NAEGA Discussion Paper on Trade Practices - Payment of Cash in Advance in Relation to US Exports of Bulk Grains to Cuba

Following is a discussion of the US bulk grain export trade in relation to exports under the US Trade Sanctions Reform and Export Enhancement Act of 2000 (TSREEA), 22 U.S.C. ' 7207(b)(1).[1] Further related to the requirement for payment of cash in advance as found in 908(b)(1) of TSREEA. This discussion is intended to provide an understanding of the bulk trade in response to the question of whether the term "payment of cash in advance" requires that payment be received by U.S. exporters before goods are shipped to Cuba or whether payment may be received at other points in the shipping process so long as payment is received before the Cuban purchaser takes possession of the items in question.

I. US INDUSTRY ENVIRONMENT

U.S. export grain marketing is essentially a private sector system; with the exception of humanitarian food aid, the U.S. Government does not directly engage in the day-to-day marketing of grain and oilseeds. Grain and oilseeds are sold by competing private-sector merchants using predominately private facilities. When the US Government acts to export for international food assistance it contracts for commodity and logistics with the private-sector system.

The US grain export system is a large, diverse, and evolving industry including public, private and cooperatively owned and managed facilities and trading entities. The industry must constantly seek added efficiencies, mitigate the enormous risks associated with international trade in a mature and politically charged environment, compete and trade with subsidized and state controlled organizations, upgrade export facilities and streamline logistical capabilities in order to sustain the export of US agricultural products.

As much as one third of all grain produced in the U.S. moves into export. In 2004 approximately $20 billion worth of bulk agricultural commodities were exported from the United States via this system. It is expected that over 100 million metric tons, of primarily US corn, soybeans and wheat, were handled by the US grain export system in the calendar year 2004. Annual volumes and value vary widely based on pricing, currency values, US market access, and global supply and demand for the commodities produced in the United States.

Characteristics of the system include:

[1] The Trade Sanctions Reform and Export Enhancement Act of 2000 (TSREEA) is Title IX of P.L. 106-387, the Agriculture, Rural Development, Food and Drug Administration, and Related Agency Appropriations Act, FY 2001, enacted October 28, 2000, and is codified at 22 U.S.C. ' ' 7201 *et seq.*

1. Highly efficient system that can receive, store, sort, blend and ship large amounts of grain of uniform quality to a diverse international customer base
2. Competitive suppliers provide several options for buyers by proving a system that is highly flexible (food, feed, industrial markets).
3. System relies on contract sanctity and has built-in system of dispute resolution that includes several private dispute settlement mechanisms that provide an alternative to public judicial system. Integrity in business relationships combined with the ability to equitably resolve disputes in a timely and cost effective manner are a hallmark of the US grain export system.
4. At export, multiple commodity loading ability is combined with vessel-loading rates that reach 3200-3400 tons per hour. Year round capacity to supply a wide assortment of contractual specifications for both quality and quantity at several different ports.
5. In addition to meeting commercial contract specifications, US grains and oilseeds must meet rigorous U.S. government standards and destination market requirements before being certified for export shipment.:

    - Grain Quality inspections are certified by the US Government. For most US exports a Federal agency, the Grain Inspection Packers and Stockyards Agency (GIPSA,) provides Federal Grain Inspection Service (FGIS) certification of quality under official US grain standards, performs vessel hold inspections, and certifies the weight of export shipments.
    - US Animal Plant Health Inspection Service officials (USDA/APHIS) provide for Sanitary and Phytosanitary requirements by certifying shipments as required by international convention and sovereign regulation.
    - Third party private inspection laboratories are available to perform a wide variety of process certification, inspections and testing services to meet buyer and contract requirements.

6. **Most important to the TSREEA / payment discussion, the US export system follows well established and internationally accepted practice in which control of commodity and transfer of title are always dependent upon the transfer of possession of the Bill of Lading.2**

Exporting grain is both a competitive and a capital-intensive industry. Since the margin of profit to be earned from moving a ton of grain can be quite small, exporters depend upon moving large volumes very quickly. They seek to achieve an economy of scale that lowers their average fixed costs per unit of volume handled, provides operating flexibility, increases bargaining power in chartering for shipping, and improves the services they can provide worldwide. An effective, legally sound system of collection of funds prior to surrendering commodity is critical to the operation of the US bulk grain exporting industry.

2 Clause 25 of NAEGA II F.O.B. Contract

II. SUMMARY OF TYPICAL FOB SALE OF BULK AGRICULTURAL GOODS TO CUBA

a) A written contract between the U.S. Exporter and Cuba is negotiated and signed. The contract includes a price provision that either includes a flat price or a price that is to be established prior to shipment. The contract specifies the type of goods and the quality specifications, and generally includes some mechanism for the price to be discounted if the quality specifications are not met. The contract states the volume, plus or minus some percentage (typically 5% to 10%), which is necessary given the bulk nature of the commodity and the particular loading requirements of different vessels. Finally, the contract specifies a shipment period, payment terms and the required shipping documents.

b) The actual date of loading will depend upon the preparedness of the U.S. exporter to load and the actual arrival of the nominated vessel in the U.S. port. Typically, the loading of the nominated vessel will begin within a few days upon its arrival at the load port, depending upon weather conditions and other vessels loading that may be in line to load at the elevator. Once loading has commenced, depending upon the size of the cargo, port facilities, the vessel and weather, loading typically takes between 1 to 2 days. Actual amount of goods loaded is determined by the master of the vessel, and is based in large part on the vessel configuration, and is not precisely known until about 1 hour after completion of loading. Weight is established by elevator scales certified by the Federal Grain Inspection Service (FGIS).

c) During loading, samples of the goods are taken. Sampling methodology for grain is specified by FGIS. Sampling methodology for other agricultural goods, such as soybean meal, is specified by trade rules or independent laboratory. Results from FGIS are obtained within 1 to 4 hours after completion of loading. Analyses performed by independent laboratories may take longer.

d) Once loading is completed and the weight of the cargo is determined, the elevator issues a bill of lading, which is signed by the vessel's representative at the load port under the authority of the Master. The bill of lading governs who holds title to the goods and who has the legal right to control the goods. Whether bills of lading are issued to the order of the shipper or straight consigned, sellers retain title and control of the goods until payment has been received. Only upon receipt of payment will the U.S. exporter release documents to the importer.

e) Upon completion of the loading operations, the vessel departs from berth and begins its voyage. Total voyage time to Cuba is 2 to 4 days.

f) The U.S. exporter generates a commercial invoice using the weights and grades determined above and faxes this commercial invoice, along with a copy of the bill of lading, quality certificates and other miscellaneous documents to Cuba, requesting payment for this shipment that is on its way. The U.S. exporter retains the original documents, including the bill of lading, until payment in full is received.

g) The vessel arrives at the port in Cuba and waits to discharge. The discharge of the cargo is prohibited until Cuba presents the original bill of lading or the U.S. exporter provides its express authority to discharge. Only upon the U.S. exporter receiving payment in full does the U.S. exporter transmit the original documents, including the bill of lading, to Cuba, and authorizes the vessel to begin discharge of the cargo. In the case where the U.S. exporter has chartered the vessel for the delivery of the goods, absent an event of force majeure, the vessel typically does not enter Cuban waters or berth in the port in Cuba until the U.S. exporter receives payment in full.

h) In sum, the U.S. exporter receives cash in the U.S. exporter's account in advance of the transfer of title and control of the goods to Cuba.

III. PROBLEMS CAUSED BY REQUIRING CASH PAYMENT SOONER THAN TRANSFER OF TITLE AND CONTROL OF THE GOODS

1) Receipt of payment prior to the vessel being loaded is impossible because the exact weight and grade of the agricultural goods is not known until after loading. A U.S. exporter could require an estimated prepayment, but inevitably this would result in the U.S. exporter having either a debit or credit in favor of Cuba on its books, depending upon the actual weight and grades of the goods. In the event of an overpayment, there are no established rules or procedures in the regulations that would allow exporters to pay refunds to the buyer without being in clear violation of the law.

2) Receipt of payment prior to the vessel setting sail would also be impractical. First, this simply goes against the nature of the shipment of bulk vessels. When a vessel is loaded and the bill of lading has been issued, the vessel sets sail without delay. Second, given the delay in obtaining the grades, the vessel would be required to be anchored in the U.S. port for some time before it could set sail, likely causing the U.S. exporter to incur demurrage charges for this delay. This will only serve to increase the costs of the U.S. exporter and potentially cause congestion in the U.S. ports.

3) Coordinating receipt of payment prior to the vessel being loaded makes it extremely difficult for U.S. exporters to manage their domestic logistics. If the exporter is unable to load without payment in advance, or a delay occurs in the payment process, there will considerable delays in the supply side while exporters

track and confirm the payment of the goods. This could cause the U.S. exporter to incur barge and/or rail demurrage charges which are unrecoverable.

4) If these impossible and impractical logistic constraints could be overcome, requiring cash payment sooner than the transfer of title and control of the goods places considerable additional risk on the transaction. As a result the US exporter, responding to both buyer and seller concerns, will be forced to incorporate additional risk premiums in the contract price. In the competitive world of bulk commodity supply, most participants in the bulk agricultural trade agree, the result will be to place US agriculture in a non-competitive position and a significant volume of US agricultural exports will be lost.