

LEGAL ASPECT OF LETTERS OF CREDIT

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Abstract

Documentary letters of Credit are one of the most important payment methods used to facilitate international trade by mitigation of different risks connected with business partner or his country. Letter of credit transactions are relatively complexed and contractual relationship are governed by international rules and national laws. The aim of this scientific study is to identify legal aspects of letters of credit, to describe the relationship between parties of the letter of credit transaction and analysis the basic legal rules and laws governing these transactions. We used mainly classical scientific methods due to its descriptive character. We used the method of structured observation, determining the fundamental principles – the autonomy of letter of credit and the strict compliance, method of specification or concretisation – identification of relationship between parties and abstraction – definition of general and essential information about international rules and national laws of some countries.

Keywords: *documentary letters of credit, uniform customs and practice for documentary credits, Commercial Code.*

JEL Classification: B27, F30, F65, K22

1. Introduction

The Documentary Letter of Credit (L/C or Credit) is one of the safest payment instruments used in international trade and can mitigate the payment risks to minimum in the case of good creditworthiness of the issuing bank. It allows the buyer to obtain a lower purchase price of the goods and longer payment terms than when paying after delivery on the base of open account or documentary collection. As the payment is promised by the bank that issues an irrevocable letter of credit, it reduces or completely eliminates commercial credit risks. It can reduce certain foreign exchange and political risks without excluding them.

We can find few definitions on L/C. The most used is the one in Uniform Customs and Practices for Documentary Credits (UCP) adopted by International Chamber of Commerce (ICC): “Credit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour complying presentation.”³ Complying presentation is defined “a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of UCP rules and international standard banking practice”.⁴

By the letters of credit, the banks facilitate the international trade transactions and ensure to all contracting parties that the banks (issuing or confirming) fulfil their obligations, provided that the conditions and terms of the documentary letter of credit are met. A letter of credit provides also legal protection.

Documentary letters of credit are the most sophisticated international payment instruments, which are regulated by the international rules adopted by the International Chamber of Commerce in Paris – Uniform Customs and Practice for Documentary Credits (UCP) and supported by the legal norms of individual countries.

In this paper we would like to answer questions regarding (i) what are the roles and responsibilities of parties of letters of credit transactions, (ii) how the letters of credit transactions are covered by international rules and national laws. We explain the fundamental principles of L/Cs and we bring an overview how the letter of credit is covered by Slovak Commercial Code, US Uniform Commercial Code Article 5, Chinese law on L/Cs and the concept of L/Cs in Islamic Finance.

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³Uniform Customs and Practice for Documentary Credits 2007 Revision. ICC Publication No. 600. ICC Services, Paris. ISBN-10 92-842-1257-X.

⁴Ibid.

2. Aims and methodology

The aim of this scientific study is to identify legal aspects of letters of credit, to describe the relationship between parties of the letter of credit transaction and to analyse the basic legal rules and laws governing these transactions.

We used mainly classical scientific methods due to its descriptive character. We used the method of structured observation, determining the fundamental principles – the autonomy of letter of credit and the strict compliance.

Through systematic analysis, we have clarified the phenomena and processes related to letter of credit transactions. Method of specification, or concretization was used to identify the relationship between parties of the letters of credit transactions. Using abstraction, we have defined general and essential information about the international rules and national laws.

3. The fundamental principles of the letters of credit

The principle of autonomy. A documentary letter of credit is strictly separated from the purchase contract and other contracts to which the letter of credit may materially apply (eg transport contracts, insurance contracts and others). The article 4 UCP 600 explicitly states that “a credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary. A beneficiary can in no case avail itself of the contractual relationships existing between banks or between the applicant and the issuing bank.”⁵

The obligation of the issuing and confirming bank is not dependent on the relationship between the issuing bank and the applicant, on the relations between the banks or on the relationship between the applicant and the beneficiary. The Article 4 UCP 600 also states that “an issuing bank should discourage any attempt by the applicant to include, as an integral part of the credit, copies of the underlying contract, proforma invoice and the like.”⁶

One of the most discussed issues concerning the autonomy principle is the fraud exception. The ambit of the fraud exception is a very controversial area of commercial law.⁷

Doctrine of strict compliance. “Strict compliance” means that the stipulated documents must strictly comply with the terms of the credit. This is why the examination of documents prior to activating the L/C it concerned proves to be so important.⁸ In the case of a L/C, the issuing bank undertakes to perform on the basis of the presentation of the documents required by L/C. The bank has to decide only on the basis of documents whether to honour or not. The bank does not check the goods, but the documents. UCP 600 stipulates in Article 5 that “bank deal with documents and not with goods, services or performance to which the documents may relate.”⁹ The bank can refuse to honour on the basis of discrepancies in the documents, not on the basis of information about the condition of the goods. This documentary nature of the L/C is necessary to maintain the objectivity of the letter of credit transaction. The Bank may not refuse to honour if the presented documents comply with the L/C conditions. On the other hand, the bank may refuse to honour even with a small deviation or error in the documents. Assessing the extent to which documents comply with the terms of the letter of credit is the most complicated part of a L/C transaction and it is the most common reason for resolving a dispute in court.

⁵Uniform Customs and Practice for Documentary Credits 2007 Revision. ICC Publication No. 600. ICC Services, Paris. ISBN-10 92-842-1257-X. p. 21

⁶ Ibid.

⁷ Monteiro, Felicity. *Documentary Credits: The Autonomy Principle and the Fraud Exception: A Comparative Analysis of Common Law Approaches and Suggestions for New Zealand*. Law Review. Auckland University.

⁸ Chatterjee, Charles. 2006. *Legal Aspects of Trade Finance*. Routledge, New York. ISBN 978-1-85743-782-9. p.54

⁹ Uniform Customs and Practice for Documentary Credits 2007 Revision. ICC Publication No. 600. ICC Services, Paris. ISBN-10 92-842-1257-X. p. 20

The aim of international rules was to proceed in a uniform and standard way when checking documents. Gradually, the philosophy of the examination of documents changed. While in the past the formal side of documents was largely promoted, where the factor for decision about discrepancy was not the content of the document but its form. For example, the title of the document had to be strictly according to the wording in the letter of credit. At present, the aim is to assess the content of a document rather than its designation. This means that banks should also accept documents that are not marked as in the letter of credit, but the content corresponds to the wording. The documentary nature of the L/C is important for all parties involved in the L/C transaction. The beneficiary receives the funds when he presents the documents strictly complying with the terms of the letter of credit, i.e. his right to payment depends on the presentation of credit conform documents. The obligation of the issuing bank and confirming bank to honour is only under condition the credit conform documents are presented. Examination of documents and assessment the extent to which documents comply with the terms of the letter of credit is the most complicated part of a L/C transaction and it is the most common reason for resolving a dispute in court. That was one of the reasons why ICC approved the International Standard Banking Practice for the Examination of Documents under documentary Credits (ISBP).¹⁰

4. Relations between the parties to the letter of credit

Documentary transactions are relatively complicated and contractual relationships are established between the parties involved in these transactions, which are governed directly by the letter of credit or other underlying contracts.

The main relationships can be divided into the following areas:

Buyer (Applicant) and Seller (Beneficiary). The needs and interests of the buyer and the seller are fundamentally different. In the area of cash flow, the buyer is interested in paying at the latest, while the seller wants to receive the payment as soon as possible. With regard to documents, the buyer is interested in ensuring that the documents required under the letter of credit certify the supply of goods or services and he strives to require the most complexed documents. The buyer, in turn, is interested in making the documents requested under the L/C as simple as possible. The result should be compromised terms of the L/C, which will ensure the protection of both parties.¹¹

The agreement of the buyer and the seller on the basic attributes of the L/C protects both of them from problems in the execution of the L/C transaction. It very often happens that the wording of the L/C is not agreed in advance and problems subsequently arise. Both parties must be aware of the autonomy of the L/C from the purchase contract. However, there should be no conflict between the purchase contract as the basic contractual document governing the relationship between the applicant and the beneficiary, and the L/C.¹²

Article 1 of the ISBP states that “the terms of a credit are independent of the underlying transaction, even if a credit expressly refers to that transaction. To avoid unnecessary costs, delays and disputes in the examination of documents, however, the applicant and beneficiary should carefully consider which documents should be required, by whom they should be produced and the time frame for presentation.”¹³

The applicant and the beneficiary should also agree on when the L/C is to be issued. Unless the purchase contract provides such information, the applicant should ensure that a L/C is issued no later than the intended delivery date. The applicant must not forget that the bank does not issue a L/C automatically, but that it is subject to an approval procedure, the length of which depends on many circumstances. If the applicant has an approved limit for issuing commitment instruments, like L/Cs, bank guarantees, aval, the L/C can be issued relatively quickly. However, if the applicant does not

¹⁰ International Standard Banking Practice for the Examination of Documents under Documentary Credits. 2007. ICC Publication No. 681 E. ICC Services, Paris. ISBN: 978-92-842-0019-1.

¹¹ Jančíková, Eva. 2014. *Medzinárodné obchodné financovanie*. Sprint2. Bratislava, ISBN 9788089710003, p121.

¹² *Ibid*, p 122.

¹³ International Standard Banking Practice for the Examination of Documents under Documentary Credits. 2007. ICC Publication No. 681 E. ICC Services, Paris. ISBN: 978-92-842-0019-1, p.15

have such a credit limit, the approval may take several weeks, depending on the amount of the applicant's commitment and its creditworthiness.¹⁴

The correct completion of the application for the issuance of a L/C is the basis of the functionality of the entire operation.

The relationship between the applicant and the beneficiary is regulated by the purchase contract – an agreement that the seller will deliver the ordered goods or services and the buyer will pay with a documentary letter of credit.

Applicant and Issuing bank (Buyer's bank). Applicant requests his bank to open a L/C and he instructs his bank to give an undertaking to pay the beneficiary against the latter's submission of documents strictly in compliance with the applicant's instruction in the credit. In this connection, he undertakes to reimburse his bank when payments are made under the credit.¹⁵

Pursuant to agreement between the bank and the applicant, the bank undertakes to issue a letter of credit and the applicant undertakes to reimburse the bank for the funds paid out. From the point of view of the bank, the applicant's obligation to pay must be covered and, depending on the method of coverage, the issuing bank and the applicant sign other contracts (loan agreements, funds blocking agreements, collateral agreements). The issuing bank is usually domiciled in the applicant's country.

The relationship between the applicant and the issuing bank is regulated by the contract on the opening of a letter of credit, in which the applicant and the issuing bank agree on the conditions under which the bank will issue the letter of credit and under what conditions it will honour it.

Issuing bank and beneficiary. The relationship between the issuing bank and the beneficiary is regulated directly by the L/C, in which the issuing bank undertakes to honour the beneficiary, provided that the stipulated documents are presented. The issuing bank is irrevocably bound to honour as of the time it issues the credit. The issuing bank is usually in a country other than the beneficiary.

Issuing bank and correspondent banks. When issuing the L/C, the issuing bank uses the correspondent bank in the beneficiary's country. Relationships that arise between banks result directly from the issued letter of credit and are no longer contractually regulated. The nature of the issuing bank's relationship with such a correspondent bank depends on the functions entrusted to it by the issuing bank and on the acceptance of those functions.

The correspondent bank is only an advising bank. In this case, the correspondent bank is in fact only an intermediary between the issuing bank and the beneficiary. The advising bank does not assume any liability. Payments to the beneficiary may be applicable by presenting documents to the issuing bank.

The correspondent bank is an advising and nominated bank. In this role, the correspondent bank notifies the L/C received from the issuing bank and agrees to act as a nominated bank authorized to honour under L/C. The nominated bank notifies its consent to the nomination to the beneficiary. This notice states that the nominated bank will provide the beneficiary with the payments, provided that he presents the documents comply with the terms of the L/C. The nominated bank is therefore authorized by the issuing bank to honour the liabilities of the issuing bank. The issuing bank undertakes that if the nominated bank provides to the beneficiary, it will reimburse the nominated bank for the funds provided.

The correspondent bank is an advising and confirming bank. In this case, the correspondent bank notifies the beneficiary and confirms the L/C. With this confirmation, he undertakes to honour the beneficiary. The issuing bank undertakes to honour the confirming bank for all payments made. The relationship between the issuing and the confirming bank is in the nature of a mandate. The confirmation of a L/C by correspondent bank is subject of approval by the confirming bank. The issuing bank must examine the documents in accordance with the provisions of the uniform rules within a maximum of 5 banking days.

Advising band and the beneficiary. The advising bank notifies the L/C to the beneficiary.

¹⁴ Jančíková, Eva, op. cit. (2014), p. 91.

¹⁵ Luk, Kwai Wing. 2011, *International Trade Finance. A Practical Guide*. Second Edition. City University of Hong Kong Press, Hong Kong. ISBN 978-962-937-185-2, p. 82.

In the case the advising bank receives incomplete or unclear instructions, it may send a pre-notification to the beneficiary, only for his information without liability. The beneficiary has the opportunity to consult with the bank of any ambiguities and the bank may contact the issuing bank to make any changes to the L/C. In most cases, the beneficiary should also contact the applicant, as changes to the L/C must also be agreed by him.

The tasks of the advising bank could be summarized in several areas:

- notification of the L/C - verification of the authenticity of the L/C issued by the issuing bank, consultations on the conditions of the L/C;
- presentation of documents - the advising bank verifies that the presentation of documents was carried out by the beneficiary;
- payment under the L/C - the advising bank realize the payment in favour of the beneficiary's account, which the beneficiary has either in the advising bank or in another bank.¹⁶

Beneficiary and confirming bank. Confirming bank, in addition to the tasks performed as the advising bank, assumes the obligation to provide the beneficiary with a L/C. The Article 8 of UCP 600 stipulates “provided that the stipulated documents are presented to the confirming bank and that they constitute a complying presentation, the confirming bank must honour the beneficiary if the credit is available by sight payment, deferred payment or acceptance or must negotiate, without recourse, if the credit is available by negotiation. A confirming bank is irrevocably bound to honour or negotiate as of the time it adds its confirmation to the credit”.¹⁷

In recent years, advising banks offer their customers silent confirmation, it means this type of silent confirmation unilaterally done by the advising bank falls outside the scope of UCP 600.¹⁸

This is a separate contract between the beneficiary and the confirming bank. Under these circumstances, the issuing bank takes no liability in this respect. The issuing bank will have no obligation to inform the confirming bank of: any amendment to the L/C or in case of instances of fraudulent or falsified documents presented, the issuing bank will refuse to honour its commitments under the L/C.¹⁹

5. International rules governing letters of credit

Documentary letters of credit are most commonly used in international trade, and banks around the world apply internationally agreed rules governing all L/C transactions: Uniform Customs and Practice for Documentary Credits (UCP) issued by the International Chamber of Commerce – (ICC) in Paris.

Although the L/C itself is an instrument of national law, courts often refer to the applicable Uniform Rules and Customs when resolving disputes. Given the importance of L/Cs in international trade, it is quite surprising that they do not have L/C in many national legislations, even though they are indisputably a legal instrument. In some countries, they have only a few provisions in commercial or civil codes that deal specifically with L/C transactions and are otherwise governed by general private and commercial law. It is precisely because of the inconsistent legislation that the participants in L/C transactions - business organizations and banking institutions - have developed their own sets of rules, which have been accepted worldwide as Uniform Customs and Practice for Documentary Credits. They apply these rules not only in the absence of legal provisions, but even in cases where L/Cs are governed by special legal provisions. The uniform rules either prevail or at least be used as additional rules, supplementing the local status of documentary letters of credit. Whether national law or international rules are decisive depends on the applicable national law and the agreement of the parties involved. National legal regulations of documentary L/Cs must be taken into account even if the parties agree on the application of UCP. UCP are used as a fixed set of rules in all parts of the

¹⁶ Jančíková, Eva, *op. cit.* (2014), p. 92.

¹⁷ Uniform Customs and Practice for Documentary Credits 2007 Revision. ICC Publication No. 600. ICC Services, Paris. ISBN-10 92-842-1257-X. p. 22

¹⁸ Luk, Kwai Wing, *op. cit.* (2011), p. 84.

¹⁹ Bhogal Tarsem, Trivedi Arun. 2019. *International Trade Finance. A Pragmatic Approach*. Second edition. Springer Nature Switzerland AG., Cham. ISBN 978-3-030-24539-9. p. 65.

world, but they are still interpreted differently by practitioners on the one hand and by courts on the other. In addition, UCP do not fully address all issues that may lead to confrontation between the parties involved in a L/C. National provisions and legal sciences are therefore sources of law, even if UCP are applied.²⁰

At the beginning of the last century, the use of L/Cs spread throughout the world and the first efforts to unify the rules and procedures for their use began to emerge. At first, these rules were created by national banking associations, e.g., French L'Union Syndical de Paris et de la Province "Clauses et modalités applicable aux ouvertures de crédit documentaire", German Berliner Stempelvereinigung "Regulativ für das Akkreditivgeschäft" and in the US at the New York Bankers' Commercial Credit Conference in 1920. The disadvantage of these rules was their local nature. Therefore, it was necessary to look for possibilities of wider harmonization of the regulation of L/C transactions. The International Chamber of Commerce in Paris, founded in 1919 to promote international trade, became the international institution to oversee these efforts to unify procedures for processing L/Cs. The first rules were adopted in 1933 by banks in Belgium, France, Germany, Italy, Romania, the Netherlands and Switzerland as ICC publication no. 69. These first rules only started the process of unifying the L/C and were more of a regional nature, in fact they began to spread in the same countries that signed the Geneva Convention in the field of bills of exchange.²¹

After the Second World War, when international trade restarted, the first efforts began to revise the UCP, which would respond to changes in business practice. The first revision of the UCP took place in 1951 (ICC Publication No. 151). The main interest of the ICC was to achieve a wider acceptance of UCP. Although new banks were gradually joining, they were still not accepted worldwide because they were not accepted by England and the British Commonwealth. The following years brought the finding that although many banks joined UCP, there were large differences of opinion in their interpretation. The ICC tried to overcome these problems and in 1957 published a commentary on UCP. At the same time, work was under way on a new revision, which was adopted in 1962. The aim of this revision was to introduce clearer and more precise wording of the rules and to ensure wider international acceptance. This was also successful and the new revision was accepted by the banks in 178 countries, including the British Commonwealth.²²

The 1960s brought changes in transport and transportation systems that became more sophisticated, and this required a further revision of the UCP, which was adopted in 1974 (ICC Publication No. 290). Developments in transport have not stopped and the participants in L/C transactions have not yet even managed to get acquainted with UCP, and they had to be updated again. New technical standards in transport and telecommunications led to another revision in 1983 (ICC Publication No. 400), which for the first time mentioned deferred payment credits and was the first revision to respond to the existence of SWIFT (Society for Worldwide Interbank Financial Telecommunication).²³

While the revisions in 1974 and 1983 were most influenced by the development of transport and telecommunications, the revision in 1993 was not caused directly by technical developments, but rather by changes in international trade and transport documents. The revision also aimed to make the existing rules easier to apply and to eliminate ambiguity. It is debatable whether this goal has been achieved. It was a relatively deeper revision, which caused quite a lot of ambiguity, as evidenced by the need to publish four so-called Position Papers of the ICC Banking Commission immediately after the introduction of UCP500, which were to bring the correct interpretation of individual articles. In addition to these Position Papers, the ICC Banking Commission issued a number of so-called Opinions in which they responded to questions from the professionals.²⁴

The 2007 revision of the Uniform Customs and Practice for Documentary Credit, which were approved by the ICC Executive Board in November 2006 and published for the first time as the ICC

²⁰ Jančíková, Eva, *op. cit.* (2014), p. 92.

²¹ *Ibid.*

²² *Jednotné zvyklosti a pravidla pro dokumentární akreditivy.* 1978. Československá obchodní a průmyslová komora, Praha.

²³ *Jednotné zvyklosti a pravidla pro dokumentární akreditivy.* 1983. Československá obchodní a průmyslová komora, Praha.

²⁴ *ICC Jednotné zvyklosti a pravidla pro dokumentární akreditivy (UCP500).* 2002. ICC Česká republika, Praha. ISBN 92 8421155 7.

Publication 600, is currently in force (Uniform Customs and Practice for Documentary Credits 2007 Revision, ICC Publication No. 600).²⁵

This revision was triggered by changes in business practice and was considered by the goals:

- Reduce the number of discrepancies in documents (more than 70% of documents presented under L/Cs were rejected at the first presentation);
- Remove expressions that lead to inconsistent application and interpretation;
- Reduce legal disputes;
- Incorporate opinions that have been published in the meantime by ICC (Position Papers, ICC Opinions and DOCDEX Decisions).²⁶

UCP application and related problems. Opinions on the application of UCP are different. According to some, these are standard contract terms, others consider them part of the Commercial Code (*lex mercatoria*). Others consider UCP to be codified business practices, customary law or provisions that are sui generis (special) in nature. While the standard terms and conditions require agreement between the parties to be part of the L/C, customary law, business practices or *lex mercatoria* apply regardless of the express agreement of the parties. The opinion on the legal nature of UCP automatically conditions the requirements for their application.²⁷

In many jurisdictions, the prevailing view is that UCP are a set of standard terms and conditions that become part of an agreement between the parties if the parties expressly agree or their behaviour indicates that they intend to apply UCP. UCP are a codification of rules that have been prepared to take into account the interests of all parties involved in a L/C transaction, with a view to establishing generally accepted rules. Thus, their nature is different from the provisions which normally govern safeguard provisions or standard commercial conditions.²⁸

The unique nature of UCP as a system of rules adopted by all parties concerned, which take into account the multilateral interest and their international effect, does not allow them to be compared with any existing schemes of laws or contract provisions. Therefore, they should be considered as sui generis (special) rules. The ICC rightly recommends that UCP be applied only if the parties explicitly agree. Finally, UCP are rules that are not proposed by public authorities and thus remain a privately created system of rules that may at some point in the future acquire the character of a *lex mercatoria* (Commercial Code). Whether the parties have agreed on their application is a question to which the UCP does not answer, but the laws that apply in the letter of credit agreement. Therefore, there is no general rule determining whether UCP apply.²⁹

Accession to UCP. Since their introduction in 1933, it has become good practice among banks around the world to express their accession to UCP. In many countries, such accession has been declared on a collective basis by national banking associations or central banks. At present, the significance of such an accession is already questionable, as neither the accession declared by a banking association nor a specific bank has a binding effect on the parties involved in the letter of credit transaction.³⁰

Although it is relatively tempting to consider accession - whether expressed on an individual or collective basis - as a general agreement of banks to apply UCP to all their documentary letters of credit. Although this was the original intention of formally expressing accession, such a method of adoption would not work in many systems. The application of UCP must be agreed by the parties involved in the letter of credit transaction, i.e. it must be an expression of agreement - either explicitly or in the conduct of the parties - that the party wants to apply the UCP and the other parties must accept and confirm this intention. Therefore, an appeal to the UCP must be included in the letter of

²⁵Uniform Customs and Practice for Documentary Credits 2007 Revision. ICC Publication No. 600. ICC Services, Paris. ISBN-10 92-842-1257-X.

²⁶ Byrne, James E. 2007. *The Comparison of UCP600 & UCP500*. The Institute of International Banking Law & Practice, Inc. Montgomery Village. ISBN 1-888870-42-7, p. 78.

²⁷ Chatterjee, Charles. 2006. *Legal Aspects of Trade Finance*. Routledge, New York. ISBN 978-1-85743-782-9, p. 65.

²⁸ Byrne, James E. 2004. *LC Rules & Laws Critical Texts*, 3rd edition, The Institute of International Banking Law & Practice, Inc. Montgomery Village. ISBN 1-888870-36-2., p. 97.

²⁹ Ibid.

³⁰ Marvanová, Maria, Houda Martin. 1995. *Platební styk. Platební a zajišťovací instrumenty ve vnitřním a zahraničním obchode*. Brno. ECON. ISBN 80-901627, p. 152.

credit itself in order to establish (constitute) an agreement between the parties on the application of the UCP.³¹

International Standard Banking Practice. Due to the complexity of the letter of credit and the different practices applied in individual banks in document control, the Banking Commission at the ICC decided to unify this practice and issued the International Standard Rules for Document Examination under Documentary Letters, Revision 2007 for UCP 600 the Examination of Documents under Documentary Credits 2007 Revision for UCP 600 - abbreviated ISBP). It was a revision of the ISBP, which were first issued in 2003. ISBPs are mainly a practical tool to help practitioners check documents. This is not a commentary on UCP, but the definition of areas in which the most common problems occur in interpretation. ISBPs can be divided into three parts.

The first part deals with the instructions for opening the L/C itself and emphasizes the need for clear and precise instructions in the orders to issue the L/C.³²

The second part deals with general principles such as corrections and changes in documents, dating of documents, issuers of documents, language in which the documents are to be issued, mathematical calculations in documents, typographical and spelling errors, signing of documents.³³

The third part concerns the requirements of the documents that we most often encounter in L/C, i.e. bills of exchange, invoices, bills of lading, individual transport documents, insurance documents and certificates of origin.³⁴

These ISBPs are a very useful tool for practice, used mainly by bank staff, whose task is to check the documents that are presented under of LC.

Opinions of the ICC Bank Commission. The Banking Commission of the ICC issues its opinions on issues related to the interpretation of UCP. At the regular meetings of the Bank Commission, which take place twice a year, they approve the answers to the questions they receive in the meantime. At first, these "responses" were called "Decisions", but since the Commission is not a judicial body, it changed their designation to "Opinions". Opinions are distributed to members of the Banking Commission and published in the ICC publications.³⁵

The views of the Banking Commission are of great importance for banking practice, as the Banking Commission, as the main creator of international rules and a representative of the global banking community, has the authority to interpret its rules in terms of international standard banking practice. In the case of disputes, the bank, courts or arbitrators generally accept these views. Their disadvantage is that they answer a specific question in a specific business case, which may not automatically be generally applicable.

ICC Rules for Expert Dispute Resolution in Documentary Letters. In 1997, the International Expert Center at the ICC adopted the ICC Rules for Documentary Instrument Dispute Resolution Expertise (DOCDEX). Initially, they were intended to facilitate the resolution of disputes concerning UCP, but were later extended to other rules.

The DOCDEX system is a fast and reliable dispute resolution mechanism based on the expert opinion of three experts selected from a list of DOCDEX experts (appointed by each national committee), reviewed by a technical adviser at the Banking Commission and issued by an expert center at the ICC. This opinion under DOCDEX is not binding on the parties to the dispute, unless the parties agree otherwise. A dispute can be submitted to DOCDEX at any time, but it is recommended that the relevant document include a clause: "This letter of credit is subject to the Uniform Customs and Rules for Documentary Credits (UCP600) and the ICC DOCDEX Rules." The DOCDEX system is primarily intended for banks and other participants in letter of credit transactions as an effective and affordable form of out-of-court dispute resolution.³⁶

³¹ Jančíková, Eva, *op. cit.* (2014), p. 121.

³² International Standard Banking Practice for the Examination of Documents under Documentary Credits. 2007. ICC Publication No. 681 E. ICC Services, Paris. ISBN: 978-92-842-0019-1.

³³ *Ibid.*

³⁴ *Ibid.*

³⁵ Andrlé Pavel. 2009. Komentář k UCP 600. Komentář k Jednotným zvyklostem a pravidlům pro dokumentární akreditivy, revise 2007, publikace ICC p. 600 (UCP 600). ICC Česká republika. Praha. ISBN 978-80-903297-8-2.

³⁶ DOCDEX Rules, 2015. Publication 872-1. ICC Paris. ISBN 978-92-842-0312-3

In the event of a dispute between the parties over a documentary credit, the claimant shall submit a brief summary of the case, together with appropriate copies of the documents, and pay a fee of USD 5,000 to the ICC Expert Center. In exceptional cases where the value of the letter of credit exceeds \$ 500,000, an additional \$ 5,000 may be required.³⁷

Subsequently, the parties are contacted by an expert center and the DOCDEX experts who draw up an opinion are selected on the basis of a recommendation from the ICC National Committees. In most cases, the parties can expect a decision within six to twelve months. However, experts shall, by default, provide their decision within one month of having all the necessary documents and all the conditions for granting a decision are met.

6. National legislation on documentary letters of credit

As we have already mentioned, countries that have special provisions in their laws on documentary letters of credit are in the minority. The quality of legal provisions varies greatly, from comprehensive coverage - as can be found in Article 5 of the US Uniform Commercial Code - to much simpler rules, which include more or less only a reference to the applicability of the UCP.³⁸

Although some geographical areas have not adopted any legal provisions on L/Cs - the only provisions on documentary letters of credit until the 2004 EU enlargement were in Greece's Greek Commercial Code - other regions have accumulated special laws on documentary letters of credit, such as Central America or Arab countries. Some national legal rules correspond to the provisions of the UCP, others are regulated differently, for example in Kuwait and Colombia, the principle of general revocability of documentary letters of credit applies.³⁹

In the US, the Uniform Commercial Code (UCC) provides standard legal rules for a number of business processes. Letters of credit are covered by the article 5 UCC. The law was drafted by a commission of experts and subsequently adopted into national law.⁴⁰

However, because Article 5 of the U.C.C. is drafted as a statute of real law, there is one major difference between Article 5 and the UCP or other ICC rules. This is that Article 5 contains provisions regarding the fraud rule, which the UCP does not.⁴¹

Legal regulation in the Slovak Republic. In the legislation of the Slovak Republic, the letter of credit is regulated in Act no. 513/1991 Coll., Commercial Code in Part XX, Contract on the opening of a letter of credit, in paragraphs 682 to 690. These provisions address the contractual relations that arise between the customer (applicant) and its bank are involved in Paragraph 682 which states that "Under a contract on opening a letter of credit, the bank (banking institution) assumes the obligation to provide at the customer's request, and at his account, a certain fulfilment towards a third party (the beneficiary), provided that the beneficiary meets the stipulated conditions within a certain period of time, the customer undertakes to pay the bank for its services. The contract must be writing".⁴²

Paragraph 683 stipulates the position of the bank which "in accordance with the contract, shall notify in writing the beneficiary of the opening of a letter of credit to his benefit, at the same time advising the beneficiary of its contents. The advisory note on the letter of credit must specify the bank's obligation to render performance to the beneficiary, the validity of the letter of credit, and the conditions to be met by the beneficiary prior to the bank's obligation to render its fulfilment. The bank shall notify the beneficiary, without undue delay following the conclusion of the contract with the customer, unless the contract stipulates that the bank shall notify the beneficiary only upon the customer's request. The obligation of the bank towards the beneficiary is established by the

³⁷ Luk, Kwai Wing, *op. cit.*, 2011, p.107.

³⁸ Schütze Rolf A., Fontane, Gabriele. 2001. *Documentary Credit Law throughout the World*. ICC Publishing S.A. Paris. p. 170. ISBN 92-8421298-7.

³⁹ *Ibid.*

⁴⁰ Byrne, James E., *op. cit.* (2004), p. 98.

⁴¹ Xiang Gao, Buckley Ross P. 2003. *The Unique Jurisprudence of Letters of Credit: Its Origin and Sources*, San Diego International Law Journal, Vol. 4, Issue 1. Available at: <https://digital.sandiego.edu/ilj/vol4/iss1/6>.

⁴² ACT 513/1991. Commercial Code. The National Assembly of the Slovak Republic.

notification. The customer's obligation towards the bank is established upon opening the letter of credit. The advisory note on the letter of credit may specify the bank's duty to pay a certain amount or to accept a bill of exchange."⁴³

In section 684 is stated the obligation of the applicant to reimburse the bank "unless a remuneration for opening a letter of credit has been agreed, the customer is bound to pay the bank the remuneration common at the time of the conclusion of the contract".⁴⁴

The law also regulates the issuing bank's relationship with the beneficiary. Pursuant to the law, the bank's obligation under the letter of credit is independent of the legal relationship between the payer and the beneficiary. In Section 685 it stated that "the bank's obligation arising from a certain letter of credit shall not be dependent on the legal relations between the customer and the beneficiary."⁴⁵

According to the Section 686 „unless an advisory note on a certain letter of credit stipulates that the letter of credit is revocable, the bank may change or cancel the letter of credit only with the consent of the beneficiary and of the customer. If an advisory note on a certain letter of credit stipulates that the letter of credit is revocable, the bank - in relation to the beneficiary - may change or cancel it prior to the time when the beneficiary meets the conditions stipulated in the advisory note on the letter of credit. A letter of credit may be changed or cancelled only in writing."⁴⁶ This paragraph emphasizes the irrevocability of the letter of credit.

Section 687 regulates the relationship between the banks and the beneficiary and states "if the bank, which is bound to provide fulfilment from a certain irrevocable letter of credit, initiates its confirmation by another bank, then the beneficiary is entitled to demand the fulfilment from this other bank as soon as this bank has advised the beneficiary that it has confirmed the letter of credit in question. The bank, which has asked for the confirmation of the letter of credit, and the bank which has confirmed it, shall be liable towards the beneficiary jointly and severally. In order to change or cancel the letter of credit confirmed by another bank, the consent of the confirming bank shall also be required. If the bank, which has confirmed the letter of credit, rendered the performance to the beneficiary in accordance with the contents of the letter of credit, it shall be entitled to claim this performance from the bank which has asked for the confirmation of that letter of credit."⁴⁷

If the bank only notifies - notifies the beneficiary that another bank has opened a letter of credit for him, he is liable for the damage caused by the incorrectness of this notification. However, this bank does not incur a liability from the letter of credit.

Section 688 states the responsibility of the advising bank as follows: „a bank, which merely notifies the beneficiary that another bank has opened for him a letter of credit, shall be liable for any damage arising from the incorrectness of such a notification, however, it shall not assume the obligation arising from the letter of credit".⁴⁸

Sections 689 and 690 are related to the documents and their examination and states that "under a documentary letter of credit, the bank assumes the obligation to provide performance to the beneficiary, provided that the documents specified in the advisory note on the letter of credit are duly presented within the validity of the letter of credit. The bank is bound to check the consistency of presented documents and their contents with professional care and to see to it that they obviously correspond to the conditions stipulated in the advisory note on the letter of credit. The bank shall be liable for any damage caused to the customer as a result of loss, destruction or injury of the documents taken over from the beneficiary, unless it could not prevent such damage even while exerting professional care."⁴⁹

The last section 691 concerning letters of credit stipulates those previous sections 681-690 "shall apply, mutatis mutandis, to other letters of credit under which it shall be possible to demand

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Ibid.

⁴⁷ Ibid.

⁴⁸ ACT 513/1991. Commercial Code. The National Assembly of the Slovak Republic.

⁴⁹ Ibid.

performance upon meeting other conditions than the presentation of certain documents.“⁵⁰

At present, letters of credit are always required to submit documents, although in the case of standby letters of credit, these are different documents than for documentary letters of credit.

In Slovak Republic the use of letters of credit is limited and therefore also the case law in this area is very limited.

Legal regulation on letters of credit in China. Given the volume of business that is conducted with China on a letter of credit basis, it is appropriate to mention the national legislation on letters of credit in China. With effect from 1 January 2006, the Supreme Court of the PRC adopted 18 provisions concerning the settlement of disputes over letters of credit. These provisions should improve the work of Chinese courts in deciding on letters of credit. The provisions of the law can be divided into main areas: application of UCP as a decisive law, the principle of letter autonomy, document examination and discrepancies, exception in the case of fraud, legal procedures for the application for a preliminary decision prohibiting payment and its revocation and guarantees issued in connection with the issuance of letters of credit.⁵¹

Very interesting for foreign partners is the solution of standards in the control of documents and issues related to fraud and decisions to prohibit payment. With regard to document examination and discrepancies, in the event of a dispute, the courts rely on the SPC or on rules agreed by the parties. In the absence of such an agreement, the decisive factor is whether the documents are clearly in accordance with the terms of the letter of credit and mutually consistent. If the documents submitted under the letter of credit are clearly not entirely consistent with the terms of the letter of credit or with each other, but there is no contradiction between them, the documents are not considered discrepant. The provisions of the law recognize the standards for document control adopted by the ICC and confirm that "strict compliance" is not equivalent to "identity" or "mirror approach". This is fully in line with the principles adopted by the ICC.⁵²

According to the provisions governing the fraud exception, the following situations are considered fraud detected under a letter of credit:

- the creditor falsifies documents or submits documents with false content,
- the beneficiary intentionally does not deliver the goods or delivers the goods without value,
- the beneficiary and the payer or another third party conspire to submit fraudulent documents without a basic transaction,
- other contexts that involve letter of credit fraud.⁵³

The phrase "deliver goods without value" is not meant literally. In principle, this means that the goods supplied are so different or of poor quality that it is difficult for them to represent any value in the relevant letter of credit transaction. The originator, the issuing bank or another interested party may, in the event that such a situation arises and fraudulent conduct could cause them irreparable damage, request the competent court to suspend payment under the letter of credit. Due to the unique nature of letters of credit, the Supreme Court has formalized the "suspension of a payment order" as one of the measures in the event that fraud is detected and if the fraud may cause irreparable damage to the parties concerned. "Irreparable damages" are likely to refer to situations in which the proceeds of a letter of credit are unlikely to be recoverable.

In the event that the court confirms the existence of a letter of credit fraud, it shall suspend or terminate the obligation to pay under the letter of credit, unless one of the following situations has occurred:

- the party nominated or authorized by the issuing bank has made the payment in good faith according to the instructions of the issuing bank,
- the issuing bank or a party nominated or authorized by the issuing bank has accepted the bill of exchange under a letter of credit in good faith,

⁵⁰ Ibid.

⁵¹ Schütze Rolf A., Fontane, Gabriele. 2001. *Documentary Credit Law throughout the World*. ICC Publishing S.A. Paris. pp. 170. ISBN 92-8421298-7

⁵² Jančíková, Eva, *op. cit.* (2014), p. 122.

⁵³ Ibid.

- the confirming bank has performed its payment obligation in good faith,
- the negotiating bank conducted the negotiation in good faith.

In order to protect an innocent third party, or a party who was unaware of the fraud within the letter of credit, the court has explicitly identified cases where the court does not issue a deferral of payment or cancellation of payment. Typical are situations in which payments have been lawfully made by the issuing bank, the paying bank, the confirming bank and/or the negotiating bank in good faith. It is not entirely clear whether payments under a letter of credit may be suspended or cancelled if the bills of exchange submitted have been accepted, but the payment has not yet been made to the fraudster by discounting the bill of exchange. According to the Supreme Court's guidance, if such acceptance has not yet been discounted, the relevant payment obligations would be subject to suspension or cancellation so that the fraudster cannot benefit from the fraud. Importantly, the burden of proof of letter of credit fraud lies with the party requesting the suspension of the payment order. The law also regulates the court's procedure in such a transaction.⁵⁴

7. The concept of letters of credit in Islamic finance

The Islamic law called Shariah law dictates specific dos and don'ts related to all aspects of a Muslim's life, including commercial and financial transactions. Shariah law is primarily derived from the Muslim holy book, the Quran and from the Sunnah, the teachings and sayings of the Prophet Muhammad. The three main Shariah prohibitions that impact the Islamic finance and also trade finance are prohibitions of Riba (usury or interest), Gharar (uncertainty or unnecessary risk) and Maysir (games of chance).⁵⁵

An Islamic letter of credit is an undertaking by a bank to pay subject to conformity of the documents to the contractual instructions govern by the Islamic principle. The types of letters of credit in Islamic banks are similar to conventional banks. The difference is in the way of financing. Islamic banks offer the same services provided by conventional banks such as irrevocable letter of credit, non-conformed, conformed, transferable Credit, revolving and covered credit, but the funding formula varies.⁵⁶

Murabaha financing. The Islamic bank, upon the request of his applicant, imports goods for him through a letter of credit prepared for the seller of the requested goods with whom the buyer entered into a contract. The Islamic bank uses its own money to open the letter of credit and the terms of the letter of credit are consistent with the terms agreed between the seller and the buyer.⁵⁷ In the case that the applicant cannot pay to the seller the Islamic bank will become the owner of the goods in the Murabaha letter of credit. The applicant is acting as an agent for the Islamic bank to purchase the required cargo on banks behalf.⁵⁸

Under Murabaha, the bank bears genuine risks until the completion of the deliver, which puts it in a position similar to that of an actual trader. The legitimacy of Murabaha cannot be challenged, provided that two conditions are observed: The buyer should have the right to reject the goods in case they are found not to conform to the required specifications, and the bank is not permitted to assign the recourse under the supplier/manufacture's warranty to the buyer, even if it may have to act as an intermediary between the buyer and the supplier.⁵⁹

Musharaka financing. Musharaka is a partnership in profit, it means, someone provides money while the other one provides effort and work and the profit is shared according to the

⁵⁴ Ibid.

⁵⁵ Habib, Syeda Fahmida. 2018. *Fundamentals of Islamic Finance and banking*. John Wiley & Sons Ltd, Chichester, West Sussex, UK. ISBN 9781119371007.

⁵⁶ Al Amaren, Emad Mohammad, Ismail, Che Thalby, Md Nor Mohd Zakhiri and Indrivi, Rachma. 2020. Documentary *Letter of Credit in Conventional and Islamic Banks in Jordan*. International Journal of Multidisciplinary Sciences and Advanced Technology ISSN 2708-0587, Volume 1, NO 4 (2020) pp. 1-15.

⁵⁷ Lahsasna, Ahcene. 2013. *Implementation of the Islamic Letter of Credit in International Trade*. Islamic Science University of Malaysia.

⁵⁸ Al Amaren, Emad Mohammad, Ismail, Che Thalby, Md Nor Mohd Zakhiri and Indrivi, Rachma. *op. cit.* (2020), p.1-15.

⁵⁹ ROWE, M. 1997. *Letters of Credit*. London: Euromoney Publications PLC, 1997.

percentage agreed between them. After the conclusion of the Modaraba contract, the Islamic Bank opens a letter of credit for the foreign trader who exports the goods. Then the goods are imported, and the value of credit is paid to the exporter.⁶⁰

Wakalah financing. Islamic banks offer these types of letters of Credit when the customer wants to use his own money and to deposit the full amount of the price of the goods to be imported. The Islamic bank acts on behalf of the customer and plays the role of the issuing bank. The letter of credit will be advised and informed by the correspondent bank to the beneficiary. Once the beneficiary is satisfied, he ships the goods and gives all the shipping documents to his bank.⁶¹

8. Conclusion

A documentary letter of credit, issued on the basis of the client's request, is a written commitment of the bank that issued it to provide the beneficiary of the letter of credit in the form of payment, if the beneficiary meets the pre-set conditions specified in the letter of credit within a specified period.

A letter of credit is an abstract debt obligation. By their nature, letters of credit are transactions separate from purchase or other contracts that may be the basis for them, but do not bind the bank in any way. In the case of letters of credit, all parties concerned only deal with the documents and not with the goods, services or other activities to which the documents may relate.

The fulfilment of the conditions of the letter of credit is checked by the bank on the basis of the submitted documents, which means that no non-documentary conditions should be required in the letter of credit, i.e. those the fulfilment of which could not be unambiguously checked and verified on the basis of the submitted documents. The buyer (applicant, importer, principal) and the seller (exporter, beneficiary), even if they are essentially interested in the goods, must in contact with the banks give their orders and instructions on the basis of documents. In particular, if the submitted documents should be rejected, the only reason should be errors in the documents.

Uniform rules and practices cover a number of issues that arise in letter of credit transactions, but national law, which is applicable in the event of litigation, can fundamentally affect the outcome of a court decision. Equally important is the question of the jurisdiction of which court the case will be heard.

Contracts may specify what law they are governed by and who will resolve any disputes. Letters of credit do not specify the applicable law or jurisdiction of the arbitration or the court.

Each country applies its own rules when deciding on the jurisdiction of the court. In general, a certain connection is sought between the contract and the country in which the court is located.

The law of the issuing bank's country usually governs the contractual relationship between the issuing bank and the payer. Usually, both entities are based in the same country. The issuing bank authorizes another bank to notify the letter of credit to the beneficiary and/or nominates this bank as the bank in which the letter of credit is usable. The relationship between the banks is actually a mandate agreement. Unless otherwise specified, the law of the country of the agent (in this case the notifying or nominated bank) most often applies to dispute resolution. This is how it is solved, for example in the English legal system. Court decisions are often governed by the law of the place of payment. Different laws may therefore apply to letters of credit usable in the issuing bank and others to letters of credit issued by the same institution but payable in the country of the seller.

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⁶¹Al Amaren, Emad Mohammad, Ismail, Che Thalby, Md Nor Mohd Zakhiri and Indrivi, Rachma., *op. cit.* (2020), pp. 1-15.

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