the Company, such as its custom house broker in New York. If the credit standing of the Company has changed for the worse, the bank may not release the silk to the Company until the Company can provide the funds for the payment of Ling's draft drawn on the issuing bank. The silk is the bank's collateral for its commitment under the commercial credit and it may or may not release this collateral, depending upon the financial position of the Company when the bills of lading are received by the bank in New York.

In the second place, the merchandise covered by the commercial credit is described in general terms, raw silk. This is as it should be. The Chase Bank was not a party to the negotiations for the purchase of the silk and is not concerned with the quality and other details of the goods. The inclusion of such details in the credit instrument serves no useful purpose. The interested banks never see or examine the actual goods but will see to it that the goods as described in the invoices meet the same general description in the instrument. An unscrupulous seller can readily enough ship silk of an inferior quality and describe it in the invoice as silk of a required quality. Detailed descriptions of the goods only place upon the interested banks the obligation to make sure that the invoices recite exactly the desired details, without giving the buyer any additional protection.

It will be noted, also, that while the commercial credit is addressed to James Ling, its last paragraph is addressed to whomsoever may wish to become "endorsers and bona fide holders" of the draft drawn by Ling on Chase Bank in New York. Any bank in Shanghai which buys Ling's draft drawn on Chase within the provisions of the credit instrument, immediately becomes "an endorser and bona fide holder" thereof and is protected to the same extent as the drawer of the draft, James Ling, to whom the instrument is specifically addressed.

The credit instrument issued by Chase is then delivered to

Paterson Silk Company and the Company mails it to James Ling in Shanghai. The shipment is made in due course, and prior to August 15, 1947, Ling will draw a 90 days sight draft on The Chase National Bank of the City of New York for the invoice value of the silk and for the prepaid shipping charges, aggregating some \$50,000. He will, thereupon, attach to the draft the documents specified in the credit instrument and sell the documentary draft to the bank in Shanghai quoting him the best exchange rate. Let us assume the Shanghai branch of The National City Bank of New York purchases Ling's documentary draft. As the credit instrument is now entirely used up, the instrument is surrendered to the Shanghai branch of the City Bank and is attached to the draft also. James Ling, the seller, is now finished with the operation for all practical purposes. He has received full payment. While he remains liable as the drawer of the draft which he has sold, this contingency does not worry him much. Both he and the City Bank are protected by the credit instrument up to the time when the draft reaches New York and is presented to the Chase Bank for acceptance. They worry still less after Chase Bank has formally placed its acceptance on the draft because the possibility of the Chase Bank dishonoring its own acceptance is unthinkable.

The Shanghai branch of the City Bank which purchased Ling's documentary draft will forward it and its accompanying documents to its Head Office in New York, for collection. The Head Office of the City Bank, upon receiving the documentary draft, will immediately present the draft to the Chase Bank for acceptance, and will surrender all the attached documents to Chase Bank as soon as the acceptance has been created. The Head Office of the City Bank will then either discount the acceptance in the New York discount market and place its net proceeds to the credit of its Shanghai branch, or will hold the acceptance until maturity when the acceptance will be presented to Chase Bank for payment and the full face amount of the acceptance will be credited to the account of the Shanghai branch on the books of its Head Office. The payment of the acceptance by Chase Bank immediately discharges James Ling, the drawer, from his contingent liability as drawer. The Shanghai branch

of the City Bank and its Head Office in New York are fully finished with the operation also, as soon as the acceptance is paid.

Now let us follow the shipping documents which were surrendered to the Chase Bank when that bank formally accepted Ling's 90 days sight draft on Chase. The Chase Bank is not required to pay the acceptance until it matures some ninety days after the date the acceptance was made. The Paterson Silk Company is not required to place the Chase Bank in funds until a day or two before the maturity of the acceptance. The Company agreed to do this in the application for the commercial credit. However, the Company is anxious to receive the documents so that it may take possession of the silk on its arrival date in New York. The Chase National Bank may release the documents to the Company either against a simple receipt or against a trust receipt, depending upon the existing credit arrangements between the bank and the Company. It may well be that during the ninety days when the acceptance is running to maturity, Paterson Silk Company may have been able to process the raw silk and to sell the finished piece goods, or may have been able to resell the raw silk to other silk mills at a considerable profit. In either event, the Company will not be called upon to place Chase Bank in funds for the payment of the outstanding acceptance until a day or two before its maturity. As soon as Chase Bank receives the required cover from the Company and the commission due it for the commercial credit financing, and the acceptance is paid on its due date, the operation has been entirely completed.

It must be noted that, in the consummation of the above typical operation, the bank issuing the instrument has not used one cent of its own funds. It has only loaned its good name to the operation for which it receives a nominal commission. Moreover, if the draft happens to be a long time draft, as in this case, instead of a sight draft, payable on demand, the probabilities are that the buyer of the merchandise can complete his merchandise turnover before being obliged to furnish the funds required for the payment of the acceptance. In other words, the buyer also profits from the use of the good name of the bank issuing the credit instrument.

We have indicated several times that the draft to be drawn under the credit instrument may be drawn either on the bank issuing the credit instrument or on another bank designated in the instrument. While the above described operation between Paterson Silk Company and James Ling is in United States dollars and the dollar draft of Ling is to be drawn on the Chase Bank in New York, it may well be that Ling desires to make the sale in sterling. In that event, the credit instrument may provide that Ling is to draw a 90 days sight draft, in sterling, say on Barclays Bank in London. Under these circumstances, Paterson Silk Company would have undertaken in the commercial credit agreement to have the required sterling available in London on the date when the acceptance of Barclays Bank would mature. Barclays Bank is protected because it accepts Ling's draft by order and on the responsibility of the Chase Bank. When the acceptance matures, Barclays will simply debit its value to the sterling account of the Chase Bank on the books of Barclays Bank. Barclays is not concerned if that sterling account has actually been credited with sterling supplied by Paterson Silk Company. Also, James Ling, the drawer of the draft, and the Shanghai branch of the City Bank, the "endorser and bona fide holder" of the draft, are protected by the Chase Bank's promises contained in the credit instrument until such time when the draft has been accepted by Barclays, after which they are protected both by the credit instrument and by the actual acceptance of the drawee bank in London.

While the mechanics of the above described operation involves an importation of merchandise into the United States and the instrument issued is called an Import Credit, the mechanics of an Export Credit involving goods exported by us is very similar, but with the parties reversed. As a matter of fact every American Import Credit is, at the same time, an Export Credit to our foreign suppliers.

### Parties to Commercial Letters of Credit

**The Buyer.**—The buyer of the merchandise, who is also the buyer of the credit instrument, is the party who initiates the operation. His contract is with the bank which is to issue the

instrument and is represented by the Commercial Credit Agreement form which he signs, supported by the mutually made promises contained in the Agreement.

**The Seller.**—The seller of the merchandise is called the Beneficiary of the credit instrument. The instrument is addressed to him and is in his favor. It is the written contract of the bank which has created the instrument. While the bank cannot compel the beneficiary to ship and to avail himself of the benefits of the instrument, the seller may recover from the bank the value of his shipment if made within the terms of the instrument, even though he has not given the bank any direct consideration for the bank's promises contained in the instrument. By a stretch of imagination, and in order to support the instrument as a two-sided contract, supported by mutually given considerations, the courts seem to hold that the commission paid or to be paid by the buyer to the bank is also the consideration flowing from the seller to the bank.

**The Opening Bank.**—The Opening Bank, usually the buyer's bank, is the bank which actually issues the instrument. It is also known as the Issuing Bank. The selection of the opening bank is important. It should be a strong bank, well known and well regarded in international trading circles. This is the reason our smaller banks do not attempt to issue their own commercial credit instruments but take advantage of the facilities of their much larger, stronger, and better known correspondent banks in New York and in the other larger American business centers. The purposes of commercial credit may not be readily accomplished unless the opening bank is well known and well regarded.

**The Notifying Bank.**—Whenever the instrument is not delivered to the buyer and by him mailed to the beneficiary, the opening bank will advise the existence of the credit to the beneficiary through its correspondent bank operating in the same locality as the seller. Such correspondent bank becomes the Notifying Bank. The services of a notifying bank must always be utilized if the credit is to be advised to the beneficiary by cable. A cable addressed to the beneficiary by the opening bank is meaningless as it cannot be authenticated. The seller does not

have the authenticating code of the opening bank. On the other hand, the correspondent bank does have this code and gives good standing to the credit instrument by addressing an official letter to the beneficiary stating, for instance: "We have received the following message by cable, duly authenticated, from The Chase National Bank of the City of New York: [followed by the actual terms and conditions of the credit]." Moreover, in peacetime, the cable expense is much reduced by the use of special ciphers between the opening bank and its foreign correspondents. The notifying bank may not be in any way involved with the instrument. It merely acts as the agent of the opening bank in bringing the instrument to the attention of the seller.

**The Negotiating Bank.**—If the draft contemplated by the credit instrument is to be drawn on the opening bank or on another designated bank *not* in the city of the seller, any bank in the city of the seller which buys or discounts the draft of the beneficiary becomes the Negotiating Bank. As a rule, whenever the facilities of a notifying bank are used, the beneficiary is apt to offer his drafts to the notifying bank for negotiation, thus giving the notifying bank the character of a negotiating bank also. By negotiating the beneficiary's drafts, the negotiating bank becomes "an endorser and bona fide holder" of the drafts and within the protection of the credit instrument. It also is protected by the drawer's signature, as the drawer's contingent liability, as drawer, continues until discharged by the actual payment of the bills of exchange.

**The Paying Bank.**—The Paying Bank is the bank on which the drafts are to be drawn. It may be the opening bank, it may be a bank other than the opening bank and *not* in the city of the beneficiary, or it may be a bank in the city of the beneficiary, usually the advising bank. If the beneficiary is to draw and receive payment in his own currency, the notifying bank will be indicated as the paying bank also. When the draft is to be paid in this manner, the paying bank assumes no responsibility but merely pays the beneficiary and debits the payment immediately to the account which the opening bank has with it. If the opening bank maintains no account with the paying bank, the paying

bank reimburses itself by drawing a bill of exchange on the opening bank, in dollars, for the equivalent of the local currency paid to the beneficiary, at its buying rate for dollar exchange. The beneficiary is entirely out of the transaction because his draft is completely discharged by payment, and the credit arrangements between the paying bank and the opening bank do not concern him.

**The Confirming Bank.**—Whenever the beneficiary stipulates that the obligation of the opening bank shall also be made the obligation of a bank local to himself, we have what is known as a confirmed commercial credit and the bank local to the beneficiary becomes the Confirming Bank. In view of the fact that commercial credits issued by American banks in favor of foreign sellers are invariably issued only by our larger well known banks, no seller requests that they be confirmed by another bank. The standing of the American opening bank is good enough. But many foreign banks are not particularly strong or well known, compared with our own banks issuing these credit instruments. Indeed, many banks operating abroad are only known through the Bankers' Almanac. They serve a useful purpose in their own small communities and perhaps maintain dollar accounts with the larger American banks. But their names are quite meaningless to the American exporter, and when the foreign buyer offers to his American seller a credit instrument issued by such a bank, the seller may not receive the protection and other facilities which an instrument issued by a large, strong, and well known bank will give him. To overcome this, he requests that the credit as issued by the local bank of the foreign buyer be confirmed by a well known American bank, which will turn out to be an American bank with which the local bank of the buyer carries a dollar account. The liability of the confirming bank is a primary one and is not contingent in any sense of the word. It is as if the credit were issued by the opening and confirming banks jointly, thus giving the beneficiary or a holder for value of drafts drawn under the credit, the right to proceed against either or both banks, the moment the credit instrument has been breached. The confirming bank receives a commission for its confirmation from the opening bank which

the opening bank, in turn, passes on to the buyer of the merchandise.

### The Purposes of Commercial Credits

There are, as we shall see, several forms or types of commercial credits, each form being especially suited for the purpose to be accomplished. We can at this stage, however, point out the various purposes which commercial credits generally accomplish.

As to the seller, credit risks are eliminated for all practical purposes. He receives the assurance of the opening bank and, in the case of confirmed credits, also of the confirming bank, that the seller's drafts will be duly honored. He can manufacture the goods ordered with the assurance that the order will not be canceled before shipment. This is especially important if the goods are of a special type or are to bear the marks or labels of the buyer. A lawsuit against a buyer in some foreign countries for breach of contract may be worthless if the suit must be prosecuted in the courts of the buyer. The chances of recovery are much brighter if the seller can sue the buyer's bank (which has opened a commercial credit) in our courts by attaching the assets which the bank may have in the United States, or by suing the confirming American bank. To be sure, if it is credit security which the seller wants, he will not accept the commercial credits of any and all opening banks but will insist that the credits be confirmed by American banks. Next to cash with order, the confirmed commercial credit gives the seller the best form of credit security.

Oftentimes, however, especially in a sellers' market, the credit standing of the buyer is vastly better than the credit standing of the seller. The seller may have goods but may not be able to obtain credit facilities, secured or otherwise, either from his own or from any other bank. He may not be able to induce any bank to buy or to discount his documentary bills of exchange on his foreign buyers even though the credit standing of the drawees (the foreign buyers) is excellent. The commercial credit does enable him to finance his foreign sales and to receive the price of the merchandise sold, while the goods are in transit from the seller to the buyer. Indeed, many small sellers could not carry

on were they obliged to tie up their small capital in foreign shipments, the payments for which may not reach them for sixty days or more from the dates of shipment. Moreover, even should the seller enjoy the advantages of a line of credit at his own bank for the discounting of his drafts drawn on his foreign buyers, commercial credits established in his favor are of value to him also. Such shipments, which are financed under commercial credits, are not charged against his line of credit and he may use the entire line for the financing of his foreign sales not covered by commercial credits. This is important if the line of credit is not large enough for the full requirements of the seller.

We say, therefore, that commercial credits give the seller first, credit security and second, enable the seller to finance his foreign sales while the goods are in transit to the buyer without seeking credit facilities from his own bank. The seller will require the form of commercial credit which accomplishes for him the particular purpose which he has in mind. If a seller is looking solely for credit security he will insist upon a credit instrument which is confirmed by a good American bank. If he is quite satisfied with the credit standing of the buyer and requires a credit instrument for the sole purpose of husbanding his limited capital, any form of commercial credit which will enable him to negotiate his draft or to receive payment against the delivery of the shipping documents to a designated bank, will be entirely satisfactory to him. The form of the credit instrument should always be determined by the purpose or purposes which are to be accomplished.

As to the buyer, credit facilities are extended to him by his bank in the form of commercial credits, which facilities the bank may not be willing to extend to him on other bases. Whenever a bank opens a commercial credit for account of a buyer, the buyer, by means of the commercial credit agreement which he signs, pledges the merchandise involved to the opening bank, to be held by the bank until the bank has been paid by the buyer or until the bank is quite willing to release the merchandise on some other basis entirely satisfactory to the bank. The credit facility extended to the buyer by means of the commercial credit becomes in the nature of a self-liquidating secured loan. The

merchandise has value and if the opening bank is not entirely satisfied with the standing of the buyer, plus the collateral value of the merchandise, it can demand a marginal deposit from the buyer before opening the credit. This deposit, plus the forced-sale value of the merchandise, will usually eliminate the credit risk which the bank takes in opening the credit.

In more normal competitive times, commercial credits allow a buyer to obtain the necessary financing in the market which permits the financing at the lowest cost. We must always remember that the expenses incident to the financing of a shipment are always charged to the buyer. He either pays these expenses as separate items or the expenses are included in the cost of the merchandise. It follows, therefore, that any reduction in such expenses reduces the cost of the merchandise to the buyer, thus enabling him to make a larger margin of profit or better to meet competition. Whenever the buyer wishes to have some time before he is called upon to reimburse the bank opening the commercial credit, the instrument will provide that the seller draw time drafts, usually at 90 days sight, on the opening bank or on another bank designated in the credit instrument. These time drafts are to be accepted by the drawee banks, and, upon acceptance, become bankers' acceptances, eligible for discount in the open discount markets.

As the buyer pays this discount, either as a separate item or in the price for the merchandise, it follows that his interests will be best served were the acceptances created and discounted in the market offering the lowest discount rate. For instance, if the rate for discounting bankers' 90 days sight acceptances in New York is  $\frac{3}{8}\%$ , and the rate for similar paper in London is  $\frac{1}{4}\%$ , it follows that it will be decidedly in favor of the buyer to have the credit instrument call for the drawing of 90 days sight drafts, in sterling, on a London bank, so that the drafts can be accepted and discounted in the London market. Such operations involve foreign exchange risks which must be considered and covered. The average buyer seldom considers this purpose of commercial credit operations except in a highly competitive market, wherein every cent in the net cost price counts, and unless the buyer and his employees know enough about the

intricacies of foreign exchange to enable them to make a proper decision.

And so, it is said that commercial credits give the buyer an opportunity to secure credit facilities from his bank which he may not otherwise be able to obtain, by pledging the goods involved to the bank as collateral security for the accommodation, and also give the buyer the privilege of borrowing the required funds in the cheapest market.

In closing these comments as to the purposes served by commercial credits, it may be well to point out that the advantages obtained by the seller far outweigh the advantages obtained by the buyer. The buyer seldom offers to have commercial credits opened in favor of the seller unless the seller demands them or unless the buyer wishes to use the facility as a trading point to obtain better prices. In a tight merchandise (sellers') market, the seller will dictate the terms. If he has in mind the elimination of the credit risk, he will insist upon the opening of a particular form of commercial credit which adequately does that. If he is quite satisfied with the standing of the buyer but cannot obtain credit facilities from his local banks, which prefer not to buy or discount the seller's drafts on the buyer, he will accept any form of commercial credit which will enable him to obtain such facilities from his local banks. No doubt, the primary purpose of commercial credit financing is to give the seller the greatest possible degree of credit security. The other advantages mentioned above and applying both to the seller and to the buyer have their places in this form of financing, but, generally speaking, are not controlling factors.

### Forms of Commercial Credits

**Export Operations.**—Although the New York Bankers' Commercial Credit Conference, held in 1920, adopted certain standard forms for commercial credits, the wording of the forms now used by American banks varies considerably, due to the influences of their respective lawyers. Each law office recommends a form which, in its own opinion, makes for more clarity and eliminates unnecessary and possibly ambiguous words. Our endeavors to clarify commercial credits, however,

will be served well enough by the use of the forms as adopted and recommended by the Conference, because the real substance of the forms now in use by the different banks is the same as the real substance of the Conference forms. For the purpose of comparison, each Conference form is followed by the corresponding form as currently used by one of the leading New York banks.

**The Advice of Authority to Pay (Conference Form A).—**

This form is intended to represent a revocable commercial credit opened by the foreign buyer's bank in favor of the American seller. The Conference and banks hesitate to call it a revocable credit simply because a revocable credit is to remain in full force and effect until the advice of revocation has been actually served on the beneficiary, while the Authority to Pay may be revoked without prior notice to the beneficiary. But this difference seems to be well taken care of by the sentence in the Conference form reading: "The authority given to us is subject to revocation or modification at any time without notice to you." Moreover, the Conference did not adopt a special form for revocable credits and the natural presumption is that the Authority to Pay form is to be utilized as the instrument for revocable credits.

In a credit instrument of this type—the Authority to Pay—the beneficiary obtains no credit security whatsoever. The facility may be withdrawn at any time without prior notice to him. He could never maintain a lawsuit successfully against the opening bank for its refusal to pay. The bank would simply introduce into evidence the instrument itself with its damaging provision that it may be revoked or modified at any time without notice to the beneficiary. Obviously, such an instrument should not be accepted by the beneficiary if he is seeking credit security over and above the security available to him by the contract of sale between him and the buyer of the merchandise. He may sue the buyer for breach of contract but he cannot sue the opening bank if, when he presents the shipping documents to the designated American bank, he is told that payment will not be made because the opening bank has elected to revoke the instrument. But the Authority, if not revoked, will enable the beneficiary to be paid as soon as the shipment has been made. He will not be

**ADVICE OF AUTHORITY TO PAY**

Advice No. \_\_\_\_\_

\_\_\_\_\_, 19\_\_\_\_  
(City)

Dear Sir: \_\_\_\_\_

We advise you that \_\_\_\_\_ Bank  
(Correspondent Bank)  
have authorized us to honor your drafts for account of \_\_\_\_\_  
\_\_\_\_\_ for a sum or sums not exceeding a total of  
\_\_\_\_\_ (figures) \_\_\_\_\_ (words)  
on us at \_\_\_\_\_  
to be accompanied by \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

evidencing shipment of:

\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_ insurance to be effected by \_\_\_\_\_

All drafts so drawn must be marked:

"Drawn as per \_\_\_\_\_ Bank's  
(Advising Bank)  
Advice No. \_\_\_\_\_ dated \_\_\_\_\_ 19\_\_\_\_"

Drafts so drawn, with documents as specified must be presented at our office not later than \_\_\_\_\_ 19\_\_\_\_.

The authority given to us is subject to revocation or modification at any time without notice to you.

Each of the provisions on the back hereof, except so far as otherwise expressly stated, is incorporated as a part of this advice. (See provisions on page 315.)

This advice conveys no engagement on our part or on the part of \_\_\_\_\_ Bank and is simply for your guidance in preparing  
(Correspondent Bank)  
and presenting drafts and documents.

Yours very truly,  
\_\_\_\_\_

**IRVING TRUST COMPANY**ONE WALL STREET  
NEW YORK**REVOCABLE**

Advice No.

Dated New York  
Expiring in New York  
Amount

We are informed by

that you will draw on us at  
for account of  
to the extent of

The following documents (complete sets unless otherwise stated) must accompany your drafts:

Bills of Lading issued to order and endorsed in blank

Invoice

Insurance Certificates/Policies issued by Insurance Companies covering

evidencing shipment of

SPECIMEN

Drafts must clearly specify the number of this advice, and be presented at this Company on or before

This advice, which is revocable at any time without notice, is for your guidance only in preparing documents and conveys no engagement or obligation on our part or on the part of

Unless otherwise expressly stated, this advice is subject to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Seventh Congress of the International Chamber of Commerce and certain guiding provisions.

Any amendment of the terms of the advice must be in writing over an authorized signature of this Company.

Very truly yours

IRVING TRUST COMPANY

By

If you are unable to comply with the terms of the advice, please communicate with us and/or your customer promptly with a view to having the conditions changed.n 45976

required to ask his bank to extend him credit by offering to it a bill of exchange for discount. Indeed, his bank may not be willing to extend him credit in any form. He is not much worried about the fact that the instrument may be revoked without notice to him because he may be operating in a sellers' market when goods are scarce and buyers find it difficult to keep their shelves full.

On the other hand, the probability of revocation is great when, with an abundance of goods, it becomes a buyer's market and prices begin to fall. Under such conditions the buyer may ignore his contract with the seller and purchase the same line of goods from another seller at lower prices. The big danger with these Authorities to Pay is that the average seller either does not read the instruments or does not understand plain English, and places too much confidence in the names of the banks appearing in them and the fine paper on which the forms are printed. Indeed, many sellers erroneously regard the Authority to Pay as irrevocable credits.

We have already intimated that no liability attaches to the opening bank, because it may revoke the instrument the moment the standing of the buyer, its client, becomes worse and providing the seller has not been paid in the meantime. If the payment has been made, the seller is out of the transaction and, of course, it is too late to revoke. The notifying and paying American bank assumes no liability to the seller. It states in the instrument that the opening bank has requested it to make the payment. The revocable promise to pay is made by the opening bank and not by the advising and paying bank and in order to make the positions of the two banks absolutely clear, the last paragraph of the conference form reads: "This advice conveys no engagement on our part or on the part of—(opening bank)—and is simply for your guidance in preparing and presenting drafts and documents." If the instrument has not been revoked and payment has been made to the seller, the paying American bank simply debits the dollar account of the opening bank on its books.

But suppose the account of the opening bank is not in sufficient funds or, perhaps, is overdrawn? This is a risk which the

paying bank takes and should it wish to avoid this risk and not create an overdraft in the account or increase an existing overdraft, it may segregate the required funds from the account of the opening bank when advising the Authority to the seller. The fact remains, moreover, that the American bank can always decline to pay until the opening bank has provided the required funds.

Authorities to Pay are often established by foreign buyers without the intervention of an opening bank. These buyers, themselves, carry dollar accounts with American banks and they simply instruct these banks to pay their American suppliers against shipping documents. The American banks usually segregate the required funds from the accounts of the foreign buyers so that they may not be embarrassed when the sellers present the documents and demand payment. These banks are less inclined to permit their commercial clients, as distinguished from their bank clients, to overdraw their accounts. After all, the revocable promise to pay upon the part of a commercial house is just as good as the revocable promise to pay upon the part of the best bank, especially when the bank's promise is made by order and for account of the same commercial house.

**Correspondent's Irrevocable Commercial Credit (Conference Form C).**—While the Authority to Pay (the foreign bank's revocable commercial credit) always provides that the beneficiary is to draw sight drafts in his own currency on the designated paying bank in America, the correspondent's irrevocable commercial credit may call for the drawing of sight or time drafts, in the currency of the American seller or in the currency of the foreign buyer, and drawn either on the advising American bank, or on the foreign opening bank, or on another foreign bank designated in the credit as the drawee-paying bank. It will be easier to understand the purposes of this type of credit and the functions and responsibilities of the parties to the instrument, by first considering the simplest form of the correspondent's irrevocable commercial credit as illustrated by Conference Form C on page 304. Under this form, the beneficiary's drafts may be drawn on the advising American bank

**CORRESPONDENT'S IRREVOCABLE CREDIT**

Advice No. \_\_\_\_\_

\_\_\_\_\_, 19\_\_\_\_

(City)

Dear Sir: \_\_\_\_\_

We are instructed by \_\_\_\_\_ Bank  
(Correspondent Bank)  
to advise you that they have opened their irrevocable credit in your  
favor for account of \_\_\_\_\_ for a sum or  
sums not exceeding a total of \_\_\_\_\_ (figures) \_\_\_\_\_  
\_\_\_\_\_ (words) available by your drafts on us at \_\_\_\_\_  
to be accompanied by \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

evidencing shipment of \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

\_\_\_\_\_ insurance to be effected by \_\_\_\_\_

All drafts drawn must be marked:

"Drawn as per \_\_\_\_\_ Bank's  
(Advising Bank)

Advice No. \_\_\_\_\_ dated \_\_\_\_\_ 19\_\_\_\_"

Each of the provisions on the back hereof, except so far as otherwise  
expressly stated, is incorporated as part of this advice.

\_\_\_\_\_ Bank engages with you that all drafts  
(Correspondent Bank)  
drawn under and in compliance with the terms of this advice will be  
duly honored on delivery of documents as specified if presented at this  
office on or before \_\_\_\_\_ 19\_\_\_\_.

This letter is solely an advice of credit opened by \_\_\_\_\_  
\_\_\_\_\_ Bank and conveys no engagement by us.  
(Correspondent Bank)

Yours very truly,  
\_\_\_\_\_

**IRVING TRUST COMPANY**ONE WALL STREET  
NEW YORK 15, N.Y.

ADVISE NO.

*Dated New York*

Gentlemen:

We are informed by

that they have issued their Irrevocable Credit No.  
to the extent of

in your favor

for account of

available by your drafts on us at  
bearing the number of this advice, accompanied by the following documents (complete sets  
unless otherwise stated):

SPECIMEN

Evidencing shipment of

Drafts must clearly specify the number of this advice, and be presented at this Company on or  
beforeUnless otherwise expressly stated, this advice is subject to the Uniform Customs and Practice for  
Commercial Documentary Credits fixed by the Seventh Congress of the International Chamber  
of Commerce and certain guiding provisions. Any amendment of the terms of this advice must  
be in writing over an authorized signature of this Company.This letter is to be considered only as an advice of credit established by our correspondent indicated  
above, and conveys no engagement or obligation on our part.**NOTE***Documents must conform strictly with the  
terms of this Credit. If you are unable to  
comply with its terms, please communicate  
with us and/or your customer promptly with  
a view to having the conditions changed.*

Very truly yours

IRVING TRUST COMPANY

By

either at sight or as time drafts. If drawn at sight, the advising-paying bank merely pays the beneficiary's sight draft and debits the payment to the correspondent's dollar account on its books. If drawn at a long usance—at 30, 60, or 90 days sight—the advising-drawee bank accepts the draft, and pays it at maturity, and again debits the payment to the dollar account of the correspondent bank on its books.

A credit instrument of this type is irrevocable; it cannot be canceled by the opening bank without the consent of the beneficiary. This irrevocable feature does give the seller credit security. The seller can manufacture the goods and ship them with the assurance that he will be paid or will receive a banker's acceptance as soon as he submits the required documents to the paying or accepting bank. But the protection afforded him by the instrument is only as good as the opening bank, which may be an internationally known bank or a small foreign bank with very limited assets in the United States. To sue the opening bank in a foreign country is not a cheerful outlook, but if the foreign opening bank has an agency in the United States or adequate dollar deposits with American banks, the lawsuit may be commenced and prosecuted in our own courts by attaching the American assets of the foreign opening bank.

Assuming the beneficiary is quite satisfied with the standing of the opening bank, he acquires by this type of credit instrument both credit security and the ability to finance the shipment during its transit to the buyer. If the beneficiary is to draw at sight on a bank local to himself, he receives payment as soon as the shipment has been made. If he is to draw time drafts on a distant bank, a bank local to himself will be quite willing to negotiate such drafts irrespective of the financial standing of the beneficiary. The negotiating bank will depend upon the promise of the opening bank that the drafts drawn within the terms of the instrument will be duly honored.

When we speak of an American bank local to the beneficiary, we do not have in mind that the bank must be operating necessarily in the same city in which the beneficiary has his business but rather that the facilities of such bank must be readily available to the beneficiary. The manufacturer in Dayton, Ohio,

maintains bank accounts not only in Dayton but also with banks in Chicago and in New York. He is close to and a client of all these banks. If he has an account with Bank A of New York and that bank is also the notifying-paying bank under a commercial credit in his favor, he sends the required documents to Bank A and requests that the payment be made and be credited to his account with Bank A. Should Bank A be the New York depository of the manufacturer and Bank B of New York be the notifying-paying bank, he may forward the documents to Bank A with the request to collect from Bank B, and credit the dollars to the manufacturer's account with Bank A. Indeed, even in the event the manufacturer has no relations with a bank in New York, the notifying-paying Bank B of New York will be local to him for all practical purposes. Instead of presenting the documents to Bank B by a messenger, the presentation may be made by mail or through the facilities of his bank in Dayton. Air mail has accomplished wonders in such operations.

The correspondent's irrevocable commercial credit represents the obligation of the opening bank (the correspondent) only, and the advising American bank definitely disclaims all liability by the use of the words: "This letter . . . conveys no engagement by us." When, however, an American bank acts as the advising-paying bank of a commercial credit opened by its foreign correspondent, it serves notice on the beneficiary that the required funds are or will be made available by it for account of its correspondent.

Except in the case of a correspondent bank which is quite important and constantly keeps large dollar balances with the advising-paying American bank, the American bank usually segregates the required funds from the account of the correspondent at the time when the correspondent's credit is advised to the beneficiary. The advising bank dislikes refusing payment on the sole ground that the opening bank does not have available with it the required funds at the moment when the beneficiary wishes to receive payment. Such action may place the American bank in a bad light with the beneficiary. On the other hand, should the correspondent bank fail between the time when the credit has been advised to the beneficiary and the time when the

beneficiary submits the required documents and demands payment, the advising-paying bank need not pay if the segregated funds are required by itself as an offset to any indebtedness of the failed correspondent to the advising-paying bank. The segregation is not made for the protection of the beneficiary but for the purpose of avoiding a situation somewhat embarrassing to the advising-paying bank.

While the beneficiary's draft drawn under this type of credit instrument is usually drawn at sight, at times the instrument will call for the drawing of time drafts, also in United States dollars. This does not change the procedure nor the rights and liabilities of the parties except that when the designated American drawee bank has accepted the beneficiary's long draft it must pay the acceptance at maturity, irrespective of the financial position of the foreign correspondent bank on the maturity date. If funds have been segregated, these funds may be utilized for the payment at maturity. If funds have not been segregated, the accepting American bank must pay, nevertheless, and look to the correspondent bank or to its receiver for reimbursement. No bank would dare to dishonor its own acceptance, even though it may experience difficulty in obtaining reimbursement from the correspondent for whose account the acceptance was made.

When the beneficiary's time draft is accepted, the acceptance is returned to him and he may either hold it until maturity or discount it in the open market. The long draft and the required documents are submitted to the drawee bank by the beneficiary direct or through a bank located in his own city. At the maturity of the acceptance, the drawee bank pays it and debits its value to the correspondent's account on its books. If the required funds have been previously segregated from the correspondent's account, these segregated funds are used for the payment of the acceptance.

Whenever time drafts are drawn under commercial credits of this type it is well to bear in mind that the buyer of the merchandise may not be required to place the correspondent opening bank in funds until the acceptances mature. This means that, through the intervention of his own bank (the opening bank) and of the American bank (the advising-accepting-paying bank)

he has borrowed the funds represented by the acceptance in the American discount markets at very attractive rates. The American seller receives payment as soon as the shipment has been made, since he is in a position to discount the acceptance. The discount which he pays has been taken into account when he fixed his selling prices for the merchandise, or may be charged to the buyer of the merchandise as a separate item of expense.

**Straight and Negotiation Credits.**—The correspondent's irrevocable credit, which we have discussed up to this point, is also known as a "straight" credit as distinguished from a "negotiation" credit. Under the straight credit, the beneficiary is paid by a bank local to him and designated by the opening bank. The drafts are usually drawn in the currency of the American seller. The designated paying bank, immediately upon paying the beneficiary, debits the payment to the dollar account of the opening bank on the books of the paying bank. Oftentimes, however, the instrument may provide that the beneficiary is to draw his drafts in a foreign currency and either on the opening foreign bank or on another designated foreign bank. The beneficiary may then sell his drafts so drawn either to the American advising bank or to any other American bank which is willing to buy the drafts as so much foreign exchange. The purchasing banks rely upon the credit security afforded them by the commercial credit of the opening bank. Such an instrument is known as a negotiation credit because the beneficiary negotiates (sells) his foreign currency drafts drawn under the credit to the American bank offering him the best rate.

Form C, with the necessary slight variations, is used to advise negotiation credits as well as straight credits. The name of the foreign bank on which the beneficiary is to draw is indicated in the instrument, and if it be a bank other than the opening bank the original shipping documents are mailed to the opening bank either by the beneficiary or by the American negotiating bank. The duplicate shipping documents are attached to the beneficiary's draft so that the foreign drawee bank may know that the beneficiary has properly complied with the conditions of the credit. This procedure will be clearly indicated in the credit instrument.

A credit of this character—negotiation credit—imposes upon the advising American bank no liability whatsoever. The American bank does not pay. It does not accept the drafts. It acts merely as a transmitting agent in communicating to the beneficiary the establishment of the credit by the opening bank in favor of the beneficiary. Indeed, the services of an advising bank could be dispensed with altogether if time would permit the delivery of the instrument by the opening bank to the buyer and its mailing by the buyer to the seller. Most of the time, however, these credits are opened by cable and the cable is relayed through the American correspondent of the foreign opening bank so that it may be properly authenticated. The advising bank may wish to negotiate the beneficiary's drafts, and if it does negotiate such drafts its position will be exactly the same as that of any other bank which, relying upon the representations of the opening bank contained in the credit instrument, elects to purchase the drafts drawn under the instrument.

The drawee bank may be the foreign opening bank or another foreign bank designated in the instrument. But the drawee bank thus designated and other than the opening bank assumes no liability either to the beneficiary or to anyone else who may choose to buy the beneficiary's draft. If the draft is a long item, say drawn at 90 days sight, the drawee bank becomes primarily liable for the payment of the draft, providing the drawee bank has accepted it. But there is no promise upon the part of the drawee bank to accept and it is only the opening bank which "engages" that the drafts drawn under and in compliance with the terms of the credit will be duly honored by payment or by acceptance and subsequent payment, as the case may be.

While the drawer of a bill of exchange remains liable on the bill which he has created until this liability is discharged by payment, the American bank which may purchase the drawer's draft drawn under this type of credit is induced to buy almost entirely by the opening bank's assertion that the drawer's draft will be honored. We shall discuss the drawer's liability to the purchaser of the draft later. The greater the standing of the opening bank the more readily can the drawer's drafts be negotiated. Again, the credit is good or worthless, depending entirely upon

the standing of the opening bank and the faith which the mercantile world has in that bank.

**Correspondent's Confirmed Irrevocable Credit (Conference Form D).**—Whenever a seller requires a commercial credit for the purpose of obtaining better protection of the credit risk than is afforded by the buyer's promise to pay, the standing of the opening bank assumes an even larger importance. The opening bank may be the best bank of the buyer's country and quite good for the amount involved by the credit instrument. Nevertheless, the credit instrument may not give the seller the absolute credit protection which he desires. Suppose, for some reason or other, the American bank designated in the credit as the accepting and/or paying bank does not pay when the beneficiary submits the required documents. He cannot sue the American bank because it distinctly disclaimed all liability when advising the credit instrument to the beneficiary. His cause of action lies against the foreign opening bank. Can he sue the opening bank in our courts? Yes, but only if the opening bank has assets in America and the beneficiary knows where such assets are located. He can, of course, sue the opening bank in the courts of the country in which the opening bank operates but that is a gamble at best and may increase his losses instead of giving him full recovery. And so, the irrevocable commercial credit of a foreign bank, especially of a small foreign bank, may not give the seller the credit security and the peace of mind which he desires.

Under such circumstances the seller may require that the irrevocable commercial credit of the buyer's bank be confirmed by a good American bank. If the reader will now examine the last sentence in Conference Form D, he discovers that the American advising bank says: "We confirm the credit and thereby undertake that drafts drawn and presented as above specified will be duly honored by us." This sentence really tells us the meaning of confirmation. Whenever a bank other than the opening bank undertakes that drafts drawn and presented within the terms and conditions of a commercial credit will be duly honored, we say that such other bank has confirmed the credit instrument of the opening bank. The wording of the confirmation clause is well chosen. The undertaking of the confirming bank is abso-

**CORRESPONDENT'S  
CONFIRMED IRREVOCABLE CREDIT**

\_\_\_\_\_, 19\_\_\_\_

Dear Sir: \_\_\_\_\_

We are instructed by \_\_\_\_\_ Bank to  
(Correspondent Bank)  
advise you that they have opened their irrevocable credit in your favor  
for account of \_\_\_\_\_ for a sum or sums  
not exceeding a total of \_\_\_\_\_ (figures) \_\_\_\_\_ (words)  
available by your drafts on us at \_\_\_\_\_ to be  
accompanied by \_\_\_\_\_

\_\_\_\_\_ evidencing shipment of \_\_\_\_\_

\_\_\_\_\_ insurance to be effected by \_\_\_\_\_

All drafts drawn under the credit must be marked:

"Drawn under \_\_\_\_\_ Bank's  
(Advising Bank)  
Credit No. \_\_\_\_\_ dated \_\_\_\_\_ 19\_\_\_\_"

Each of the provisions on the back hereof, except so far as expressly stated, is incorporated as part of this credit.

\_\_\_\_\_ Bank engages with you that all drafts  
(Correspondent Bank)  
drawn under and in compliance with the terms of this credit will be duly honored on delivery of documents as specified, if presented at this office on or before \_\_\_\_\_ 19\_\_\_\_; we confirm the credit and thereby undertake that all drafts drawn and presented as above specified will be duly honored by us.

Very truly yours,

\_\_\_\_\_

**IRVING TRUST COMPANY**ONE WALL STREET  
NEW YORK 15, N. Y.**Confirmed Irrevocable Credit No.****Dated New York****Gentlemen:****We are informed by**that they have issued their Irrevocable Credit No. \_\_\_\_\_ in your favor  
to the extent of \_\_\_\_\_for account of \_\_\_\_\_  
available by your drafts on us at \_\_\_\_\_  
bearing the number of this credit, accompanied by the following documents (complete sets unless otherwise stated)

SPECIMEN

**Evidencing shipment of**

Drafts must clearly specify the number of this credit, and be presented at this Company on or before \_\_\_\_\_

Unless otherwise expressly stated, this credit is subject to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Seventh Congress of the International Chamber of Commerce and certain guiding provisions. Any amendment of the terms of this credit must be in writing over an authorized signature of this Company.

The above mentioned correspondent engages with you that all drafts drawn in conformity with the conditions of this credit will be duly honored. At the request of our correspondent we confirm their credit and also engage with you that drafts drawn in conformity with the conditions of this credit will be duly honored.

**NOTE***Documents must conform strictly with the terms of this Credit. If you are unable to comply with its terms, please communicate with us and/or your customer promptly with a view to having the conditions changed.*

Very truly yours

IRVING TRUST COMPANY

By \_\_\_\_\_

lute and is not contingent upon the default of the opening bank. We now have two banks instead of one—the opening bank and the confirming bank—which assure the seller that he will be paid. In case of necessity, the seller may sue either the opening bank, or the confirming bank, or both. By confirming the credit instrument, the American bank makes the irrevocable credit of the foreign opening bank its own irrevocable credit also, and both banks, jointly or severally, become liable to the seller and to those who may have given value to the seller's drafts drawn under the credit instrument.

As the confirming bank becomes liable with the opening bank exactly in the same manner and to the same extent as the opening bank, it follows that the confirmation will not be supplied unless the confirming bank has full confidence in the opening bank or unless it segregates the required funds from the account of the opening bank when the credit, bearing the confirmation, is advised to the beneficiary. The credit risk of the confirming bank is, therefore, relatively small, although it receives a commission, usually of  $\frac{1}{8}\%$ , from the opening bank for its confirmation. Moreover, any and all expenses which the confirming bank may incur in defending a suit brought against it by the beneficiary or by another interested party, are chargeable to the opening bank which requested the American bank to confirm and, at the same time, agreed to indemnify the American bank against loss and damage.

Needless to say, the irrevocable credit instrument of the buyer's bank, confirmed by the American correspondent of the opening bank, is the best form of commercial credit an American exporter can obtain and it gives him every protection and facility which he requires.

As the confirmation is added to the correspondent's irrevocable credit, it follows that the confirmed credit may again be in straight or negotiation form. Forms 20 and 21, pages 312, 313, portray the straight confirmed credit. It may be written up as a negotiation credit by observing the changes and details discussed in connection with the correspondent's irrevocable credit under the heading of "Straight and Negotiation Credits" on page 309.

The Authority to Pay and any and all other forms of revocable credits are never confirmed because the confirmation would be meaningless.

**Regulations Affecting Export Commercial Credits.**—In order to assist the beneficiary properly to prepare the documents required by the credit instrument and at the same time clarify many points which may arise in the mind of the beneficiary, the New York Bankers' Commercial Credit Conference of 1920 adopted certain regulations, amended to March 15, 1934, which are generally printed on the back of the letter of credit advices addressed to the beneficiary. Reference may be made to these regulations in the body of the advice—the credit instrument—and each item of the regulations, except in so far as otherwise expressly stated, is to be regarded as a part of the credit. These regulations read as follows:

(a) FORWARDERS' BILLS OF LADING and BILLS OF LADING FOR SHIPMENT BY SAILING VESSELS will not be accepted unless specifically authorized.

RAILROAD THROUGH BILLS OF LADING will not be accepted, unless expressly stipulated, except on exportations, via Pacific ports, to the Far East.

Bills of Lading stipulating that they have been issued under the terms of and subject to the conditions of a "CHARTER PARTY" will not be accepted unless expressly stipulated in the credit.

(b) BILLS OF LADING INDICATING TRANSSHIPMENT will be accepted unless direct shipment is specified.

(c) Bills of Lading shall contain no notations qualifying the acceptance of merchandise in apparent good order and condition.

(d) When "OCEAN" bills of lading are required, unless otherwise stipulated, we will accept "RECEIVED FOR SHIPMENT" or "ALONGSIDE" or "PORT" or "CUSTODY" Bills of Lading. "On Board" Bills of Lading will not be demanded unless expressly required even though the credit mentions the name of a steamer.

(e) The date of the Bill of Lading in each case will be taken to be the date of shipment. When "ON BOARD" shipment is required and such shipment is represented by an "On Board" Bill of Lading, the Bill of Lading date will be taken as the date when such shipment was effected; if evidenced by "On Board" endorsement, the endorsement date will be so taken.

Unless evidence of actual departure of carrier of merchandise is specifically required "LOADING", "DISPATCH", "DEPARTURE" shall be interpreted in the same manner as the term "SHIPMENT".

(f) Documents for partial shipments may be accepted unless expressly prohibited. Even though the credit mentions the name of a steamer, a partial shipment or shipments by that steamer may be accepted.

(g) If shipment in instalments within stated periods is specified, each instalment will be treated as a separate transaction, and if there is a failure to ship in any designated period, shipments of subsequent instalments, made in their respective designated periods, may be drawn against.

(h) The use of "TO", "UNTIL", "ON", and words of similar import, in indicating expiration, is interpreted to include the date mentioned.

(i) Any extension of the date of shipment shall extend for an equal length of time the date for presentation or negotiation of draft and documents. However, any extension of a date for presentation or negotiation of draft and documents shall not be considered as extending the date of shipment.

(j) When the indicated expiration date for presentation or negotiation falls upon a Sunday or legal holiday, the expiration is extended to the next succeeding business day. (This rule, however, does not apply to date of shipment.)

(k) We reserve the right to refuse to take up documents if, in our opinion, they are not presented within reasonable time after date of shipment.

(l) The terms "PROMPT SHIPMENT", "IMMEDIATE SHIPMENT", "SHIPMENT AS SOON AS POSSIBLE", and words of similar import, shall be interpreted, if the credit advice contains no specific conditions to the contrary, as requiring shipment to be effected within 30 days from the date of notification to the beneficiary.

(m) The term "FIRST HALF", "SECOND HALF", of a month shall be construed as from the 1st to the 15th, and the 16th to the last day of each month inclusive, respectively.

(n) The terms "BEGINNING", "MIDDLE" or "END" of month, or words of similar import, shall be construed respectively as from the 1st to the 10th, the 11th to the 20th and the 21st to the last day of each month, each inclusive. When a credit bears "good for one month", "good for six months", etc., or a similar time limit and the date from which the term is to run is not specified, the term shall be calculated from the date of notification to the beneficiary.

(o) Our credit advice, if without expressed duration, shall not continue in force longer than six months from its date.

(p) The terms "APPROXIMATELY", "ABOUT", or words of similar import, shall be construed to permit a variation of not to exceed ten per centum.

When the merchandise, by its nature, does not allow the delivery of the exact quantity indicated, as, for instance, metal bars, oil in barrels, etc., a leeway of 3% more or less will be allowed, even if the terms of the credit call for a fixed weight or measurement.

(q) The term "INSURANCE" shall be construed as either policy of insurance or underwriters' certificate of insurance. Brokers' Cover Notes will not be accepted unless specifically stipulated.

(r) Definitions of Export Quotations will be those adopted by the National Foreign Trade Council, Chamber of Commerce of the U.S.A., National Association of Manufacturers, American Manufacturers' Export Association, Philadelphia Commercial Museum, American Exporters' and Importers' Association, Chamber of Commerce of the State of New York, New York Produce Exchange and New York Merchants' Association, at a conference held in India House, New York, on December 16, 1919.

As these regulations apply to export credits only, opened by the foreign buyers' banks, it is only natural that there be an understanding of these regulations between the foreign opening banks and the American advising banks which are required to determine the adequacy of the documents presented by the beneficiaries. And so, the interested American banks in New York, and in the other large American cities, prepared and forwarded to their correspondent banks a circular letter on this subject which reads as follows:

#### *TO OUR CORRESPONDENTS:*

Export Commercial Credits are treated in conformity with the following regulations:

1. We assume no liability or responsibility for the form, sufficiency, correctness, validity, genuineness or legal effect of any documents or papers, or for the existence, description, quantity, weight, quality, condition, packing, delivery or value of the merchandise represented thereby, or for the general or particular conditions stipulated in the documents, or for the good faith or acts of the shipper or any other person whomsoever, or for the solvency, standing, etc., of the carriers

or insurers of the merchandise; but documents and papers will be examined with care sufficient to ascertain that on their face they appear to be regular in general form.

2. We assume no liability or responsibility for consequences arising out of delay or loss in transit of telegrams, cables, letters and/or documents, or for delay, loss or mutilation or other errors in the transmission of telegrams or cables, or for errors of translation or interpretation of technical terms, and we reserve the right to transmit credit terms without translating them.

3. We assume no liability or responsibility for consequences arising out of the interruption of our business either by a decision of a public authority, or by strikes, lockouts, riots, wars, Acts of God or other causes beyond our control. On credits expiring during such interruption of business, we will be able to make no settlement after expiration, except on specific instructions from our principals.

4. We will interpret the terms "DOCUMENTS", "SHIPPING DOCUMENTS" or words of similar import, as comprehending only full set of ocean bills of lading (motor-vessel bill of lading included) and marine insurance (but not war risk) in negotiable form, with invoices.

5. Instructions shall be interpreted according to our law and customs, but, in any event, in accordance with the following general rules:

[Here follow regulations (a) to (r), as appearing on pages 315-317.]

6. Correspondents will understand that the above regulations shall govern in all credit transactions in the absence of other specific agreements. If the beneficiary shall make representations, or shall offer security satisfactory to the bank that no loss shall result to its correspondent or client by the waiver of any of such regulations, or any instruction, the bank reserves the right to make such waiver, and shall recognize no claim in the premises unless substantial direct damage shall be shown to have resulted.

These regulations, uniformly understood and applied by all interested banks as well as by the buyer and seller, have had a tendency to simplify commercial credit procedure and have reduced misunderstandings. Moreover, these regulations, in revised form, are incorporated in the more recent Uniform Customs and Regulations for Commercial Documentary Credits Fixed by the Seventh Congress of the International Chamber of Commerce with Guiding Provisions. (See Appendix I.)

Should the credit instrument make reference to these regulations of the International Chamber of Commerce, no regulatory provisions need be printed on the back of the instrument.

**Circular Commercial Credits as Used in our Export Trade.**—The commercial credit forms which we have discussed up to this point have been especially advised. Their existence has been made known to the beneficiaries through American banks. These credits have provided that the beneficiaries are to draw their drafts on American banks and the American banks have accepted and paid the drafts. The circular credit is the irrevocable credit instrument of a bank which is addressed to the beneficiary and placed in his hands without the intervention of another bank. The required drafts are to be drawn on the opening bank or on another bank designated in the credit and, generally, a bank foreign to the beneficiary. They are drawn in the currency of the designated drawee bank and the drawer-beneficiary is privileged to sell the drafts to any bank in his vicinity which cares to purchase them. Their negotiation or sale is not restricted to any particular bank or banks, although the issuing bank may attach to the instrument or indicate on the back of the instrument, the names of several banks in the vicinity of the beneficiary which maintain relations with the issuing bank and, consequently, will be glad to purchase the drafts drawn within the conditions contained in the credit instrument.

Circular credits, as used in our export trade, are issued by well-established foreign banks favorably known both to American banks and exporters. The assertion that the beneficiary's drafts will be honored is made solely by the issuing bank, and is not supplemented in any sense by an American bank. The beneficiary is privileged to verify the standing of the issuing bank by consulting the credit department of his own American bank. If he entertains any misgivings about the standing of the issuing bank, he may return the credit to his foreign buyer and request him to have established a form of credit available at an American bank. While the beneficiary may be willing to accept the instrument as the genuine contract of the issuing bank, the banks which may be interested in purchasing the drafts of the bene-

fiary will wish properly to verify the official signatures of the issuing bank by comparing them with the specimen signatures of the issuing bank on file with the interested purchasing banks. The issuing bank, therefore, should be one which is favorably regarded by all the larger American banks and whose specimen signatures are on file with them. It is difficult to sell drafts drawn under the circular commercial credit of a small and obscure bank, and such banks do not issue credits of this type.

Circular credits cannot be issued in revocable form. They must always be irrevocable. Not knowing the identity of the bank which may purchase the beneficiary's drafts, an attempted revocation, to be effective, must be addressed to all banks throughout the world and that is a physical impossibility. A revocable credit, such as the Authority to Pay, can be effectively revoked because the relative drafts are payable at only one bank local to the beneficiary, while the drafts drawn under a circular credit are negotiable by any bank to which the same may be offered by the beneficiary.

As circular credits are issued only by the larger and best known banks, they are not confirmed by a second bank. The confirmation cannot strengthen an instrument which is already strong.

Australian banks issue circular commercial credits quite extensively. The credit instrument is delivered by the issuing bank to the buyer and by him forwarded to the seller. As to the phraseology used in the instrument, see Form 22 on page 321.

When the Australian credit mentions "one of the bank's agents," it does not intend to restrict the negotiation of the beneficiary's drafts to the indicated agents (banks) but rather to inform the beneficiary that the designated agent banks maintain relations with the issuing bank, hold the specimen signatures of the issuing bank, and will be glad to purchase the drafts of the beneficiary. It will accept the certificate of any good and well-known American bank indicating that the proper documents have been received and that the specified copies have been mailed to Australia by the certifying bank. If the certificate has not been correctly issued and the opening bank suffers loss, the bank issuing the certificate becomes liable to the opening bank.

# The Bank of Australasia

INCORPORATED IN ENGLAND BY ROYAL CHARTER 1838.  
(THE LIABILITY OF THE MEMBERS IS LIMITED)

Cable Address: "TRALAS"

AUSTRALIA.

## LETTER OF CREDIT

We are pleased to authorise the negotiation at the exchange of the day with <sup>with</sup> <sub>without</sub> recourse on drawers, the drafts of

drawn under authority of this Letter of Credit and in accordance with the following terms and conditions -

NUMBER

ON ACCOUNT OF

AMOUNT

EXPIRY DATE

NATURE OF CREDIT

USANCE

DOCUMENTS REQUIRED

EVIDENCING SHIPMENT OF

INSURANCE

OTHER CONDITIONS

REIMBURSEMENT

**SPECIMEN**

Shipping Documents to order indorsed in blank and purporting to be of sufficient value of merchandise referred to above are to be handed to one of the Banks mentioned in the attached list

And THE BANK OF AUSTRALASIA hereby expressly agrees with any bona fide holder of any bill drawn in terms of this Credit that the same shall be duly honored on presentation provided it be accompanied by a certificate of one of the Bank's Agents in the form appended at foot of this Credit

Each draft is to indicate on its face that it has been drawn under this authority, the correct number of the Credit being quoted to ensure acceptance.

Particulars of the relative draft are to be endorsed on this Credit.

Acct.

Manager.

FORM OF CERTIFICATE REFERRED TO ABOVE.

"Place \_\_\_\_\_  
"Date \_\_\_\_\_

"We have to-day negotiated Messrs \_\_\_\_\_ days' sight draft on The Bank of Australasia, London, for £ \_\_\_\_\_ under that Bank's Letter of Credit No \_\_\_\_\_ dated \_\_\_\_\_ (date) \_\_\_\_\_ and certify that the terms of that Credit have been complied with."

It should be noted, moreover, that the promises of the opening bank that the drafts drawn under the credit will be duly honored, run not only to the beneficiary as the drawer of the drafts, but also to "any bona fide holder," and the American bank which purchases the beneficiary's drafts on London becomes a bona fide holder.

As circular credits are largely issued by American banks in connection with our imports, we shall discuss them in greater detail under the heading of Irrevocable Import Commercial Credits.

**The Far Eastern Authority to Purchase.**—No study of export commercial credits is complete without becoming acquainted with the Far Eastern Authority to Purchase, popularly known as the Far Eastern A/P. The reader should examine carefully the typical A/P found on page 323. It is not a commercial credit although it serves, to some extent, a similar purpose. It represents no undertaking on the part of the issuing bank that the beneficiary's drafts will be honored. The drafts are not to be drawn on the issuing bank but on the buyer. The bank says to the seller, "If you will make the shipment to The Chinese Import Co., draw on The Chinese Import Co. at 90 days sight, and accompany your draft with the stipulated documents, we shall be glad to negotiate (discount) your draft."

But such an offer to negotiate the seller's drafts drawn on the buyer is valueless to the seller if the seller's bank is quite willing to negotiate the particular seller's drafts drawn on any of his foreign buyers. The A/P gives the seller no additional credit security nor does it reduce the seller's liability as drawer. The seller-drawer must always reimburse the negotiating bank should the buyer-drawee dishonor the draft.

The A/P must not be confused with the Authority to Pay, which is the Conference substitute for the correspondent's revocable commercial credit. While the seller is required to draw drafts under the Authority to Pay, such drafts are to be drawn on the paying bank and not on the buyer and the liability of the seller as drawer is extinguished the moment the paying-drawee bank pays the seller's draft. Under the A/P, his liability as

FD-207 - REV. 4-26  
U. S. G.

**AUTHORITY TO PURCHASE**  
(Please note that this advice is NOT a BANK CREDIT)  
**THE NATIONAL CITY BANK OF NEW YORK**  
65 WALL STREET, NEW YORK, N. Y.

.....19

Dear Sir(s):

1. We have been authorized by our Branch in ..... to purchase, with right of recourse thereon against you, draft(s) drawn by you at ..... sight on ..... aggregating not more than ..... for ..... invoice cost of ..... shipped from .....

when accompanied by the following shipping documents:

- A All negotiable copies of on board ocean Bills of Lading made to ORDER OF SHIPPER and blank endorsed, freight and insurance to be prepaid and included in invoice
- B Invoices in duplicate
- C All negotiable copies of Marine Insurance Policies or Certificates made to order and blank endorsed If Bills of Lading contain "both to blame" clause, insurance must cover.

2. Each draft drawn hereunder shall bear an inscription reading substantially as follows:

"Payable at the selling rate of The National City Bank of New York in the place of payment for Telegraphic Transfers or Demand Drafts on New York on the date of actual payment, with interest at % per annum from date hereof to approximate date of returns reaching New York",

shall be marked "DRAWN UNDER THE NATIONAL CITY BANK OF NEW YORK A. P. No .....", and shall

be presented to us with this Instrument on or before ..... in order that the amount of each draft so purchased by us may be endorsed on the reverse side hereof.

3. The presentation of any draft to us for purchase hereunder shall be deemed an authorization from you to us.

- A To place the said inscription, as set forth in Paragraph 2 hereof, on the draft in event it does not then appear thereon
- B To insert in the said inscription the interest rate. This rate will be that which is then in effect as fixed by the "Association of Far Eastern Banks in New York" for like drafts drawn on the country in which the drawee is located
- C To waive the noting and/or protest thereof in event of its non acceptance and/or non payment, unless at the time of such presentation you instruct us in writing to the contrary

4. In event of the dishonor by the drawee and/or acceptor of any such draft(s) purchased by us hereunder, you shall remain liable thereon as drawer for the payment of the principal and interest owing on such dishonored draft(s), and in addition thereto you shall be obligated to pay to us upon demand such expenses as we may incur in connection therewith.

5. This Authority to Purchase is NOT a "BANK CREDIT", and we may decline at any time, without prior notice to you, to negotiate any draft(s) presented to us hereunder.

Very truly yours,  
**THE NATIONAL CITY BANK OF NEW YORK**

.....  
*Assistant Cashier*

drawer continues in full force and effect until the buyer-drawee pays the seller's draft.

This instrument, however, serves several useful purposes. As in commercial credits, the buyer induces his bank to issue the A/P and to offer to negotiate the seller's drafts on him, by pledging to the bank the merchandise as collateral security. You will note that the instrument calls for "to order" bills of lading, blank endorsed. If the seller is financially small and unable to induce his own bank to negotiate his documentary drafts drawn on his foreign buyers, the A/P gives such small seller this credit facility. In turn, the facility enables the buyer to obtain better prices and longer terms.

All drafts negotiated under A/Ps are enfaced with the Far East interest clause. The drawer-seller receives the full face amount of the drafts and the drawee-buyer pays all interest and collection charges.

As stated above, the A/P is of value to the small seller because it enables him to negotiate his documentary draft on the buyer, when, perhaps, his own bank may not wish to extend to him such facility. But it is also of value to the larger seller enjoying credit facilities at his own bank. In the first place, the establishment of the A/P serves notice on him that the issuing bank regards the buyer as a good credit risk. A/Ps are not established in behalf of irresponsible buyers. Then again, by negotiating his drafts to the bank issuing the A/P, the seller does not use, to that extent, the line of credit held at his disposal by his own bank for the negotiation of the seller's bills on foreign buyers.

The A/P serves still another useful purpose. It enables the issuing bank to secure business which might otherwise go to other banks. Because of the higher rates of interest applicable to Far East bills, the business is particularly attractive. Because of the fact that documents attached to Far East bills, irrespective of the usances of the bills, are delivered to drawees against the payment of the bills, the credit risk is small. Strange as it may seem, and despite the bold allegation in the instrument that it is not a bank credit (commercial credit) and that the seller is not relieved from the ordinary liability attaching to the drawer

of a bill of exchange, most beneficiaries of A/Ps regard these instruments as a form of commercial credit and make every effort to utilize them. Consequently, the A/P does bring business to the issuing bank which business may not be otherwise offered to it.

All these points and more are contained in a memorandum prepared for the author some years ago by the late Guy Holman, Assistant Vice President of The National City Bank of New York, who was a very able authority on banking procedures in the Far East. We shall quote this memorandum as our summation of the subject of A/Ps.

"The instrument called an 'authority to purchase' is in effect a letter from Branch A of the Bank to Branch B (or to its Head Office), intimating to the latter that John Doe, client of Branch A, authorizes Richard Roe, in Branch B's territory, to draw on him, i.e., on John Doe, under certain specified conditions. Branch A says to Branch B: 'If it suits your book, we suggest you offer to negotiate Richard Roe's drafts on John Doe—of course with the usual recourse on drawer.' The whole idea is merely to keep in the family business which appears to be safe and profitable.

"What does the drawer get out of the arrangement? Mainly this—and I think it no small advantage—that he can feel assured our Branch A would not have commended the business to Branch B's attention if it had not been pretty well satisfied with the credit worthiness of John Doe. That John Doe gets authority-to-purchase facilities from our branch signifies he is a regular client in good standing whose affairs receive the branch's careful attention. In many cases he will have put up security with the Branch to sweeten his credit standing. In no case is a branch likely to enter into this A/P relation lightly or casually or with a weak client whose paper is expected to become respectable merely because Richard Roe is going to be on it.

"In some cases, these Far Eastern A/Ps serve still another purpose. A drawer (exporter) of less than top rating may be enabled to secure the negotiation of his bills, in association with a good drawee, under the A/P when his own name alone might not quite suffice to satisfy the negotiating bankers."

**Bank Guaranties Covering Exports.**—An American seller, at times, is offered a Letter of Guaranty issued by the buyer's bank in order to induce the seller to sell to the buyer and to cover the sale by his draft, at sight or at a longer usance, drawn on the foreign buyer. The texts of these bank guaranties naturally differ, but they all seem to follow the same general pattern and all hope to accomplish the same end—to induce the seller to consummate the business with the buyer, to draw on the buyer direct, and not to insist upon the opening of a more satisfactory commercial credit in favor of the seller. The bank guaranty is intended to give the seller a form of credit security. However, only the buyer and his bank regard the guaranty "just as good" as a commercial credit. The bank issuing the guaranty says, in effect, to the seller, "If you will ship such and such merchandise to X Co. and draw on X Co. at 90 days sight for the value of the said merchandise up to the amount of so many dollars, we hereby guarantee the acceptance and payment of your draft by X Co."

A bank guaranty is not a commercial credit because it contains no primary obligation or promise of a bank to accept and/or pay the shipper's drafts to be drawn, not on the buyer, but on the bank. Under the commercial credit, the relations between the buyer and his bank, which has opened the credit, do not concern the shipper. The opening bank may not be able to induce the buyer to take delivery of the goods which he has ordered and payment for which has been made by the opening bank. While we know that an irrevocable commercial credit cannot be revoked without the consent of the beneficiary, we do not know if a bank guaranty gives the seller the same protection as to irrevocability, irrespective of the phraseology used.

While the law of guaranties is much older than the law of commercial credits, it may be quite different in the various foreign countries. The law of commercial credits is more uniform throughout the world, due to its more recent origin and the great stress placed upon uniformity by bankers and courts both here and abroad. The seller will never be sure if the guaranty of a foreign bank, stated to be good up to a certain date, is, in fact, irrevocable up to that date and will be so construed by the courts of the bank issuing the guaranty.

While the wording of guaranties is suave and is intended to reassure and not to alarm the beneficiary, the guarantor's contract is not so attractive, according to our laws. A guarantor cannot be called upon to make the guaranty good and cannot be sued, until the holder of the guaranty has exhausted all his legal remedies against the party in whose behalf the guaranty was given. If, for instance, the seller's draft on X Co. were dishonored by non-payment, according to our laws on the subject, the seller will not be permitted to sue the guarantor bank unless and until the seller had obtained a final judgment against X Co. and that judgment could not be satisfied. This is the naked meaning of a guaranty given by banks or by natural persons.

Assuming the corresponding law of the country of the bank issuing the guaranty is similar to ours, for all practical purposes the guaranty becomes worthless to the American seller. To sue the buyer in his own courts entails much expense, and the outcome of such a suit, prosecuted in a jurisdiction naturally hostile to the American seller, is highly problematic. Assuming the American seller has obtained a judgment against the foreign buyer and the judgment cannot be satisfied, he must then commence a new suit against the guarantor bank. What an outlook for an American seller seeking credit security!

While the primary purpose of a bank guaranty is to give the seller credit security by assuring him that the buyer will duly honor the seller's drafts drawn on the buyer, the assurance represented by the guaranty is of very little value in the eyes of American banks. No bank will discount the drafts of an unworthy (from a credit point of view) drawer simply because the honoring of such drafts, by the drawees, has been guaranteed by a foreign bank. Nine times out of ten, the guaranty represents a lawsuit in a foreign jurisdiction and an unsuccessful one at that.

If a bank guaranty is less expensive to a buyer than a commercial credit, it becomes more expensive to the seller and this greater expense to the seller will be reflected in the price of the goods. For instance, oftentimes a buyer will be granted a cash discount of 2% when he arranges, by means of a commercial credit, to pay the seller against the delivery of shipping docu-

ments to the American paying bank. Under a bank guaranty, the seller usually pays the discount and collection charges incident to his drafts on the buyer, should he wish to discount such drafts.

From the seller's point of view, a commercial credit is a far more satisfactory instrument than a bank guaranty. If the buyer is unable to induce his bank to open a commercial credit in favor of the seller instead of a guaranty, it may be more prudent for the seller to forego the business.

# CHAPTER 15

## COMMERCIAL LETTERS OF CREDIT

(CONTINUED)

### Forms of Commercial Credits

**Import Operations.**—We have already noted that every export operation, from our point of view, is also an import operation from the point of view of the foreign buyer. Similarly, every American export commercial credit is also an import commercial credit from the viewpoint of the foreign buyer. Were we to change places with the buyers of our export credits, therefore, we would regard the same credits as import credits. But we cannot comment upon the forms or the wordings which our correspondents in different foreign countries use in advising our import credits to the beneficiaries, nor on the absolute legal effects of such advices. We expect them to follow our forms, but law and language differences often confuse. We can instruct our correspondent bank in London to pay John Smith a certain amount of pounds sterling against the delivery to it of certain specified documents, and to debit the payment to our sterling account with the correspondent bank, thus effecting an operation contemplated by the Authority to Pay. We can also instruct our correspondent bank to advise the beneficiary, John Smith, in irrevocable terms, that we have authorized it to accept and subsequently to pay the time drafts of John Smith providing John Smith has met the conditions stipulated in our instructions, thus effecting an operation contemplated by the correspondent's irrevocable commercial credit.

**Irrevocable Import Commercial Credit (Conference Form B).**—The great majority of commercial credits established by American banks in cover of our imports follow the phraseology suggested by Conference Form B, illustrated on page 330. This

**IRREVOCABLE CREDIT**

Credit No. \_\_\_\_\_

\_\_\_\_\_, 19\_\_\_\_  
(City)

Dear Sir: \_\_\_\_\_

We hereby open our irrevocable credit in your favor for account of \_\_\_\_\_ for a sum or sums not exceeding a total of \_\_\_\_\_ (figures) \_\_\_\_\_ (words) available by your drafts on \_\_\_\_\_ at \_\_\_\_\_ to be accompanied by \_\_\_\_\_

\_\_\_\_\_ evidencing shipment of \_\_\_\_\_

\_\_\_\_\_ insurance to be effected by \_\_\_\_\_

All drafts so drawn must be marked:

"Drawn under \_\_\_\_\_ Bank's  
(Issuing Bank)

Credit No. \_\_\_\_\_ dated \_\_\_\_\_ 19\_\_\_\_"

(To be used when not all the documents are to accompany draft)

There must be forwarded by early mail to \_\_\_\_\_ Bank at \_\_\_\_\_ the following documents \_\_\_\_\_

All remaining documents must accompany the draft.

The amount of any draft drawn under this credit must, currently with negotiation, be endorsed on the reverse hereof, and the presentment of any such draft shall be a warranty by the negotiating bank that such endorsement has been made and that documents have been forwarded as herein required.

This credit must accompany any draft which exhausts the credit and must be surrendered concurrently with the payment of such draft.

We hereby agree with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same shall be duly honored on due presentation and delivery of documents as specified at \_\_\_\_\_ if negotiated on or before \_\_\_\_\_ 19\_\_\_\_.

Yours very truly,

\_\_\_\_\_

FORM B

**THE NATIONAL CITY BANK OF NEW YORK**

IRREVOCABLE CREDIT

55 WALL STREET

NEW YORK

ALL DRAFTS DRAWN MUST BE MARKED:  
DRAWN AS PER CREDIT No. COM.

DEAR SIR:

WE HEREBY AUTHORIZE YOU TO VALUE ON

FOR ACCOUNT OF

UP TO THE AGGREGATE AMOUNT OF

AVAILABLE BY YOUR DRAFTS AT

TO BE ACCOMPANIED BY CONSULAR INVOICE

DRAWN TO THE ORDER OF

AND COMMERCIAL INVOICE EVIDENCING SHIPMENT OF

FOR

INVOICE COST

BILLS OF LADING

SPECIMEN ORIGINAL SPECIMEN

INSURANCE

BILLS OF LADING MUST BE DATED NOT LATER THAN

BILLS OF EXCHANGE MUST BE NEGOTIATED NOT LATER THAN

A COPY OF THE CONSULAR INVOICE, COMMERCIAL INVOICE, AND ONE BILL OF LADING MUST BE FORWARDED BY FIRST MAIL DIRECT TO

ATTACHING TO THE DRAFT A STATEMENT TO THAT EFFECT. ALL REMAINING DOCUMENTS MUST ACCOMPANY THE DRAFT.

TO ENABLE THE BENEFICIARY(IES) TO PAY FOR THE MERCHANDISE FOR THE PURCHASE AND SHIPMENT OF WHICH THIS CREDIT IS OPENED, MAY MAKE CLEAN ADVANCES TO HIM(THAM) AT ANY TIME OR TIMES NOT EXCEEDING IN ALL EITHER (A) THE AGGREGATE AMOUNT OF

OR (B) THE REMAINING UNUSED BALANCE OF THIS CREDIT (WHICHEVER IS LESS) REPAYABLE WITH INTEREST OUT OF THE PROCEEDS OF DRAFTS WHICH MAY THEREAFTER BE DRAWN HEREUNDER BY THE BENEFICIARY(IES) UPON PRESENTATION OF REQUIRED DOCUMENTS, BUT IF NOT SO REPAID DURING THE CURRENCY OF THIS CREDIT TO BE CHARGEABLE AS WITHDRAWALS HEREUNDER.

THE AMOUNT OF EACH DRAFT DRAWN UNDER THIS CREDIT AND/OR OF EACH ADVANCE MADE UNDER THE RED CLAUSE IS TO BE ENDORSED ON THE REVERSE SIDE HEREOF.

WE HEREBY AGREE WITH THE DRAWERS, ENDORSERS AND BONA FIDE HOLDERS OF DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS OF THIS CREDIT THAT THE SAME SHALL BE DULY HONORED ON DUE PRESENTATION TO THE DRAWEE.

YOURS VERY TRULY,

THE NATIONAL CITY BANK OF NEW YORK

COM. 508 & PARTS  
E. C.

\* Printed in red.

Form 25. Irrevocable Import Commercial Credit as Issued by The National City Bank of New York and Patterned After Conference Form B. This form includes the Red Clause.

is a circular type of credit and is usually issued and delivered to the American importer and by him mailed to the foreign seller. If the element of time is important, the credit instrument is cabled to a correspondent bank in the city of the seller. The correspondent bank is acquainted with Form B and the cable expense is reduced by mentioning in the cable message only the details to be put into the form. In peacetime, the expense is further reduced by the use of special ciphers established between the American opening bank and its foreign correspondent banks. The correspondent bank, upon receiving the cable from the opening bank, writes a letter to the beneficiary reading about as follows :

We have received by cable, duly authenticated, the following message intended for you :

(Here may follow the wording of the credit, exactly in the same terms and language as the instrument issued in America and delivered to the importer to be forwarded by him to the seller.)

All that the correspondent does under these circumstances is to communicate the opening and existence of the credit to the beneficiary. It could not be communicated to the beneficiary direct because he does not hold the key of the opening bank for authenticating cable messages. The correspondent bank does hold such a key and can assure the beneficiary that the message received from the opening bank is genuine. The advising bank, under these circumstances, assumes no liability whatsoever to the beneficiary, providing it has correctly decoded the cable and correctly advised it to the beneficiary. If, under the terms of the credit, the advising bank is perhaps to accept and subsequently pay time drafts to be drawn on it by the beneficiary, the advising bank, which is now also the accepting-paying bank, need not accept the drafts, as it has made no promise to accept. Only the opening bank states and undertakes that the drafts to be drawn by the beneficiary shall be honored and the beneficiary's remedy lies against the opening American bank and not against the bank other than the opening bank which may be designated in the instrument as the drawee bank. However, once the designated drawee bank has accepted the seller's drafts, it must honor them by payment at maturity, irrespective of the

then credit position of the opening bank or the then relationship between it and the opening bank.

Our import commercial credits are seldom confirmed by foreign banks of the seller's country. Only the largest and best known American banks open import letters of credit. Our smaller banks do their commercial credit business through the facilities of their large correspondent banks in New York, Chicago, San Francisco, and in other American commercial centers. Confirmation is intended to strengthen a commercial credit but it is impossible to strengthen an instrument which is 100% strong in its own right because of the excellent standing of the bank which creates it.

Being circular credits, these Form B instruments are always irrevocable. The undertaking of the opening bank that the drafts to be drawn by the beneficiary shall be duly honored is addressed to the "drawers, endorsers, and bona fide holders." While the revocation of a credit can always be communicated to the drawers direct or through the medium of an advising bank, it cannot be communicated to all possible "endorsers and bona fide holders" because the opening bank cannot determine the identity of these possible purchasers of the drafts. Moreover, the purpose of the circular type of credit is to place in the hands of the beneficiary an instrument which will be acceptable to any bank to which he may offer his drafts for negotiation and no bank would undertake to buy or to discount such drafts unless the instrument is irrevocable. And, finally, the beneficiary's drafts under this form of credit may be drawn at sight or at longer usances, in dollars or in any other currency, and on the opening bank or on another bank designated in the instrument as the drawee bank.

**The Application for Commercial Credits.**—While the Bankers' Conference has also suggested a form of application for commercial credits, we shall not print it here because the attorneys of the different interested American banks have revised this form to meet their own individual likes and dislikes. The application for commercial credit of The Chase National Bank (Form 26, page 334) is typical of all such applications. The

APPLICATION FOR COMMERCIAL CREDIT

DATE \_\_\_\_\_

TO THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK,

FOREIGN DEPARTMENT,  
FINE STREET CORNER OF NASSAU,  
NEW YORK 19, N. Y.

PLEASE ISSUE  BY CABLE  FOR OUR ACCOUNT AN IRREVOCABLE CREDIT AS FOLLOWS:

IN FAVOR OF \_\_\_\_\_

UP TO THE AGGREGATE AMOUNT OF \_\_\_\_\_

FOR ACCOUNT OF \_\_\_\_\_

AVAILABLE BY DRAFTS AT \_\_\_\_\_ DRAWN AT YOUR OPTION

ON YOU OR YOUR CORRESPONDENTS FOR \_\_\_\_\_ % OF THE INVOICE VALUE.

DOCUMENTS REQUIRED: PLEASE INDICATE BY CHECK (✓)

COMMERCIAL INVOICE \_\_\_\_\_

CONSULAR INVOICE \_\_\_\_\_

MARINE WAR INSURANCE CERTIFICATE \_\_\_\_\_ (IF INSURANCE EFFECTED OTHER THAN BY SHIPPER, GIVE NAME OF ISSUING COMPANY)

OTHER DOCUMENTS \_\_\_\_\_ (IF SPECIAL DOCUMENTS ARE REQUIRED, PLEASE STATE NAME OF COMPANY TO ISSUE SAME)

FULL SET ON BOARD BILLS OF LADING TO ORDER OF THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK MARKED NOTIFY OURSELVES \_\_\_\_\_

EVIDENCING SHIPMENT OF \_\_\_\_\_ (PLEASE MENTION COMMODITY ONLY, OMITTING DETAILS AS TO GRADE, QUALITY, PRICE, ETC.)

FROM \_\_\_\_\_ TO \_\_\_\_\_

DRAFTS MUST BE DRAWN AND NEGOTIATED NOT LATER THAN \_\_\_\_\_

SPECIAL INSTRUCTIONS \_\_\_\_\_

In consideration of your opening, at our request, your Commercial Letter of Credit (herein called "the Credit") substantially in accordance with the foregoing application, we hereby agree as follows:

1. As to drafts or acceptances under or purporting to be under the Credit, which are payable in United States Currency, we agree: (a) in the case of each sight draft, to reimburse you at your office, on demand, in United States currency, the amount paid on such drafts, or, if so demanded by you, to pay to you at your office in advance in such currency, the amount required to pay such draft; and (b) in the case of each acceptance, to pay to you, at your office, in United States currency, the amount thereof, on demand but in any event not later than one business day prior to maturity; or, in case the acceptance is not payable at your office, then on demand but in any event in time to reach the place of payment in the course of the mails not later than one business day prior to maturity.

2. As to drafts or acceptances under or purporting to be under the Credit, which are payable in currency other than United States currency, we agree: (a) in the case of each sight draft, to reimburse you, at your office, on demand, the equivalent of the amount paid, in United States currency, at the rate of exchange then current in New York for cable transfers to the place of payment in the currency in which such draft is drawn; and (b) in the case of each acceptance, to furnish you, at your office, on demand, but in any event in time to reach the place of payment in the course of the mails not later than one business day prior to maturity with first class bankers' demand bills of exchange to be approved by you for the amount of acceptance, payable in the currency of the acceptance and bearing our endorsement, or, if you so request, to pay to you, at your office, on demand, the equivalent of the acceptance in United States currency at the rate of exchange current in New York for cable transfers at time of transmission to the place of payment in the currency in which the acceptance is payable. If for any cause whatsoever there exists at the time in question no rate of exchange generally current in New York for effective cable transfers of the sort above provided for, we agree to pay you on demand an amount in dollars of United States currency equivalent to the actual cost to you of settlement of your obligation to the payor of the draft or acceptance or any holder thereof, as the case may be, and however and whenever such settlement shall be made by you, including interest on the amount of dollars payable by us, from the date of payment of such draft or acceptance, to the date of our payment to you, at the rate then customarily charged by you in like circumstances.

3. We also agree to pay you, on demand, your commission and, in any event, a minimum commission, and all charges and expenses paid or incurred by you in connection therewith, and interest where chargeable.

4. We hereby recognize and admit your ownership in and unqualified right to the possession and disposal of all property shipped under or pursuant to or in connection with the Credit or in any way relative thereto or to the drafts drawn thereunder, whether or not released to us on trust or bailee receipt, and also in and to all shipping documents, warehouse receipts, policies or certificates of insurance and other documents accompanying or relative to drafts drawn under the Credit, and in and to the proceeds of each and all of the foregoing, until such time as all the obligations and liabilities of us or any of us to you at any time existing under or with reference to the Credit or this agreement, or any other Credit or any other obligation or liability to you, have been fully paid and discharged, all as security for such obligations and liabilities; and that all held and disposed of by you as hereinafter provided; and the proceeds of any thereof, coming into the possession of you or any of your correspondents, may be whatsoever nature, including cash, shall not be deemed a waiver of any of your rights or powers herein recognized.

5. In the event that you deliver to us any of the goods, wares or merchandise covered by the Credit prior to your having received reimbursement with respect to the relative drafts or acceptances as herein provided, we agree to sign and deliver to you a Trust Receipt or Trust Receipts defined in and complying with the requirements of the Uniform Trust Receipts Law of the State of New York and a Statement of Trust Receipt Financing in the form specified in the said statute, and we further agree that your rights specified herein shall be in addition to and not in limitation of your rights under the said statute or any other applicable statute.

6. Except in so far as instructions have been heretofore given by us in writing expressly to the contrary, we agree that you and any of your correspondents may receive and accept as "Bills of lading" under the Credit, any documents issued or purporting to be issued by or on behalf of any carrier which acknowledge receipt of property for transportation, whatever the specific provisions of such documents, and that the date of each such document shall be deemed the date of shipment of the property mentioned therein; and that you may receive and accept as documents of insurance either insurance policies or insurance certificates.

7. Except in so far as instructions have been heretofore given by us in writing expressly to the contrary, we agree that part shipments may be made under the Credit and you may honor the relative drafts; and that if the Credit specifies shipments in instalments within stated periods, and the shipper fails to ship in any designated period, shipments of subsequent instalments may nevertheless be made in their respective designated periods and you may honor the relative drafts.

8. We agree that in the event of any extension of the maturity or time for presentation of drafts, acceptances or documents, or any other modification of the terms of the Credit, at the request of any of us, with or without notification to the others, or in the event of any increase in the amount of the Credit at our request, this agreement shall be binding upon us with regard to the Credit so increased or otherwise modified, to drafts, documents and property covered thereby, and to any action taken by you or any of your correspondents in accordance with such extension, increase or other modification.

9. The users of the Credit shall be deemed our agents and we assume all risks of their acts or omissions. Neither you nor your correspondents shall be responsible; for the existence, character, quality, quantity, condition, packing, value or delivery of the property purporting to be represented by documents; for any difference in character, quality, quantity, condition, or value of the property from that expressed in documents; for the validity, sufficiency, or genuineness of documents or drafts, even if such documents or drafts should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged; for the time, place, manner or order in which shipment is made; for partial or incomplete shipment or failure to shipment or responsibility of any insurer, or for any other risk connected with insurance; for any deviation from instructions, delay, default or fraud by the shipper or anyone else in connection with the property; for delay in arrival or failure to arrive of either the property or the property of any party issuing any documents in connection with the property; for delay in giving notice of arrival or any other notice; for any breach of contract between the shippers or vendors and ourselves or any of us; or for any laws, customs and regulations which may be effective in countries of negotiation and/or payment of this credit; for failure of any person to note the amount of any draft on the reverse of the Credit, or failure of documents to accompany any draft at negotiation, or failure of any person to note the amount of any draft on the reverse of the Credit; each of which provisions, if contained in the credit or to send forward documents apart from drafts as required by the terms of the Credit; in transmission, or delivery of any messages, the Credit itself, it is agreed may be waived by you, or for errors, omissions, interruptions or delays in transmission, or delivery of any messages, by mail, cable, telegraph, wireless or otherwise, whether or not they be in cipher; nor shall you be responsible for any error, neglect or default of any of your correspondents; and none of the above shall affect, impair or prevent the vesting of any of your rights or powers hereunder. If the Credit provides that payment is to be made by your correspondent, neither you nor such correspondent shall be responsible for the failure of any of the documents specified in such failure or delay in the receipt by you or by any correspondent of such documents. In furtherance and extension and not in limitation of the specific provisions hereinbefore set forth, we agree that any action taken by you or by any correspondent of yours under or in connection with the Credit or the relative drafts, documents or property, if taken in good faith, shall be binding on us and shall not put you or your correspondent under any resulting liability to us; and we make like agreement as to any inaction or omission, unless in breach of good faith. We agree to hold you and your correspondents indemnified and harmless against any and all loss or liability howsoever arising from or in connection with the Credit.

10. We agree to procure promptly any necessary import and export or other licenses for the import or export or shipping of the property and to comply with all foreign and domestic governmental regulations in regard to the shipment of the property or the financing thereof, and to furnish such certificates in that respect as you may at any time require, and to keep the property adequately covered by insurance satisfactory to you, in companies satisfactory to you, and to assign the policies or certificates of insurance to you, or to make the loss or adjustment, if any, payable to you, at your option; and to furnish you if demanded with evidence of acceptance by the insurers of such assignment. Should the insurance upon said goods for any reason be unsatisfactory to you, you may, at our expense, obtain insurance satisfactory to you.

11. Each of us agrees at any time and from time to time, on demand, to deliver, convey, transfer or assign to you, as security for any and all of his and/or our obligations and liabilities hereunder, and also for any and all other obligations and liabilities, absolute or contingent, due or to become due, which are now or may at any time hereafter be owing by him or to you, additional security of a value and character satisfactory to you, or to make such payment as you may require. As security for the payment and performance of any and all of our obligations and liabilities to you, direct or indirect, absolute or contingent, due or to become due, now existing or hereafter arising, each of us hereby pledges to you and/or gives you a general lien upon and/or right of set-off of, all right, title and interest of each of us in and to the balance of every deposit account, now or at any time hereafter existing, of each of us with you, or any other claims of any of us against you, and in and to all money, negotiable instruments, commercial paper, notes, bonds, stocks, credits, choses in action, claims, demands, or any interest in any thereof, and in any other property rights and interests of each of the undersigned, or any evidence thereof, which have been or at any time shall be delivered to or otherwise come into your possession, custody or control, or into the possession, custody or control of any of your agents or correspondents for any purpose, whether or not accepted for the purpose or purposes for which they are delivered or intended; and you shall be deemed to have possession, custody or control of any such property actually in transit to or set apart for you or any of your agents, correspondents or others acting in your behalf. Each of us agrees that upon his or our failure at all times to keep a margin of security with you satisfactory to you; or upon the death of any of us; or if any of the obligations and liabilities of any of us to you shall not be paid when due; or if any of us shall become insolvent (however such insolvency may be evidenced) or commit any act of insolvency, or make a general assignment for the benefit of creditors; or if any of us shall suspend the transaction of his or our usual business or be expelled or suspended from any exchanges; or if an application is made under Article 45 of the New York Civil Practice Act by any judgment creditor of any of us for an order directing you to pay over money; or if a petition in bankruptcy shall be filed by or against any of us; or if a petition shall be filed by or against any of us or any proceeding shall be instituted by or against any of us for any relief under any bankruptcy or insolvency laws or any laws relating to the relief of debtors, readjustment of indebtedness, reorganizations, compositions or extensions; or if any governmental authority, or any court at the instance of any governmental authority, shall take possession of any substantial part of the property of any of us or shall assume control over the affairs or operations of any of us; or if a receiver shall be appointed of any of us or shall assume control over the affairs of any of us, whether now existing or hereafter incurred, shall become and be due and payable forthwith without further notice or demand; and each of us, as to property in which he may have any interest, and all of us, as to property in which we may have any interest, expressly authorize you in any such event, or upon his or our failure to pay any of such obligations or liabilities when it or they shall become or be made due, to sell immediately, without demand for payment, without advertisement and without notice to us or any of us, all of which are hereby expressly waived, any parcels and at such time or times and at such place or places and for such price or prices and upon such terms and conditions as you may deem proper, and to apply the net proceeds of such sale or sales, together with any balance of deposits and any sums credited by or due from you to him or us in general account or otherwise, to the payment of any and all of his and/or our obligations or liabilities to you, however arising. If any such sale be at brokers' board or at public auction, you may yourself be a purchaser at such sale, free from any right of redemption, which we and each of us hereby expressly waive and release.

12. You shall not be deemed to have waived any of your rights hereunder, unless you or your authorized agent shall have signed such waiver in writing. No such waiver unless expressly as stated therein, shall be effective as to any transaction which occurs subsequent to the date of such waiver, nor as to any continuance of a breach after such waiver.

13. The word "property" as used in this agreement includes goods, merchandise, securities, funds, choses in action, and any and all other forms of property whether real, personal or mixed and any right or interest therein.

14. If this agreement is signed by one individual, the terms "we," "our," "us," shall be read throughout as "I," "my," "me," as the case may be. If this agreement is signed by two or more parties, it shall be the joint and several agreement of such parties.

15. The obligations hereof shall continue in force, and apply, notwithstanding any change in the membership of any partnership undersigned, whether arising from the death or retirement of one or more partners or the accession of one or more new partners, and the obligations hereof shall bind the heirs, executors, administrators, successors and assigns of the undersigned, and all rights, benefits and privileges hereby conferred on you shall be and hereby are extended to and conferred upon and may be enforced by your successors and assigns.

16. This guaranty and all rights, obligations and liabilities arising hereunder shall be construed according to the laws of the State of New York.

PLEASE SIGN OFFICIALLY

application is the agreement or contract between the buyer and the opening bank. The buyer requests the bank to open the credit and agrees to pay the bank a commission for the facility and also to see to it that the drawee bank, be it the opening or another designated bank, is provided, in time, with the required funds for the payment of the drafts. Relying upon these promises on the part of the buyer, the bank agrees to and does open the requested instrument. All other provisions of the agreement are intended to secure the opening bank against the buyer, the creditors of the buyer, and any other persons who may interfere with the bank's right to be reimbursed by the buyer and by the imported merchandise. Because of the fact that these commercial credit agreements are rather long and somewhat involved, some buyers hesitate to sign them without study and advice. Even such buyers will sign promptly when assured that the provisions have one and only one objective—reimbursement for the opening bank under any and all possible circumstances.

**Additional Security for the Opening Bank.**—The opening bank is generally secured by the merchandise being imported. The credit instrument will call for negotiable bills of lading, consigning the merchandise either to the order of the bank or "to order," blank endorsed. The bank need not release the shipment to the buyer until it is fully and properly reimbursed. But the bank is not in the merchandising business and will not wish to depend upon the merchandise for reimbursement. The importer may have purchased the goods at prices above the market, or the prices for the goods may have slumped badly between the date when the sale contract was consummated and the credit opened and the date when the bank is to be reimbursed. The goods may have deteriorated in transit and this deterioration may not be recoverable either from the carrier or from the insurance company. Under such circumstances and whenever the financial standing of the buyer is not sufficiently strong, the bank may require the buyer to place it in funds, wholly or partially, at the time when the credit is opened or at any other time before the date when it should be fully reimbursed. If this is done, the bank will be relying upon the buyer, his cash deposit, and the merchandise, for its reimbursement.

**Bank Guaranties in Behalf of Applicants for Commercial Credits.**—The operations of banks are limited by the charters or articles of incorporation under which they are organized and operate as banking institutions. They can engage in operations which their charters permit, and cannot engage in operations which their charters do not permit. Banks are seldom permitted to act as guarantors in the same sense as a surety company which is organized to operate as such. National banks are not authorized to act as guarantors or to give guaranties on behalf of their clients. Not that they commit a crime when so acting but rather that the act is not enforceable against the guaranteeing banks and they may elect to escape responsibility by alleging that the giving of guaranties is “*ultra vires*” (beyond their powers) as to them and the contracts of guaranty are unenforceable against them. The person who accepts and relies upon a guaranty issued by a bank does so at his own peril. Because of this rule of law, banks do not wish to act as guarantors, although the rule is often violated as, for instance, when a bank gives a guaranty to a carrier for the later production of shipping documents which have been delayed in transit between the shipper and consignee.

We have already mentioned that the smaller and less-known banks of the United States do not issue their own commercial credits but request their larger and better known correspondents to issue these instruments for their account. XYZ Manufacturing Company of Fairfax, Indiana, has an account with the First National Bank of Fairfax. It has no account with banks in Chicago or in New York which regularly issue commercial credits in favor of foreign suppliers. It does import foreign materials from time to time and is required to establish credits in favor of foreign suppliers. Being comparatively unknown to the larger credit issuing banks, it cannot request them to establish credits without, at the same time, depositing the required funds with them. It does not wish to tie up funds in this fashion for the reason that it enjoys ample credit facilities at its own bank, First National Bank of Fairfax. It cannot request its bank to give a guaranty to the larger credit issuing bank because banks are not authorized to give guaranties.

What is XYZ Manufacturing Company to do under these circumstances? The answer is quite simple. Instead of requesting the First National Bank of Fairfax to guarantee the commitments of the Company contained in the application (agreement) to be addressed to the Chicago or New York bank which has been selected to open the credit, the Company requests the Fairfax Bank to sign the application with the Company. We then have an application signed jointly by XYZ Manufacturing Co. and by First National Bank of Fairfax. The Fairfax Bank becomes a principal party to the contract and not the guarantor of the commitments of the Company. The issuing bank will regard the Fairfax Bank as the other real party to the contract and may ignore the security represented by the signature of the Company. This maneuver successfully overcomes the difficulty and is generally used whenever the banks in the interior wish to make it possible for their customers to make use of the commercial credit facilities of the larger banks.

**The "Red Clause."**—Whenever the importer-buyer has his own representative abroad for the purpose of purchasing merchandise from various available sources, and does not wish to tie up his own funds or to place his funds at the uncontrolled disposal of the representative, he accomplishes these desired ends by requesting the establishment, in favor of the representative, of a commercial credit containing the Red Clause, so called because it is generally printed in that color. The application for a credit of this type to be signed by the buyer will contain a paragraph which may read as follows :

In the event of the beneficiary informing your foreign branches or correspondents that he requires temporary advances to enable him to pay for the merchandise for the purpose of shipment of which this credit is opened, your branches or correspondents are hereby authorized to make such advances, which are to be repaid, with interest, from the payment to be made under this Credit. We undertake that should such advances not be repaid by the beneficiary in terms and during the currency of this Credit, we will repay them with interest accrued to date.

It is understood that the making of the temporary advances

or the payments to the above mentioned beneficiary shall be optional on the part of your branches or correspondents.

To enable the foreign branches and correspondents of the opening bank to make such advances with safety, the credit must be irrevocable, must be deposited with the bank abroad which is to make the advances, and must contain a provision to the effect that all availments under the clause are to be endorsed on the instrument.

The request of the buyer for the facilities of the red clause is made effective by the opening bank by the inclusion of the red clause in the credit instrument (see Form 25, on page 331). The clause itself may read as follows :

To enable the beneficiary to pay for the merchandise for the purchase and shipment of which this credit is opened,

—(Bank in territory involved)—

may make clean advances to him at any time or times not exceeding in all either (a) the aggregate amount of (the amount of credit or less)

or (b) the remaining unused balance of this credit (whichever is less) repayable with interest out of the proceeds of drafts which may thereafter be drawn hereunder by the beneficiary upon presentation of required documents, but if not so repaid during the currency of this credit, to be chargeable as withdrawals hereunder.

While credits of this character are generally circular in form and the beneficiary may negotiate his drafts drawn under the credit to any bank in the territory in which he is to make his purchases, he will be obliged to limit the negotiation of his drafts to one foreign bank, the bank indicated in the red clause, if he is to avail himself of the facilities of the clause.

The procedure under the red clause is about as follows : Let us assume Acme Coffee Co. of New York desires to purchase 1,000 bags of coffee in Colombia, not from the leading coffee exporters of that country, but rather from the smaller producers who generally sell to the leading exporters. To accomplish this and at the same time place the stress upon quality or price, or both, the company decides to send one of their employees, John

Smith, to Colombia. He is supplied with a circular irrevocable credit in the required amount, containing the red clause, issued by the American bank of the Acme Coffee Co. The Colombian bank to make the temporary advances to Smith may be indicated in the credit as Banco de Bogota. Smith arrives in Bogota, consults Banco de Bogota, obtains from that bank a temporary loan of Pesos 10,000., leaves with it the circular credit as security for the loan, and requests the Banco de Bogota to advise its branches in the interior to make similar advances to him after consulting their Head Office in Bogota or otherwise, as occasion may arise. He then goes to the interior to carry out his buying mission. As he makes his purchases, the coffee is shipped to a seaport and held for him. The temporary loans made to him by the interior branches are reported to their Head Office in Bogota. When he has completed his purchases, he ships the entire lot by steamer to his principals in New York and then presents the ladings and other required documents to Banco de Bogota in Bogota and receives payment from that bank under the circular credit. At the same time Banco de Bogota in Bogota reimburses itself for the advances made to Smith by itself and by its branches, together with the interest due that bank and its branches in connection with the advances. The draft which Smith draws under the credit is drawn in dollars on the opening bank in New York. Banco de Bogota buys Smith's draft as so much dollar exchange payable in New York. When the draft is presented to the opening bank for payment, the opening bank calls upon Acme Coffee Co. to provide the necessary dollars.

Now let us consider the results obtained by the use of the credit containing the red clause. In the first place, Acme Coffee Co. was not obliged to put up any money until the date when the opening bank was presented with Smith's draft for payment, assuming, of course, the company is enjoying credit facilities at the opening bank. Were it not for this consideration—the conservation of the working capital of the company—Smith could have been supplied with a travelers' letter of credit and he could have supplied himself with needed funds by cashing drafts drawn under that letter or by the use of travelers' checks.

As a rule, however, travelers' checks and travelers' letters of credit must be paid for when purchased.

But even if this were not the case and even if the bank selling the travelers' checks or letters were willing to defer charging for the checks or drafts until they were received for payment by the drawee bank, the company might not like the idea of placing the funds represented by such payments at the unrestricted disposal of Smith, who may be tempted to misuse his principal's funds instead of purchasing coffee from the smaller growers in Colombia. When a member of a financially strong buyer's office force is sent abroad on a buying trip and the required funds for his purchases are supplied him by means of a commercial credit containing the red clause, the buyer's interests are better protected because it becomes more difficult for the agent to succumb to temptation.

This theory is borne out by the peculiar wording of the clause as advised, to the foreign bank which is designated as the bank to make the temporary advances to the beneficiary. It will be noted that the making of the advances is left to the discretion of the designated bank which must be satisfied that the agent is not apt to misuse the funds to be advanced to him under the clause. Moreover, the agent is not permitted to apply for such advances until on and after a certain date, usually after the date of his arrival in the field of operation. In other words, the bank to make the advances is supposed to keep in mind the best interests of the buyer.

Whenever the agent is permanently located in the country in which the purchases are to be made, the establishment of the credit with the red clause is advised to him through a bank of his country and he will wish to obtain the contemplated facilities from such advising bank and its branches. Such a buying agent may not have the cash with which to make the purchases and the American buyer may not be willing to make all the necessary funds available to him in advance. The credit and clause will make the funds available to him as he needs such funds and the bank designated to make the advances will bear in mind the interests of the buyer. Once the credit has been advised to him,

he carries on his buying operations in the same manner as the agent sent from New York.

Commercial credits containing the red clause are at times designated as Packing Credits, meaning that the beneficiary is to buy from different sources, consolidate the purchases, and pack and ship the purchases to his principal, the real buyer.

**Revolving Commercial Credits.**—A buyer may make purchases regularly from a certain foreign seller and be unable to induce his bank to issue the credit instrument in a sufficiently large amount to cover all shipments. Moreover, he may not wish to have to establish a new credit for each shipment. Under these circumstances, the credit instrument may provide that the availments made, in whole or in part, shall again become available to the seller just as soon as the opening bank has advised the negotiating or paying bank that the drafts already drawn by the beneficiary have been reimbursed to the opening bank by the buyer.

An American watch merchant, let us suppose, has contracted with a Swiss watch manufacturer to buy from him all the watches which the seller can supply him for a period of twelve months. Both understand that the watches will be shipped, in lots, as fast as they can be made. The value of the probable shipments for the year may run up to \$240,000. but both understand that, in all probability, each lot will be worth about \$20,000. There is no good reason for opening the credit for \$240,000. Indeed, the opening American bank may hesitate to make such a large commitment at one time for its client, the American buyer. A credit in the amount of \$40-\$50,000. would be quite adequate for the needs of the parties. And so, the credit is opened for \$50,000., with the provision that as each shipment is received and reimbursed to the opening bank by the buyer, the amount thus reimbursed and advised to the negotiating Swiss bank will again be available to the Swiss seller. We call a credit of this type a Revolving Credit.

**Periodic Credits.**—Whenever a commercial credit is established in revolving form and the limitation not only determines the amounts payable to the beneficiary at any one time but also

the time within which the contemplated partial shipments are to be made, say so much every thirty days or in each quarter of the year, we have what is known as a Periodic Credit. The purpose of this limitation as to the quantity which may be shipped within the specified periods of time, is to prevent the availability of the goods in the hands of the buyer in quantities which he cannot conveniently handle.

**Cumulative and Non-Cumulative Credits.**—Credits which are in revolving form, both as to the amounts available and as to the quantity which may be shipped at designated intervals, must also indicate if the amounts not drawn, or the quantities not shipped during one interval lapse altogether or may be included in the allotment for the following interval. We say the credit is in Cumulative form whenever it provides that the non-availment, partial or whole, of one interval may be utilized in succeeding intervals. The instrument is Non-cumulative if it provides that the partial or entire non-availment of any one interval lapses completely and may not be used as an excess part of future intervals. Assuming the foreign seller is to ship at the rate of not more than \$10,000. during each calendar month and, due to strikes, fires, or other unforeseen circumstances, he ships only \$3,000. worth in June, may he ship \$17,000. worth in July? He can if the credit is cumulative; he cannot if the credit is non-cumulative.

## CHAPTER 16

### SOME LEGAL ASPECTS OF COMMERCIAL CREDITS

**All Parties Must Strictly Follow the Conditions of the Credit.**—As to the opening bank, if it does not establish exactly the type of instrument called for by the buyer's application, the buyer is relieved from responsibility and need not accept the shipment nor reimburse the opening bank. The same situation results if the opening bank has not included in the instrument the exact conditions stipulated in the application, when such negligence upon the part of the opening bank causes losses to the buyer. The conditions must be as simple as possible.

Because of the fact that a credit does not protect the buyer and that the buyer must depend upon the integrity of the seller to ship the actual merchandise ordered by the buyer, some buyers feel that the banks interested in the instrument should act as their unofficial "watchdogs" or inspectors to make sure that the seller does not take advantage of their helplessness. Banks are not in a position to serve in this capacity. They cannot question the invoices and documents which the seller presents, when such documents purport to cover the exact goods ordered but which, in fact, may cover other types of goods, or goods of the same nature but of inferior quality, or no goods at all but packing cases filled with sawdust and bricks. The buyer should not establish the credit if he entertains any misgivings as to the integrity of the seller.

In order to obtain this phantom assistance from the interested banks, some buyers attempt to impose too many conditions in their credits—conditions as to size, weight, individual packing, color, quality, etc. It is incumbent upon the opening bank to refuse to establish credits containing such conditions. The merchandise should always be described in general terms, such

as machinery, clocks, hardware, textiles, etc. The buyer may stipulate, however, that an inspection certificate, approving the goods and issued by an agent of the buyer, shall be one of the documents to be submitted by the seller. Indeed many types of merchandise such as food products, oils, and raw skins call for such certificates to be issued by governmental agencies.

As to the paying or negotiating bank, it must make certain, at its own peril, that the documents submitted by the seller are exactly the documents required by the credit. The opening bank will not reimburse the paying or negotiating bank unless the documents are in order and unless the seller has been paid within the limitations as to time and amount, contained in the credit instrument. Discretion cannot be used in commercial credits. Our courts have repeatedly so held. While in a rising market and when goods are scarce, the buyer may overlook slight discrepancies, in a falling market he may be anxious to be rid of an unprofitable purchase and it is quite natural for him to look for loopholes which will release him and permit him to leave the unwanted goods at the disposal of the opening bank.

Some sellers attempt to cure their failure to strictly comply by offering their guaranties to the paying or negotiating banks. This raises an interesting problem. If the seller is financially strong, so that the paying or negotiating bank is justified in accepting his proffered guaranty, it follows that the seller did not request the credit so as to be able to finance the shipment while in transit. Rather, it was because he desired better credit security. He did not wish to make the shipment to the given buyer without the absolute undertaking of the buyer's bank that the drafts covering the shipment would be duly honored.

All this credit protection is lost, however, when the seller has not fully complied and endeavors to cure the omission by his guaranty. The guaranty, in effect, says this: "I have not properly met the conditions of this credit. Nevertheless, if you will disregard this and pay me, I undertake to reimburse you in the event the buyer refuses the shipment and refuses to pay because of my non-compliance." Guaranties of this nature are always offered by the seller whenever he has overshipped and thus has substantially exceeded the amount of the credit. He will at first

offer a guaranty in cover of the excess amount only. He will say, "Yes, I have exceeded the credit by \$500. but I know the buyer will be glad to have the additional goods. Moreover, I am willing to give you my guaranty for \$500. and will pay the \$500. back to you, if the buyer does not reimburse you for the amount of the credit plus the \$500. excess." Such a guaranty is quite inadequate. By overshipping and by drawing for an amount considerably larger than the amount of the credit, the seller has violated vital conditions of the credit and the buyer is at liberty to repudiate the entire operation and leave the entire shipment at the disposal of the bank which has accepted the guaranty of the seller.

The proper thing to do, under such circumstances, is to advise the seller to request the buyer to amend the credit by increasing its amount by \$500. This will obviate the necessity of a guaranty and leave the credit in full force and effect, thus giving the seller the better credit security he desired when first requesting the establishment of the credit by the buyer.

The paying or negotiating bank has no relations whatsoever with the buyer and may have no close relations with the seller. It relies upon the representations and promises of the opening bank made in the credit instrument. It cannot use its own discretion without running the risk of losing its right to be reimbursed by the opening bank. The opening bank need not reimburse the paying or negotiating bank if it has paid the seller outside of the conditions definitely stipulated in the credit instrument.

**A Commercial Credit Is Not Assignable Unless the Instrument so Provides.**—While the beneficiary of an irrevocable credit issued by a good bank is always adequately protected, as much cannot be said of the buyer. The buyer who has caused the credit to be opened in favor of the seller must rely upon the integrity of the seller to ship the exact merchandise covered by the contract of sale. An unscrupulous seller may ship inferior merchandise or no merchandise at all. The carrier issuing the bills of lading does not examine and check the merchandise. The lading recites the receipt of a number of cases or packages, "said to contain" the merchandise specified by the shipper. As

a matter of fact, it is the shipper who prepares the ladings and the carrier signs them. The banks which negotiate or pay the drafts of the seller cannot examine and check the merchandise. They merely see to it that the documents specified by the credit instrument are tendered by the seller. These documents may or may not include governmental inspection certificates, depending upon the nature of the merchandise. It is obvious, therefore, that the buyer must have had confidence in the seller in making his purchase and in establishing the credit in favor of the seller. Confidence is not assignable. Particularly is this true when the assignment is to be approved not by the party primarily interested—the buyer—but by intervening banks which may have no knowledge of the relations between buyer and seller.

If a credit is established in favor of A. L. Peregrine, and, between the establishment of the credit and the date of shipment, Peregrine incorporates his business and is then conducting business as A. L. Peregrine, Inc., the corporation cannot draw and negotiate the drafts contemplated by the credit instrument. Similarly, if the credit is in favor of Peregrine & Son, a partnership, and the partnership has become a corporation, say, Peregrine & Son, Inc., the corporation cannot acquire the benefits of the credit issued in favor of the partnership even though the exact goods desired by the buyer have been shipped. This is easy to understand when we bear in mind that the contracts of an individual or of a partnership are backed by all the assets, both business and personal, of the individual or of the individual members of the partnership, while the contract of a corporation is supported by the assets of the corporation only.

Should the seller be operating as a middleman, such as a broker or commission agent, and he, himself, is obliged to purchase the desired merchandise from a manufacturer, the manufacturer may demand better credit security from him, especially if he is operating with limited capital. Under such circumstances, the seller may request the foreign buyer to have the credit opened in favor of the seller and/or his nominee, or in favor of the seller or order, or in favor of the seller or assignee. If this is done, the beneficiary-seller may instruct the notifying American bank to establish the credit, in whole or in part, in

favor of the manufacturer instead of in his favor. The price of the goods in the credit in favor of the manufacturer will be lower than the price to be charged to the foreign buyer by the original beneficiary and the difference in prices will be the contemplated profit of the original beneficiary. The American bank understands this procedure and will gladly substitute the invoices of the original beneficiary for the invoices of the manufacturer.

**Loans Under Non-Assignable Credits.**—If a commercial credit does not provide for its assignment in whole or in part, it may, nevertheless, be utilized as an instrument for obtaining credit facilities. A reliable foreign bank has established a circular credit in favor of Tom Nolan. The involved amount may be considerable. Tom enjoys an excellent reputation but is short of working capital. He is obliged to buy the merchandise from a manufacturer. The manufacturer does not wish to prepare the goods for shipment without a substantial deposit. Under these circumstances, Tom may be able to induce his bank or the bank which will be requested to negotiate his draft to be drawn on the bank opening the credit, to make him a temporary demand loan so that he can provide the deposit requested by the manufacturer. He will deposit the credit with the lending bank as security for the loan, which, in reality, becomes a self liquidating operation, providing the shipment can be made within the time limitation of the credit.

**“Back to Back” Credits.**—Exporters and banks understanding foreign banking operations can find many ways of utilizing assignable and non-assignable commercial credits for subsidiary or collateral financing. However, should the instrument not permit assignments the American bank must shape the collateral financing in a manner which will enable it to be reimbursed by the payments to be made to the beneficiary of the credit strictly within the definite provisions of the credit. For example, the tight merchandise market which prevailed during and immediately following World War II popularized the so-called “back to back” commercial credit financing. Tom Nolan may be the beneficiary of an irrevocable credit opened by a foreign bank of excellent standing, duly confirmed by one of our best banks in

New York. The buyer of the merchandise has placed in Nolan's hands the type of credit instrument which will give him the utmost credit protection. But Nolan is obliged to purchase the involved merchandise from X Manufacturing Company and the Company will not accept Nolan's order for the merchandise unless it is sweetened by prepayment in cash or by some form of financing which will be just as good. Nolan may not be in a position to attach his check to the order.

Assuming his integrity is unquestionable, he may request his bank or the bank confirming the credit to establish a domestic irrevocable commercial credit in favor of X Manufacturing Company, to be available by the Company's sight draft on the bank, accompanied by railroad bill of lading consigning the involved merchandise to the bank. The invoice value of the merchandise in the domestic credit will be somewhat less than the invoice value indicated in the confirmed foreign credit, the difference being Nolan's profit. The domestic credit will also give the shipping date from the factory and the expiration date of the instrument some days earlier than the corresponding dates indicated in the confirmed credit.

If the bank meets Nolan's request and establishes the domestic credit in favor of the Company, we say the domestic credit is "backed" by the confirmed credit and we have a "back to back" commercial credit operation. The risk which the bank takes in opening the domestic credit is a nominal one. If the Company cannot make the shipment within the specified time limitation, the domestic credit expires and the beneficiary need not be paid. If the shipping date is to be extended, the bank need not extend unless and until the foreign bank opening the confirmed credit has agreed to advance correspondingly the shipping date of its own credit. There is a possibility, of course, that although the Company may ship in time, the merchandise may not arrive at the seaboard in time to permit Nolan to make the ocean shipment and offer to the confirming-paying bank the ocean bills of lading required under the confirmed credit within the time limitations indicated therein. But even under these circumstances the risk of the American bank is nominal. In all probability the foreign buyer will gladly amend his credit as to

the shipping date, since he is anxious to have the goods. If not, the bank is secured by the merchandise and it may not be difficult to sell it to others without much, if any, loss. Nolan would have agreed in his application for the domestic credit to indemnify the bank against such losses.

Oftentimes, this risk can be much minimized if not entirely eliminated. Instead of calling for railroad bills of lading, the domestic (back to back) credit in favor of X Manufacturing Company may call for ocean bills of lading. In this event the shipping date and the expiration date in the domestic credit may be the same as or a little prior to the corresponding dates in the confirmed credit. If the Company does not comply, the bank has made no payment and may consider the credit as being expired. If the Company does comply, it is paid and the bank immediately reimburses itself by the confirmed credit. As in the case of the assignable credit, Nolan will supply the bank with his own invoices at higher prices which will be substituted for the invoices of the Company and will receive from the bank the difference between the two sets of invoices.

The bank issuing the "back to back" credit may wish to hold the confirmed credit in favor of Nolan and may also request Nolan to prepare and leave with the bank a set of his own invoices and his draft required by the terms of the confirmed credit. These documents will enable the bank to complete the operation under the confirmed credit if Nolan, himself, because of illness or otherwise, is unable to act prior to the expiration date of the confirmed credit.

In operations of this character the bank issuing the domestic credit will receive a commission from the beneficiary of the confirmed credit. It will also collect its usual commissions from the foreign bank of the buyer for advising and confirming the foreign bank's credit.

**Opening, Negotiating, and Paying Banks Are Not Responsible for Genuineness of Documents.**—Both in the application form for import credits and in the regulations governing our export credits, it is definitely provided that the banks involved shall not be responsible for the genuineness of the documents submitted under commercial credits. If the buyer of merchan-

dise has sufficient confidence in the integrity of the seller to provide payment to the seller against shipping documents to be tendered to the bank by the seller, as provided by the credit instrument, it follows that the same confidence should extend to the tendering of genuine documents. If the seller is dishonest, he need not attempt to defraud the buyer by the tender of forged documents. He can obtain the desired evil end with less opportunity for prompt detection by shipping inferior goods or no goods at all. The carrier does not pry into the cases and packages to make sure that the merchandise is, in fact, as described in the bill of lading and invoices which are prepared by the shipper. The tender of forged documents for the purpose of obtaining money is a crime and the seller who commits such a crime is prosecuted and jailed.

**The Interested Banks Are Not Responsible for Character or Quality of the Goods or for Terms of the Sale Contract Not Incorporated in the Credit.**—Neither can the interested banks assume responsibility for the character or quality of the goods shipped nor for the terms of the sale contract not incorporated and made part of the credit instrument. How could they? While the parties to the sale contract may be experts as to the involved merchandise the banks are not, generally speaking, sufficiently versed in the fine points of each and every class of merchandise which they finance. Even assuming the bank has men in its employ who can qualify as experts in certain lines of merchandising, it would not wish to extend this sort of service without adequate compensation but such service is not a banking function.

As we have indicated before, in the event the seller does not enjoy the full confidence of the buyer, the buyer should have a third party in whom he has full confidence examine the merchandise and issue a certificate of full compliance, which certificate may be designated in the credit as one of the several documents which must accompany the seller's draft. Some buyers attempt to get this service from the banks involved with the credit instrument by describing the merchandise in exacting terms. But such an effort places additional burdens and responsibilities upon the banks without giving the buyers the desired

protection. The unscrupulous seller may describe the merchandise in the invoices and bills of lading with the same details as indicated in the credit instrument but, as neither the banks nor the carriers can or wish to examine the contents of the cases, the seller wishing to defraud the buyer may, nevertheless, ship inferior goods or no goods at all. Because of this the credit should describe the goods in general terms only and the buyer should trust that the seller will ship the exact merchandise ordered. If the buyer is not satisfied with the moral standing of the seller, he should not open the credit but buy on open account basis, or subject to draft terms with the additional requirement that the draft need not be paid until after the buyer has had an opportunity to examine the goods to make sure that he has received exactly what he ordered.

**Recourse to the Drawer.**—Some American beneficiaries of commercial credits, who refuse to sell without the protection of such credits, insist that their drawing of drafts under the commercial credits should not impose upon themselves the usual warranties and responsibilities of the drawers of bills of exchange. They do not object to the drawing of the drafts required by the credit instruments but wish to add to their signature as drawers, the words “without recourse.” Such a drawer serves notice to all holders of the draft that if the drawee bank—the bank designated in the credit as the drawee bank—does not accept or pay the draft, the holders are not to look to the drawer for reimbursement. It is quite natural for a beneficiary to wish to consider the financing of his shipment irrevocably and finally completed when he has made the shipment, has presented the required draft and documents to the paying or negotiating bank, and has received the payment for his goods.

But a draft drawn under a commercial credit on a designated American bank, duly accepted by the drawee bank, thus becoming a bankers' acceptance, cannot be freely discounted and rediscounted in the American discount market when drawn “without recourse” to the drawer. This is because such acceptances are ineligible for discount with the Federal Reserve Banks. If a bankers' acceptance created in connection with a commercial

credit cannot be freely discounted and rediscounted at the best going discount rates, the primary purpose of an acceptance commercial credit—to obtain cheap financing while the goods are in transit and are being resold by the buyer who has established the credit in favor of the seller—is defeated.

But drawers of drafts who are beneficiaries of commercial credits need not be so concerned about their responsibility as drawers. In the first place, recourse is not involved if the beneficiary-drawer is to draw at sight on a bank local to himself and receive payment in his own currency. The payment of the sight draft by the designated local bank immediately discharges the drawer from all liability as drawer. Similarly, payment also discharges all endorsers of a draft. The payment kills the draft as a draft and the liability of the drawer and of endorsers dies with it.

If the credit calls upon the drawer to draw sight drafts on the foreign opening bank and to negotiate such drafts with American banks, no recourse can be had to the drawer, unless and until the drawee-opening bank dishonors the drafts by non-payment. The same is true if the drafts are to be drawn on a designated foreign bank other than the opening bank. Should such drafts be dishonored by non-payment, the drawer will have a good cause of action against the opening bank which issued the credit. Good banks will not break their contracts as represented by their commercial credits. Weaker banks cannot afford to regard their credit obligations lightly if they expect merchants to be satisfied with the binding force of commercial credits opened by them. When sight credits are also confirmed by an American bank, the beneficiary-drawers may recover the value of the drafts not only from the opening banks but also from the confirming banks, and no American bank which confirms credits of foreign banks will hesitate to reimburse the beneficiaries whose drafts are dishonored by the designated drawee banks.

We then come to acceptance credits. Up to the date when the beneficiary's time draft is accepted, the beneficiary-drawer may be slightly concerned about his liability as drawer although, in the event the time draft is dishonored by non-acceptance, he

has recourse to the bank opening the credit. If the credit has been confirmed also, he has a good cause of action against the confirming bank. After the time draft has been duly accepted by the designated drawee bank, such bank is primarily liable for the payment of its acceptance. True, the drawer is still liable as drawer until the acceptance is duly paid. But before the drawer is called upon to suffer a loss, the accepting bank, the opening bank, and in the case of confirmed credits, the confirming bank must have failed. This is a very remote possibility, of course, because commercial credits are issued by the larger and better foreign banks, the resulting time drafts are drawn on the same type of banks, and the credits are confirmed by the larger American banks.

Assume that all intervening banks have failed during the time the commercial credit operation is taking place. Under this contingency, the beneficiary-drawer who has been obliged to reimburse the holder of the dishonored draft may still look to the buyer of the merchandise. It was the buyer who established the credit in favor of the seller so that the seller would be paid for the goods sold and delivered. The payment facility established by the buyer is worthless and the seller is unpaid. It is only equitable that the seller should be permitted to recover the value of his goods from the buyer.

Up to this point we have considered recourse to an American drawer of a draft, drawn in connection with an export commercial credit operation. Let us now examine this question of recourse to the drawer in connection with the drafts of foreign beneficiaries of commercial credits opened by American banks for account of American importers.

Recourse is not involved if the foreign beneficiary is to draw sight drafts in his own currency and on a bank local to himself. The beneficiary-drawer's liability is entirely discharged as soon as the sight draft is paid by the foreign drawee bank. Should the credit instrument require the beneficiary to draw time drafts on a bank local to himself, the presumption is that he will not be permitted to absolve himself from liability by writing after his name the words "without recourse" or other words of similar force and effect. The involved foreign discount market will

refuse to take an acceptance when the maker's (the drawer's) signature and responsibility are so qualified. No recourse can be had to the drawer unless the accepting bank has failed. Should that occur the drawer is obliged to reimburse the holder of the unpaid acceptance, but he has a valid cause of action against the American opening bank. If both the accepting foreign bank and the opening American bank have failed before the maturity and payment of the acceptance the drawer must reimburse the holder, but he becomes a creditor of both failed banks and his chances of complete recovery are not too dim, as we shall presently discover.

Most of our import credits are circular in form and authorize the foreign beneficiaries to draw sight and time drafts, in dollars, on the American opening banks. The beneficiary is obliged to negotiate (sell) such dollar drafts to banks in his own country and locality. When the drafts are drawn at sight, the foreign negotiating bank may permit the drawer to draw "without recourse," particularly when the drawer is financially weak and his signature as maker gives no credit protection whatsoever to the negotiating bank.

Under such circumstances, the negotiating bank relies entirely upon the "engagement" or contract of the opening bank as represented by the credit instrument. But banks, both foreign and American, dislike negotiating bills which are drawn without recourse to the drawers. Such drawers, however, are not required to reimburse the holders for value unless the drawee banks—which in this instance are also the opening banks—have failed. This is a remote possibility because the American opening banks of import commercial credit are our largest and best banks.

Should the credit stipulate that the beneficiary is to draw time drafts on the opening bank, his drafts cannot be drawn without recourse because, after being accepted, the resulting bankers' acceptances will be ineligible for discount, if there is to be no recourse against the drawer. Should the American drawee bank fail before the time draft has been accepted, both the foreign drawer (the seller) and the foreign bank which has negotiated the draft still hold the shipping documents which represent the

involved merchandise. Should the drawee bank fail after having accepted the draft but before the draft's maturity and payment, in all probability the foreign negotiating bank will obtain reimbursement from the shipper, thus exercising its right of recourse against the drawer.

The foreign drawer's plight, however, is not so sad as it seems. Our courts have decided that if the American buyer has not placed the opening-drawee bank in funds prior to the failure of the bank, he need not do so but may use his funds to take up the dishonored acceptance. By its failure and consequent inability to pay the acceptance, the opening bank has broken its contract with the American importer represented by the commercial credit application. The opening bank agreed, first, to open the credit and, second, to honor the beneficiary's drafts. Having failed, the opening bank cannot fulfill the second part of its contract. But suppose the buyer placed the opening bank in funds at the time he signed the application for the credit or at some subsequent time, but before the opening bank's failure? In order not to restrict commercial credit operations, our courts hold that the funds, so advanced by the importer to the opening bank, are in the nature of trust funds and may be utilized by the receiver of the defunct bank, to pay and retire the particular acceptances in connection with which the advances were made.

These decisions also apply to sight drafts on the defunct opening bank. If the sight credit has been prepaid by the importer, the receiver may refuse to pay the sight draft, in which event the shipper and the foreign negotiating bank have the merchandise. On the other hand, the receiver may elect to pay the sight draft with the funds represented by the prepayment, especially if such action on his part is in the best interests of the general creditors of the failed bank.

It would seem to follow, therefore, that the beneficiary-drawer cannot suffer a complete loss unless we have the following remotely probable circumstances :

1. The credit has been opened without prepayment, in whole or in part, by the importer.
2. The beneficiary must be required to draw time drafts on the opening bank.

3. The time drafts have been accepted and the documents released to the importer.
4. The opening bank fails at this point and before the maturity of the acceptances.
5. The failure of the opening bank, or some other circumstances, must throw into bankruptcy at the same time the opening bank's client, the importer.

Despite the loss of his goods and the double bankruptcy of his contractual debtors, the beneficiary-drawer may be able to partially reimburse himself by the dividends which may be paid from the two bankrupt estates. If a very conservative drawer is willing to accept a certified check in lieu of cash, he need not be so concerned about his liability as the drawer of a bill of exchange created under and protected by the commercial credit of a good bank.



## APPENDIX



## APPENDIX I

### UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS FIXED BY THE SEVENTH CONGRESS OF THE INTERNATIONAL CHAMBER OF COMMERCE AS ADOPTED MAY 29-JUNE 3, 1933, WITH GUIDING PROVISIONS SUBSEQUENTLY ADDED BY AMENDMENTS

#### GENERAL PROVISIONS

(a) Provisions, definitions, interpretations, &c. contained in the following Articles are to be understood as uniform directions in regard to Commercial Documentary Credits, applicable exclusively when other express and previously agreed arrangements between the parties do not intervene, and when such contrary agreements are not expressed in the conditions of credits or of Commercial Letters of Credit.

(b) It is essential that instructions regarding papers or documents required, be complete and precise. If, however, this should not be the case and Banks find themselves obliged to pay against documents without these being particularly specified, they will refer to SECTION C of the present text. It is also necessary that the use of technical terms should not give rise to confusion, owing to different interpretation.

(c) The beneficiary of a credit can in no case avail himself of the legal relations existing between Banks, or between the Bank of the principal (purchaser) and the latter.

#### A.—Form of Credits

ARTICLE 1.—Commercial Documentary Credits are essentially distinct transactions from sales contracts, on which they may be based, with which Banks are not concerned.

ARTICLE 2.—Commercial Documentary Credits may be either:

- (a) revocable, or
- (b) irrevocable.

ARTICLE 3.—All credits, unless clearly stipulated as irrevocable, are considered revocable, even though an expiry date is specified.

**ARTICLE 4.**—Revocable credits are not legally binding undertakings between Banks and beneficiaries. Such credits may be modified or cancelled at any moment without the Bank being obliged to notify the beneficiary. When a credit of this nature has been transmitted to a correspondent or to a branch, its modification or cancellation can take effect only upon receipt of notification by the said correspondent or branch with which the credit has been made available.

**ARTICLE 5.**—Irrevocable credits are definite undertakings by an opening Bank in favor of the beneficiary. Such undertaking can neither be modified nor cancelled without the agreement of all concerned.

**ARTICLE 6.**—Irrevocable credits may be notified to the beneficiary through an advising Bank without responsibility on the latter's part when it has merely been asked to notify the beneficiary.

**ARTICLE 7.**—An advising Bank may be called upon by the opening Bank to confirm an irrevocable credit. In this case, the advising Bank makes itself responsible to the beneficiary as from the date on which it gives confirmation.

**ARTICLE 8.**—In the event of the period of validity of the credit not being stipulated in an order to open, to notify or to confirm an irrevocable credit, the beneficiary will be advised of the credit for information only, and this implies no responsibility on the part of the correspondent or advising Bank. The credit will only be irrevocably opened or notified or confirmed later when the correspondent or the advising Bank has received supplementary details on the duration of validity.

**ARTICLE 9.**—When an irrevocable credit is opened in the form of a Commercial Letter of Credit, the Letter of Credit itself must include notification of the opening of an irrevocable credit and constitute the definite engagement by the issuing Bank towards the beneficiary and holder in good faith to honor all drafts issued by virtue of and in conformity with the clauses and conditions contained in the document. This document may be transmitted and/or notified by another Bank without engagement for the latter.

When a correspondent is instructed by cable or telegram to notify such Letter of Credit, the issuing Bank must send the original of the said Letter of Credit to the said correspondent, if it is intended to put the document itself into circulation; if any other procedure were followed, the issuing Bank would be responsible for all consequences which may result therefrom.

All the other provisions applicable to Commercial Documentary Credits are also applicable to the Commercial Letter of Credit.

### B.—Liability

ARTICLE 10.—Banks must examine all documents and papers with care so as to ascertain that on their face they appear to be in order.

Payment against documents in accordance with the terms and conditions of a credit by a Bank instructed to do so binds its principal to take them up.

ARTICLE 11.—Banks assume no liability or responsibility for the form, sufficiency, correctness, genuineness, falsification or legal effect of any documents or papers, or for the description, quantity, weight, quality, condition, packing, delivery or value of goods represented thereby, or for the general and/or particular conditions stipulated in the documents, or for the good faith or acts of the consigner or any other person whomsoever, or for the solvency, standing, &c. of the carriers or insurers of the goods.

ARTICLE 12.—Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of cables or telegrams, letters and/or documents, or for delay, mutilation or other errors in the transmission of cables or telegrams, or for errors in translation or interpretation of technical terms, and Banks reserve the right to transmit credit terms without translating them.

ARTICLE 13.—Banks assume no liability or responsibility for consequences arising out of the interruption of their business either by a decision of a public authority, or by strikes, lockouts, riots, wars, acts of God or other causes beyond their control. On credits expiring during such interruption of business, Banks will be able to make no settlement after expiration, except on specific instructions from their principal.

ARTICLE 14.—Banks utilizing the services of another Bank assume no liability or responsibility towards their principal (unless they themselves are at fault) should the instructions they transmit not be carried out exactly, even if they have themselves taken the initiative in the choice of their correspondent. Banks consider themselves authorized to make provision for credits with the Banks whose services they utilize, for the account and at the risk of the principal, and without any responsibility.

The principal (purchaser) is responsible to the Banks for all obligations imposed upon the latter by foreign laws and customs.

### C.—Documents

ARTICLE 15.—Unless otherwise instructed, Banks consider themselves authorized to honor the documents which they judge necessary, if presented in a suitable form, viz.:

(a) In maritime traffic:

Full set of Sea or Ocean Bills of Lading in negotiable and transferable form;  
Transferable Policy or Certificate of Insurance;  
Invoice.

(b) In inland traffic:

Complete set of negotiable and transferable inland waterway Bills of Lading, or  
Inland Waterway Consignment Note, or  
Railway Consignment Note, or  
Counterfoil Waybill;  
Transferable Policy or Certificate of Insurance;  
Invoice.

(c) In postal traffic:

Postal Receipt;  
Transferable Policy or Certificate of Insurance;  
Invoice.

Banks have the right to waive insurance papers, if the beneficiary furnishes proof satisfactory to them that the insurance is covered by the principal or the consignee of the goods.

ARTICLE 16.—The date of the Bill of Lading, or date indicated on the reception stamp of the Railway or Inland Waterway Consignment Notes, Counterfoil Waybills, Postal Receipts or other shipping documents will be taken in each case to be the date of shipment of the goods.

ARTICLE 17.—Proof of payment of the freight will be considered by the Banks sufficient if the mention of "freight paid" or other similar expression is affixed by stamp or in handwriting on the shipping documents.

ARTICLE 18.—Shipping documents bearing reservations as to the apparent good order and condition of the goods may be refused.

Unless otherwise implied by the conditions of credit or documents presented, Banks may honor documents stating that the goods are sub-

ject to C.O.D., insofar as such C.O.D. represents freight or transportation charges.

### *Bills of Lading*

ARTICLE 19.—When Sea or Ocean Bills of Lading are required, the following may be accepted:

- (a) "Received for Shipment", or "Alongside" Bills of Lading;
- (b) "Port" or "Custody" Bills of Lading for shipments of cotton from the United States of America, drawn under the "Liverpool Cotton Bill of Lading Conference" of 1907;
- (c) Transshipment Bills of Lading which, apart from printed clauses, permit transshipment on the way, on condition however that the entire voyage be effected under one and the same Bill of Lading.

Should it, for technical reasons be impossible that the entire voyage be covered by the same document, transshipment Bills of Lading may nevertheless be accepted without any responsibility for the Banks;

- (d) "Through Bills of Lading" issued by steamship companies or their agents (see guiding provision No. 3).

ARTICLE 20.—Bills of Lading issued by forwarding agents will be refused, as also Bills of Lading for shipment by sailing vessels (see guiding provisions No. 1 and No. 7).

ARTICLE 21.—Banks have the right to accept Bills of Lading mentioning the stowage on deck of goods of a special nature, on condition that the insurance covers the risks arising therefrom.

ARTICLE 22.—When shipment by steamship is required, Banks may consider themselves authorized to accept Bills of Lading for shipment by motor vessels.

ARTICLE 23.—When "On Board" shipment is required and is evidenced by a "Shipped" or "On Board" Bill of Lading, the Bill of Lading date will be taken as evidence that the goods have been shipped on or before that date at the place of shipment indicated on the Bill of Lading.

When loading on board is evidenced by means of a notation, and if the documents are presented for payment or for negotiation after the date of shipment stipulated in the credit, this notation must give the date of the loading on board in the port of shipment indicated on the Bill of Lading. If the date of the loading on board is not given, the date of the notation will be considered as that of the loading on board.

ARTICLE 24.—Banks have the right to require that the name of the beneficiary of the credit appear on the Bill of Lading as shipper or endorser.

*Railway or Inland Waterway Consignment Notes,  
Counterfoil Waybills, Postal Receipts*

ARTICLE 25.—Banks will consider these documents as regular when they bear the reception stamp of the railway or postal authorities, or, in the case of Inland Waterway Consignment Notes, when signed by the master. The documents must indicate as consignee either the principal (purchaser) or the opening Bank.

ARTICLE 26.—When an attestation or certificate of weight is required in the case of railway transport, Banks may refer to the indications contained in the shipping documents, on condition that weighing has been duly witnessed by means of a weight stamp or other official means. A weight attestation will only be required on special request.

ARTICLE 27.—If, in the case of shipment by rail, by inland waterway or by post, the name of the beneficiary does not appear on the transport documents, Banks may require them to be countersigned by him.

*Insurance*

ARTICLE 28.—Banks may accept either Policies or Certificates of Insurance issued by companies or their agents, by underwriters or eventually by brokers (see guiding provision No. 2).

ARTICLE 29.—The minimum value insured must be the C. I. F. value of the goods insofar as it is possible to check it by means of the documents tendered, but in no case should it be less than the amount of the settlement, or than that of the invoice if the latter is higher.

ARTICLE 30.—Failing instructions as to the risks to be covered, Banks will accept insurance documents as tendered providing that these cover the goods against transport risks.

ARTICLE 31.—When a credit stipulates "Insurance against all Risks" Banks can in no way be held responsible if any particular risk is not covered.

*Invoices*

ARTICLE 32.—Invoices must be made out in the name of the principal (purchaser) or in the name of any other person designated by him.

ARTICLE 33.—In order to determine the quality of the goods, Banks may refer to the indications given in the Invoices, which should correspond with those stipulated in the credit. Banks will accept shipping or insurance documents bearing the generic description of the goods.

#### *Other Documents*

ARTICLE 34.—When other documents are required, such as: Warehouse Receipts, Delivery Orders, Consular Invoices, Certificates of Origin, Certificates of Weight, of Quality or of Analysis, without further definition, Banks may accept such documents as tendered without responsibility on their part.

In special cases to be determined by Banks, the latter will require all other documents which they may consider necessary.

### D.—Interpretation of Terms

#### *“About”, “Circa” or Similar Terms*

ARTICLE 35.—These terms to be construed as allowing a difference not to exceed 10% more or less applicable, according to their place in the instructions or letters of credit, to the amount of the credit, or to the quantity or unit price of the goods.

When the goods, by their nature, do not allow the delivery of the exact quantity indicated—as, for instance, oil in barrels, ore in bulk, chemicals in bulk or in cylinders, &c.—a difference of 3% more or less will be allowed, even if the terms of the credit call for a fixed weight or measurement.

#### *Partial Shipments*

ARTICLE 36.—Banks may refuse to pay for partial shipments if they think it advisable. (This article superseded by guiding provision No. 4.)

ARTICLE 37.—If shipment by instalments within given periods is specified, each instalment shall be treated as a separate transaction. The instalment not shipped within a given period cannot be added to subsequent shipments and is considered as *ipso facto* cancelled. Banks may however pay against documents for subsequent shipments provided they are made within the given periods.

#### *Maturity or Validity*

ARTICLE 38.—The period for which all irrevocable credits are to remain in force must be stipulated. The period may be either a time

for payment or a time for shipment. If the credit does not specify which, the Bank shall consider the date to be the date for payment and after its expiration shall refuse payment, even if the documents bear a date within the time for payment.

ARTICLE 39.—The words “to”, “until”, “till” and words of similar import applying to dates of maturity for payment or negotiation are understood to include the date mentioned.

ARTICLE 40.—When the stipulated expiry date falls on a Sunday or legal or local holiday, or upon any holiday recognized as such by the Banks, the last day of the period of validity will be extended until the first following business day. This does not apply to the last day for shipment which must be respected whatever the day.

ARTICLE 41.—The validity of a revocable credit, if no date is specified, will be considered to have expired six months from the date of the notification sent to the beneficiary by the Bank with which the credit is available and this Bank may refuse any payment after said period, unless its principal gives special instructions to the contrary.

#### *Shipment, Loading or Dispatch*

ARTICLE 42.—“Prompt”, “immediately”, “as soon as possible”, &c.: these terms, and others of similar import, are to be interpreted as a request for shipment within thirty days from the notification to the beneficiary, unless a date has been stipulated.

When the words “departure”, “dispatch”, or “loading” are used in Commercial Documentary Credits, and unless specific evidence in respect thereto is required, the Banks will consider these words as synonymous to “shipment”, and they may be guided by the date appearing upon the Bills of Lading or other shipping documents.

#### *Presentation*

ARTICLE 43.—Documents must be presented without delay. Banks may refuse the documents if presented to them too late, in other words at a date not justified by the usual time taken to cover the distance between the place of dispatch and the place where payment is made.

ARTICLE 44.—Banks are under no obligation to accept documents outside their banking hours.

#### *Extension*

ARTICLE 45.—Any extension of the period for shipment shall extend for an equal period the time fixed for presentation or negotiation of documents or drafts (see guiding provision No. 5).

*Date Terms*

ARTICLE 46.—The terms “first half”, “second half” of a month shall be construed respectively as from the 1st to the 15th, and the 16th to the last day of each month, inclusive.

ARTICLE 47.—The terms “beginning”, “middle”, or “end” of a month shall be construed respectively as from the 1st to the 10th, the 11th to the 20th, and the 21st to the last day of each month, inclusive.

ARTICLE 48.—When a credit is opened as good “for one month”, “for six months”, &c., and the principal has not specified the date from which the time is to run, the time shall run from the date on which the beneficiary is advised by the Bank which notified the opening of the credit, and at which the credit is to be payable.

**E.—Transfer**

ARTICLE 49.—A credit can only be transferred on the express authority of the principal. In this case the credit can be transferred once only, and on the terms and conditions specified in the original credit, with the exception of the amount of the credit and of the time of validity, which both may be reduced.

If a Commercial Documentary Credit is transferred by fractions, such fractional transfers shall be considered as constituting one single transfer only.

Authority to transfer a credit covers authority to transfer it to another place. Bank charges entailed by such transfers are payable by the original beneficiary unless otherwise specified. During the validity of the original credit, payment may be made at the place to which the credit has been transferred.

**Guiding Provisions \***

1. *In the U. S. A., Bills of Lading stipulating that they have been issued under the terms of and subject to the conditions of a “Charter Party” are not accepted unless expressly stipulated in the Credit.*
2. *In the U. S. A., “Insurance Broker’s Cover Notes” are not accepted unless expressly stipulated, as the banks in the U. S. A. construe the term “insurance” as either policy of insurance or underwriters’ certificate of insurance.*
3. *In the U. S. A., “On Board Bills of Lading” are not demanded unless expressly required, even though the Credit mentions the name of a steamer.*

\*Made effective by amendments of July 1, 1938 and March 1, 1946.

4. *In the U. S. A., documents for partial shipments are accepted unless expressly prohibited; even though the Credit mentions the name of a steamer, partial shipment or shipments by that steamer are accepted.*
5. *In the U. S. A., an extension of a date for presentation or negotiation of draft and documents is not considered as extending the date of shipment.*
6. *In the U. S. A., the Definitions of Export Quotations, which are now in wide use, are known as the "Revised American Foreign Trade Definitions—1941," adopted as of July 30, 1941. They revise and supplant "American Foreign Trade Definitions" as approved at a conference at India House, New York City, on December 16, 1919.*
7. *In the U. S. A., Railroad Through Bills of Lading are not accepted unless expressly stipulated, except on exportations via Pacific ports to the Far East.*

## APPENDIX II

### REVISED AMERICAN FOREIGN TRADE DEFINITIONS—1941

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.  
National Foreign Trade Council, Inc.

#### FOREWORD

Since the issuance of *American Foreign Trade Definitions* in 1919 many changes in practice have occurred. The 1919 Definitions did much to clarify and simplify foreign trade practice, and received wide recognition and use by buyers and sellers throughout the world. At the Twenty-Seventh National Foreign Trade Convention, 1940, further revision and clarification of these Definitions was urged as necessary to assist the foreign trader in the handling of his transactions.

The following *Revised American Foreign Trade Definitions—1941* are recommended for general use by both exporters and importers. These revised definitions have no status at law unless there is specific legislation providing for them, or unless they are confirmed by court decisions. Hence, it is suggested that sellers and buyers agree to their acceptance as part of the contract of sale. These revised definitions will then become legally binding upon all parties.

In view of changes in practice and procedure since 1919, certain new responsibilities for sellers and buyers are included in these revised definitions. Also, in many instances, the old responsibilities are more clearly defined than in the 1919 Definitions, and the changes should be beneficial both to sellers and buyers. Widespread acceptance will lead to a greater standardization of foreign trade procedure, and to the avoidance of much misunderstanding.

Adoption by exporters and importers of these revised terms will impress on all parties concerned their respective responsibilities and rights.

### General Notes of Caution

1. As foreign trade definitions have been issued by organizations in various parts of the world, and as the courts of countries have interpreted these definitions in different ways, it is important that sellers and buyers agree that their contracts are subject to the *Revised American Foreign Trade Definitions—1941* and that the various points listed are accepted by both parties.

2. In addition to the foreign trade terms listed herein, there are terms that are at times used, such as Free Harbor, C.I.F. & C. (Cost, Insurance, Freight, and Commission), C.I.F.C. & I. (Cost, Insurance, Freight, Commission, and Interest), C.I.F. Landed (Cost, Insurance, Freight, Landed), and others. None of these should be used unless there has first been a definite understanding as to the exact meaning thereof. It is unwise to attempt to interpret other terms in the light of the terms given herein. Hence, whenever possible, one of the terms defined herein should be used.

3. It is unwise to use abbreviations in quotations or in contracts which might be subject to misunderstanding.

4. When making quotations, the familiar terms "hundredweight" or "ton" should be avoided. A hundredweight can be 100 pounds of the short ton, or 112 pounds of the long ton. A ton can be a short ton of 2,000 pounds, or a metric ton of 2,204.6 pounds, or a long ton of 2,240 pounds. Hence, the type of hundredweight or ton should be clearly stated in quotations and in sales confirmations. Also, all terms referring to quantity, weight, volume, length, or surface should be clearly defined and agreed upon.

5. If inspection, or certificate of inspection, is required, it should be agreed, in advance, whether the cost thereof is for account of seller or buyer.

6. Unless otherwise agreed upon, all expenses are for the account of seller up to the point at which the buyer must handle the subsequent movement of goods.

7. There are a number of elements in a contract that do not fall within the scope of these foreign trade definitions. Hence, no mention of these is made herein. Seller and buyer should agree to these separately when negotiating contracts. This particularly applies to so-called "customary" practices.

## DEFINITIONS OF QUOTATIONS

**(I) EX (Point of Origin)**

*“EX FACTORY”, “EX MILL”, “EX MINE”, “EX PLANTATION”, “EX WAREHOUSE”, etc. (named point of origin)*

Under this term, the price quoted applies only at the point of origin, and the seller agrees to place the goods at the disposal of the buyer at the agreed place on the date or within the period fixed.

Under this quotation :

Seller must

- (1) bear all costs and risks of the goods until such time as the buyer is obliged to take delivery thereof;
- (2) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) take delivery of the goods as soon as they have been placed at his disposal at the agreed place on the date or within the period fixed;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) bear all costs and risks of the goods from the time when he is obligated to take delivery thereof;
- (4) pay all costs and charges incurred in obtaining the documents issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation or of importation at destination.

**(II) F.O.B. (Free on Board)**

*NOTE: Seller and buyer should consider not only the definitions but also the “Comments on All F.O.B. Terms” given at the end of this section (page 380), in order to understand fully their respective responsibilities and rights under the several classes of “F.O.B.” terms.*

(II-A) "F.O.B. (named inland carrier at named inland point of departure)" \*

Under this term, the price quoted applies only at inland shipping point, and the seller arranges for loading of the goods on, or in, railway cars, trucks, lighters, barges, aircraft, or other conveyance furnished for transportation.

Under this quotation:

Seller must

- (1) place goods on, or in, conveyance, or deliver to inland carrier for loading;
- (2) provide clean bill of lading or other transportation receipt, freight collect;
- (3) be responsible for any loss or damage, or both, until goods have been placed in, or on, conveyance at loading point, and clean bill of lading or other transportation receipt has been furnished by the carrier;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) be responsible for all movement of the goods from inland point of loading and pay all transportation costs;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) be responsible for any loss or damage, or both, incurred after loading at named inland point of departure;
- (4) pay all costs and charges incurred in obtaining the documents issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

(II-B) "F.O.B. (named inland carrier at named inland point of departure) FREIGHT PREPAID TO (named point of exportation)" \*

Under this term, the seller quotes a price including transportation charges to the named point of exportation and prepays freight to named point of exportation, without assuming responsibility for the goods

\* See Note (page 375) and Comments on all F.O.B. Terms (page 380).

after obtaining a clean bill of lading or other transportation receipt at named inland point of departure.

Under this quotation:

Seller must

- (1) assume the seller's obligations as under II-A (page 376), except that under (2) he must provide clean bill of lading or other transportation receipt, freight prepaid to named point of exportation.

Buyer must

- (1) assume the same buyer's obligations as under II-A (page 376), except that he does not pay freight from loading point to named point of exportation.

*(II-C) "F.O.B. (named inland carrier at named inland point of departure) FREIGHT ALLOWED TO (named point)" \**

Under this term, the seller quotes a price including the transportation charges to the named point, shipping freight collect and deducting the cost of transportation, without assuming responsibility for the goods after obtaining a clean bill of lading or other transportation receipt at named inland point of departure.

Under this quotation:

Seller must

- (1) assume the same seller's obligations as under II-A (page 376), but deducts from his invoice the transportation cost to named point.

Buyer must

- (1) assume the same buyer's obligations as under II-A (page 376), including payment of freight from inland loading point to named point, for which seller has made deduction.

*(II-D) "F.O.B. (named inland carrier at named point of exportation)" \**

Under this term, the seller quotes a price including the costs of transportation of the goods to named point of exportation, bearing any loss or damage, or both, incurred up to that point.

\* See Note (page 375) and Comments on all F.O.B. Terms (page 380).

Under this quotation:

Seller must

- (1) place goods on, or in, conveyance, or deliver to inland carrier for loading;
- (2) provide clean bill of lading or other transportation receipt, paying all transportation costs from loading point to named point of exportation;
- (3) be responsible for any loss or damage, or both, until goods have arrived in, or on, inland conveyance at the named point of exportation;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) be responsible for all movement of the goods from inland conveyance at named point of exportation;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) be responsible for any loss or damage, or both, incurred after goods have arrived in, or on, inland conveyance at the named point of exportation;
- (4) pay all costs and charges incurred in obtaining the documents issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

*(II-E) "F.O.B. VESSEL (named port of shipment)"\**

Under this term, the seller quotes a price covering all expenses up to, and including, delivery of the goods upon the overseas vessel provided by, or for, the buyer at the named port of shipment.

Under this quotation:

Seller must

- (1) pay all charges incurred in placing goods actually on board the vessel designated and provided by, or for, the buyer on the date or within the period fixed;

\* See Note (page 375) and Comments on all F.O.B. Terms (page 380).

- (2) provide clean ship's receipt or on-board bill of lading;
- (3) be responsible for any loss or damage, or both, until goods have been placed on board the vessel on the date or within the period fixed;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) give seller adequate notice of name, sailing date, loading berth of, and delivery time to, the vessel;
- (2) bear the additional costs incurred and all risks of the goods from the time when the seller has placed them at his disposal if the vessel named by him fails to arrive or to load within the designated time;
- (3) handle all subsequent movement of the goods to destination:
  - (a) provide and pay for insurance;
  - (b) provide and pay for ocean and other transportation;
- (4) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (5) be responsible for any loss or damage, or both, after goods have been loaded on board the vessel;
- (6) pay all costs and charges incurred in obtaining the documents, other than ocean ship's receipt or bill of lading, issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

(II-F) "*F.O.B. (named inland point in country of importation)*" \*

Under this term, the seller quotes a price including the cost of the merchandise and all costs of transportation to the named inland point in the country of importation.

Under this quotation:

Seller must

- (1) provide and pay for all transportation to the named inland point in the country of importation;

\* See Note (page 375) and Comments on all F.O.B. Terms (page 380).

- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) provide and pay for marine insurance;
- (4) provide and pay for war risk insurance, unless otherwise agreed upon between the seller and buyer;
- (5) be responsible for any loss or damage, or both, until arrival of goods on conveyance at the named inland point in the country of importation;
- (6) pay the costs of certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or of both, which the buyer may require for the importation of goods into the country of destination and, where necessary, for their passage in transit through another country;
- (7) pay all costs of landing, including wharfage, landing charges, and taxes, if any;
- (8) pay all costs of customs entry in the country of importation;
- (9) pay customs duties and all taxes applicable to imports, if any, in the country of importation.

*NOTE: The seller under this quotation must realize that he is accepting important responsibilities, costs, and risks, and should therefore be certain to obtain adequate insurance. On the other hand, the importer or buyer may desire such quotations to relieve him of the risks of the voyage and to assure him of his landed costs at inland point in country of importation. When competition is keen, or the buyer is accustomed to such quotations from other sellers, seller may quote such terms, being careful to protect himself in an appropriate manner.*

**Buyer must**

- (1) take prompt delivery of goods from conveyance upon arrival at destination;
- (2) bear any costs and be responsible for all loss or damage, or both, after arrival at destination.

**Comments On All F.O.B. Terms**

In connection with F.O.B. terms, the following points of caution are recommended:

1. The method of inland transportation, such as trucks, railroad cars, lighters, barges, or aircraft should be specified.

2. If any switching charges are involved during the inland transportation, it should be agreed, in advance, whether these charges are for account of the seller or the buyer.

3. The term "F.O.B. (named port)", without designating the exact point at which the liability of the seller terminates and the liability of the buyer begins, should be avoided. The use of this term gives rise to disputes as to the liability of the seller or the buyer in the event of loss or damage arising while the goods are in port, and before delivery to or on board the ocean carrier. Misunderstandings may be avoided by naming the specific point of delivery.

4. If lighterage or trucking is required in the transfer of goods from the inland conveyance to ship's side, and there is a cost therefor, it should be understood, in advance, whether this cost is for account of the seller or the buyer.

5. The seller should be certain to notify the buyer of the minimum quantity required to obtain a carload, a truckload, or a barge-load freight rate.

6. Under F.O.B. terms, excepting "F.O.B. (named inland point in country of importation)", the obligation to obtain ocean freight space, and marine and war risk insurance, rests with the buyer. Despite this obligation on the part of the buyer, in many trades the seller obtains the ocean freight space, and marine and war risk insurance, and provides for shipment on behalf of the buyer. Hence, seller and buyer must have an understanding as to whether the buyer will obtain the ocean freight space, and marine and war risk insurance, as is his obligation, or whether the seller agrees to do this for the buyer.

7. For the seller's protection, he should provide in his contract of sale that marine insurance obtained by the buyer include standard warehouse to warehouse coverage.

### (III) F.A.S. (Free Along Side)

*NOTE: Seller and buyer should consider not only the definitions but also the "Comments" given at the end of this section (page 382), in order to understand fully their respective responsibilities and rights under "F.A.S." terms.*

*"F.A.S. VESSEL (named port of shipment)"*

Under this term, the seller quotes a price including delivery of the goods along side overseas vessel and within reach of its loading tackle.

Under this quotation:

**Seller must**

- (1) place goods along side vessel or on dock designated and provided by, or for, buyer on the date or within the period fixed; pay any heavy lift charges, where necessary, up to this point;
- (2) provide clean dock or ship's receipt;
- (3) be responsible for any loss or damage, or both, until goods have been delivered along side the vessel or on the dock;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

**Buyer must**

- (1) give seller adequate notice of name, sailing date, loading berth of, and delivery time to, the vessel;
- (2) handle all subsequent movement of the goods from along side the vessel:
  - (a) arrange and pay for demurrage or storage charges, or both, in warehouse or on wharf, where necessary;
  - (b) provide and pay for insurance;
  - (c) provide and pay for ocean and other transportation;
- (3) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (4) be responsible for any loss or damage, or both, while the goods are on a lighter or other conveyance along side vessel within reach of its loading tackle, or on the dock awaiting loading, or until actually loaded on board the vessel, and subsequent thereto;
- (5) pay all costs and charges incurred in obtaining the documents, other than clean dock or ship's receipt, issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

### **F.A.S. Comments**

1. Under F.A.S. terms, the obligation to obtain ocean freight space, and marine and war risk insurance, rests with the buyer. Despite this obligation on the part of the buyer, in many trades the seller obtains

ocean freight space, and marine and war risk insurance, and provides for shipment on behalf of the buyer. In others, the buyer notifies the seller to make delivery along side a vessel designated by the buyer and the buyer provides his own marine and war risk insurance. Hence, seller and buyer must have an understanding as to whether the buyer will obtain the ocean freight space, and marine and war risk insurance, as is his obligation, or whether the seller agrees to do this for the buyer.

2. For the seller's protection, he should provide in his contract of sale that marine insurance obtained by the buyer include standard warehouse to warehouse coverage.

#### (IV) C. & F. (Cost and Freight)

*NOTE: Seller and buyer should consider not only the definitions but also the "C. & F. Comments" (page 384) and the "C & F. and C.I.F. Comments" (page 386), in order to understand fully their respective responsibilities and rights under "C. & F." terms.*

##### *"C. & F. (named point of destination)"*

Under this term, the seller quotes a price including the cost of transportation to the named point of destination.

Under this quotation:

Seller must

- (1) provide and pay for transportation to named point of destination;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) obtain and dispatch promptly to buyer, or his agent, clean bill of lading to named point of destination;
- (4) where received-for-shipment ocean bill of lading may be tendered, be responsible for any loss or damage, or both, until the goods have been delivered into the custody of the ocean carrier;
- (5) where on-board ocean bill of lading is required, be responsible for any loss or damage, or both, until the goods have been delivered on board the vessel;
- (6) provide, at the buyer's request and expense, certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or of both, which the buyer may require for importation of goods

into country of destination and, where necessary, for their passage in transit through another country.

**Buyer must**

- (1) accept the documents when presented;
- (2) receive goods upon arrival, handle and pay for all subsequent movement of the goods, including taking delivery from vessel in accordance with bill of lading clauses and terms; pay all costs of landing, including any duties, taxes, and other expenses at named point of destination;
- (3) provide and pay for insurance;
- (4) be responsible for loss of or damage to goods, or both, from time and place at which seller's obligations under (4) or (5) above have ceased;
- (5) pay the costs of certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or of both, which may be required for the importation of goods into the country of destination and, where necessary, for their passage in transit through another country.

**C. & F. Comments**

1. For the seller's protection, he should provide in his contract of sale that marine insurance obtained by the buyer include standard warehouse to warehouse coverage.

2. The comments listed under the following C.I.F. terms in many cases apply to C. & F. terms as well, and should be read and understood by the C. & F. seller and buyer.

**(V) C.I.F. (Cost, Insurance, Freight)**

*NOTE: Seller and buyer should consider not only the definitions but also the "Comments" (page 386), at the end of this section, in order to understand fully their respective responsibilities and rights under "C.I.F." terms.*

*"C.I.F. (named point of destination)"*

Under this term, the seller quotes a price including the cost of the goods, the marine insurance, and all transportation charges to the named point of destination.

Under this quotation:

**Seller must**

- (1) provide and pay for transportation to named point of destination;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) provide and pay for marine insurance;
- (4) provide war risk insurance as obtainable in seller's market at time of shipment at buyer's expense, unless seller has agreed that buyer provide for war risk coverage (See Comment 10 (c), page 387);
- (5) obtain and dispatch promptly to buyer, or his agent, clean bill of lading to named point of destination, and also insurance policy or negotiable insurance certificate;
- (6) where received-for-shipment ocean bill of lading may be tendered, be responsible for any loss or damage, or both, until the goods have been delivered into the custody of the ocean carrier;
- (7) where on-board ocean bill of lading is required, be responsible for any loss or damage, or both, until the goods have been delivered on board the vessel;
- (8) provide, at the buyer's request and expense, certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or both, which the buyer may require for importation of goods into country of destination and, where necessary, for their passage in transit through another country.

**Buyer must**

- (1) accept the documents when presented;
- (2) receive the goods upon arrival, handle and pay for all subsequent movements of the goods, including taking delivery from vessel in accordance with bill of lading clauses and terms; pay all costs of landing, including any duties, taxes, and other expenses at named point of destination;
- (3) pay for war risk insurance provided by seller;
- (4) be responsible for loss of or damage to goods, or both, from time and place at which seller's obligations under (6) or (7) above have ceased;
- (5) pay the cost of certificates of origin, consular invoices, or any other documents issued in the country of origin, or of

shipment, or both, which may be required for importation of the goods into the country of destination and, where necessary, for their passage in transit through another country.

### C. & F. and C.I.F. Comments

Under C. & F. and C.I.F. contracts there are the following points on which the seller and the buyer should be in complete agreement at the time that the contract is concluded:

1. It should be agreed upon, in advance, who is to pay for miscellaneous expenses, such as weighing or inspection charges.

2. The quantity to be shipped on any one vessel should be agreed upon, in advance, with a view to the buyer's capacity to take delivery upon arrival and discharge of the vessel; within the free time allowed at the port of importation.

3. Although the terms C. & F. and C.I.F. are generally interpreted to provide that charges for consular invoices and certificates of origin are for the account of the buyer, and are charged separately, in many trades these charges are included by the seller in his price. Hence, seller and buyer should agree, in advance, whether these charges are part of the selling price, or will be invoiced separately.

4. The point of final destination should be definitely known in the event the vessel discharges at a port other than the actual destination of the goods.

5. When ocean freight space is difficult to obtain, or forward freight contracts cannot be made at firm rates, it is advisable that sales contracts, as an exception to regular C. & F. or C.I.F. terms, should provide that shipment within the contract period be subject to ocean freight space being available to the seller, and should also provide that changes in the cost of ocean transportation between the time of sale and the time of shipment be for account of the buyer.

6. Normally, the seller is obligated to prepay the ocean freight. In some instances, shipments are made freight collect and the amount of the freight is deducted from the invoice rendered by the seller. It is necessary to be in agreement on this, in advance, in order to avoid misunderstanding which arises from foreign exchange fluctuations which might affect the actual cost of transportation, and from interest charges which might accrue under letter of credit financing. Hence, the seller should always prepay the ocean freight unless he has a specific agreement with the buyer, in advance, that goods can be shipped freight collect.

7. The buyer should recognize that he does not have the right to insist on inspection of goods prior to accepting the documents. The buyer should not refuse to take delivery of goods on account of delay in the receipt of documents, provided the seller has used due diligence in their dispatch through the regular channels.

8. Sellers and buyers are advised against including in a C.I.F. contract any indefinite clause at variance with the obligations of a C.I.F. contract as specified in these Definitions. There have been numerous court decisions in the United States and other countries invalidating C.I.F. contracts because of the inclusion of indefinite clauses.

9. Interest charges should be included in cost computations and should not be charged as a separate item in C.I.F. contracts, unless otherwise agreed upon, in advance, between the seller and buyer; in which case, however, the term C.I.F. and I. (Cost, Insurance, Freight, and Interest) should be used.

10. In connection with insurance under C.I.F. sales, it is necessary that seller and buyer be definitely in accord upon the following points:

(a) The character of the marine insurance should be agreed upon in so far as being W.A. (With Average) or F.P.A. (Free of Particular Average), as well as any other special risks that are covered in specific trades, or against which the buyer may wish individual protection. Among the special risks that should be considered and agreed upon between seller and buyer are theft, pilferage, leakage, breakage, sweat, contact with other cargoes, and others peculiar to any particular trade. It is important that contingent or collect freight and customs duty should be insured to cover Particular Average losses, as well as total loss after arrival and entry but before delivery.

(b) The seller is obligated to exercise ordinary care and diligence in selecting an underwriter that is in good financial standing. However, the risk of obtaining settlement of insurance claims rests with the buyer.

(c) War risk insurance under this term is to be obtained by the seller at the expense and risk of the buyer. It is important that the seller be in definite accord with the buyer on this point, particularly as to the cost. It is desirable that the goods be insured against both marine and war risk with the same underwriter, so that there can be no difficulty arising from the determination of the cause of the loss.

(d) Seller should make certain that in his marine or war risk insurance, there be included the standard protection against strikes, riots and civil commotions.

(e) Seller and buyer should be in accord as to the insured valuation, bearing in mind that merchandise contributes in General Average on certain bases of valuation which differ in various trades. It is desirable that a competent insurance broker be consulted, in order that full value be covered and trouble avoided.

### (VI) Ex Dock

*“EX DOCK (named port of importation)”*

*NOTE: Seller and buyer should consider not only the definitions but also the “Ex Dock Comments” at the end of this section (page 389), in order to understand fully their respective responsibilities and rights under “Ex Dock” terms.*

Under this term, seller quotes a price including the cost of the goods and all additional costs necessary to place the goods on the dock at the named port of importation, duty paid, if any.

Under this quotation:

Seller must

- (1) provide and pay for transportation to named port of importation;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) provide and pay for marine insurance;
- (4) provide and pay for war risk insurance, unless otherwise agreed upon between the buyer and seller;
- (5) be responsible for any loss or damage, or both, until the expiration of the free time allowed on the dock at the named port of importation;
- (6) pay the costs of certificates of origin, consular invoices, legalization of bill of lading, or any other documents issued in the country of origin, or of shipment, or of both, which the buyer may require for the importation of goods into the country of destination and, where necessary, for their passage in transit through another country;
- (7) pay all costs of landing, including wharfage, landing charges and taxes, if any;
- (8) pay all costs of customs entry in the country of importation;

- (9) pay customs duties and all taxes applicable to imports, if any, in the country of importation, unless otherwise agreed upon.

**Buyer must**

- (1) take delivery of the goods on the dock at the named port of importation within the free time allowed;
- (2) bear the cost and risk of the goods if delivery is not taken within the free time allowed.

**Ex Dock Comments**

This term is used principally in United States import trade. It has various modifications, such as "Ex Quay", "Ex Pier", etc., but it is seldom, if ever, used in American export practice. Its use in quotations for export is not recommended.



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