

THE LEGAL NATURE, DEVELOPMENT AND CHALLENGES OF THE INTERNATIONAL LETTER OF CREDIT OPERATIONS.

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International trade is the exchange of goods, service, performance between states. It is the most important part of the global economy. Because no single country can produce all resources by itself without the potential aid of other countries.

This is why cooperation in international trade is significant. In order to satisfy their own need, they are supposed to have a consensus over trade globally, this helps to improve the future growth of a country and an economy of the whole world. International commerce includes a wide range of transactional operations that arise between business partners - individuals and entities – located in different places.

This is related to economic and legal risks to much extent. A letter of credit (L/C), which is also referred as to a documentary credit, is one of the important tools of payment methods over the globe. Before going deep into the main points, the processes included in Letter of Credit operations should be discussed and its legal nature should be addressed.

Letter of Credit (LC) is one of the important parts of international trade which ensures security, trust and convenience for both parties who are bound with different commercial contracts.

It is argued that improvements in commercial transactions cannot be imagined without proper working system of Letter of Credits. The reason why this payment method is specifically used is not only about convenient atmosphere for entrepreneurs in business transactions, but also emergence of huge positive prospects for the growth of international commerce.

The existence of a whole certain part of legal system on this basis itself demonstrates how important L/C operations are. What is claimed here is that every single process in the field of law regarding commercial relations emerges because of the need of regulation in certain system.

In another word, “a letter of credit is a promise to pay” as Justin Pritchard noted.

The LC process is initiated when the buyer and seller enter into a sales contract in which payment by Letter of Credit is agreed. If in sales or other contract the L/C payment is chosen rather than open account and advance payment, the documentary credit operations emerge. At this point the L/C is supposed to be considered an independent agreement from the main contract (most of the time it is sales contract). The article 4 of UCP 600 also acknowledges that a credit by its nature is a separate transaction from the sale or other contract on which it may be based.

Also the article continues with the following statement which deserves a special focus: “banks are in no way is concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit.” Because this emphasizes especially the imperative and strong character of the rule of independence of L/C from other contracts.

According to this point, it is required to distinguish between them and not treat them as identical. At the next stage importer asks for a bank to issue a credit. And bank review the financial position of one asked for a credit issuing, then if it is confirmed, bank may issue a credit.

After issuing the credit a bank sends relevant documents to a beneficiary.

The beneficiary checks the requirements of L/C and if it is suitable, sends relevant goods.

After sending, all of the necessary documents, such as invoice, bill of lading, insurance certificate and others, are compiled and submitted to a bank. In its turn a bank check if the documents comply with the terms of L/C. According to American legal scholar Herman N. Finkelstein, Letter of credit is actually not a totally new term, it has the deepest history. But lately it has been transformed so substantially that today it seems as a whole new instrument.

Previously merchants used to give a document to his agent. And his agent used to buy goods with the help of this reliable document. The main reason behind this process is that at that time the international bank system was not developed to today's level. Another reason is that there were really few companies that dealt with commercial transactions. That is why an every trade firm knew each other well enough to trust.

It appears that letter of credit was used to confirm the competence of the agent of a merchant during Medieval times. And during the Renaissance in Europe, especially in Italy the number of bankers so much increased that the confirmed competence of an agent itself became useless gradually.

As new corporations entered a global trade the L/C system needed new functions rather impeccable and suitable for all. L/C started to play a crucial role in international trade. After the World war I the world transformed quickly, this led to the complex situations.

Because in every country factories started to work, and to produce goods machines became a great necessity for countries. That is the number one reason why countries start to corporate with each other drafting several contracts. This meant that payment methods could not be as simple as before. Because the partners are totally new, and neither of them could be guaranteed to be reliable. Meaning also that trade became more complex and needed improvements in this payment sphere as well. Banking systems undergone many serious alterations; many banking procedures emerged, some of them gained totally new functions, such as Letter of Credit.

On the one hand, it is a good news to have a new version of LC which ensures trust between parties in a premium level. But on the other hand, it may lead to many complexities as to how it should be utilized.

Today, there is a unified rules regulating the relations arising from letter of credit operations named "UCP 600 - Uniform Customs and Practice for Documentary Credits", which involves the whole valid process of issuing and operating the L/C.

These custom and practice governs all the relations between the bank and a particular party who asks to issue a credit. At the same time, as mentioned above UCP 600 applies when the issue is in the sphere of bank obligations and rights. It is said that UCP 600 provides standardized rules published by the International Chamber of Commerce governing documentary credits, defining bank responsibilities and document examination standards. Under the article 5 of UCP 600, banks deal with only documents, not with goods, services or performance to which the documents may relate.

Even though Letter of Credit is the most effective payment method over the world as mentioned many times, it still lacks some developments. There are serious problems that should be solved effectively. Because the improvement of efficiency in trade depends on the effective and flawless payment system, which includes banks and L/C operations.

The exact issues to be addressed should be stated. One of the main problems in the L/C system today is a serious interpretation of the standard of "strict compliance" under the article 5 of UCP 600 as mentioned above.

Because of the exact written rule of not confirming the documents submitted even with a slight error, many entities cannot receive what is aimed.

And this causes different types of difficulties in practice. It is suggested to relax the strict compliance principle in UCP 600, which regulates L/C operations.

Flexibility in this principle may lead to the prosperity of the L/C practice. Banks should not only be restricted to examination of the formality in submitted documents, but they also should take the main essence and economic value of the operation into consideration while performing Letter of Credit operations.

Sometimes implementing dispute resolution mechanisms may not be sufficient once a dispute has already reached the high level of complexity. However, introducing mechanisms for dispute prevention may be an effective approach.

Therefore, focusing only on the improvement of the alternative dispute resolution categories may not be enough. Instead, attempts should be made to prevent the disputes by understanding the system and its core process.