

THE ROLE OF BANK IN THE PAYMENT OF INTERNATIONAL TRADE CONTRACT

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Abstract

The research aims to find out the regulation of Letter of Credit (L/C) as an instrument of payment in international trade; and to analyze the role of banks in the implementation of payment services in international trade contracts. This research is a normative legal research with statutory approach, dan conceptual approach. The technique of collecting legal material is done by literature study, analyzing various legal references relevant to the examined issues to be further analyzed qualitatively and descriptively. It conducted by applying in depth and holistic review of the various references, and evaluated the legal materials as regulatory description of the role of banks in international trade contracts. The results of research indicated that, the L/C regulation as a instrument of payment, regulated in the International Civil Law (ICL) and in the Uniform Custom and Practice (UCP) provisions. According to ICL, the relations of the parties in trade contract based on the agreed legal option. If there is no legal option, it refers to the principle of the most characteristic performance, refers to the country in which the bank gives credit, or in which country the credit is disbursed. As for its regulation in UCP 600, that L/C is an agreement requiring a bank to act upon request and instruction from a customer to conduct payment to the beneficiary. Meanwhile the role of banks in the implementation of payment services in international trade contracts is to guarantee payment of goods that sent by exporters to importers in accordance with agreed price, and to ensure completeness of the shipment documents.

Keywords: banking, payment, contract, international trade

INTRODUCTION

Business transactions between countries or commonly called as International trade contracts which in principle is not different than the trade between two people within a country. The difference being that in international trade, one party happens to be in a different country. This activity can be done in export and import activities, international investment, and service trade and so on. In International trade activities, business actors refer to the rules of law that are international, both the provisions of private international law and public international law.

One of the problems that often arise in business activities, especially international

trade, is related to the way payment of imported goods. For the exporter of goods must first have a guarantee of payment of goods sold. Without guarantees from the importer it is impossible for exporters to release their merchandise. Similarly, for the importer, there needs to be a guarantee to obtain goods in accordance with the amount and quality desired. Thus, the problem in international trade is not only related to the problem of payment and delivery of goods but also from the legal and political aspects, languages, currencies, risks in the carrier and the geographical position which is different between one country and another. Therefore, the parties should be able to identify all these issues, so that it can formulate a relatively

effective, efficient and safe mechanism in International trade activities.

To anticipate payment problems in International trade contract, the role of banks is needed by exporters and importers as an institution that provides guarantee of fund to facilitate the payment traffic. Thus, banks in addition to functioning to collect funds from the community in the form of savings and channeling back to the community in the form of credit in an effort to improve the of the public welfare,¹ the bank also serves as one medium that will bridge the payment process in international trade transactions between the importer the exporter. It is agreed in the sales contract that the foreign exchange bank (Opening Bank / Issuing Bank) will issue a guarantee letter of payment known as Letter of Credit (L/C)

Letter of Credit (L/C) is a debenture issued by a foreign exchange bank at the request of the importer of the foreign exchange bank customer and addressed to an overseas exporter who is a relation of the importer. The contents of the letter stated that the exporter receiving L/C was given the right by the importer to withdraw the money order to the opening bank for the amount of money mentioned in the letter. The bank concerned guarantees to approve or otherwise (pay) the draft in accordance with the requirement contained in the letter.²

The use of L/C as an instrument of payment of goods in international trade contracts, there are two parties that play the role of exporters and importers. There are fundamental differences of the parties that separate them, such as geographical differences and state boundary. This may cause difficulties in the payment of goods if the importer has no foreign exchange. Therefore, it is necessary to have a payment facility in the form of opening

bank and advising bank which will bridge the payment process between importer and exporter. This instrument of payment will guarantee the payment of goods sent by the exporter to the importer in accordance with the price that has been agreed. This guarantee is also given to the importer that will receive the goods in accordance with the amount and quality desired.

Based on the description above, the problem in this research is, How the regulation of Letter of Credit as the instrument of payment in international trade activities?, and How the role of banks in implementing payment services in international trade contracts?. The purpose of research is to know the arrangement of Letter of Credit as an instrument of payment in international trade activities; and to know the role of banks in the implementation of payment services in International trade contracts.

This research is a law of normative research (Legal research) with approach of legislation (Statute Approach), conceptual approach. Methods/techniques of collecting legal materials is done through literature study that conducted by analyzing various references both the legislation and reference books to obtain legal materials that have relevance to the issues raised. Furthermore, the analysis of legal materials is conducted qualitatively, which analyze in depth and thorough the various references, as well as evaluate the legal materials on the role of banks in international trade contracts.

DISCUSSION

Regulation of L/C as a Payment Instrument in International Trade Contract

a. Conception of L/C

According to Hans van Houtte in Huala Adolf (2) that the Letter of Credit is:

"... an arrangement in which the bank, acting for and on behalf of the buyer (cus-

¹ Article 1 number (2), Act Number 10 Year 1998 on Amendment of Act Number 7 Year 1992 on Banking

² Amir M.S, (1) *Letter of Credit in Import-Export Business*, Ed.2, (Jakarta: PPM, 2003), page 1

tomers), undertakes to pay the seller (beneficiary) a sum of money or to accept a bill of exchange drawn by the seller, or to authorize another bank to do so on presentation by the seller of specified document and on condition that all other credit terms are met.”³

Then Gunawan Wijaya and Ahmad Yani, state that, Letter of Credit is:

“A Credit Letter is a conditional payment letter issued by Issuing Bank upon the request of Importer directed to another Bank (Advising Bank / Corresponding Bank) in the Exporting State for the Exporter interest in order to obtain payment of any amount mentioned in the letter “⁴

The definition of Letter of Credit in Uniform Custom and Practice 500 or abbreviated UCP 500 as stipulated in Article 2 states as follows:

“Letter of Credit is a promise to pay from the issuing bank to the recipient whose payment can only be made by the issuing bank if the recipient submits it to the issuing bank of documents in accordance with the terms of Letter of Credit”⁵

b. Legal Basis of Publishing Letter of Credit.

The rule of law that became the basis for regulating the use of L/C in international trade as follows:

1) International Civil Law

The International Civil Law applicable to the L/C different from the law applicable to the main contract such as the contract of sale as the basic of L/C. According to van Houtte in Huala Adolf,

the following principles usually apply practice:⁶

- a) In the relationship between the customer and the issuing bank, if the agreement or credit agreement contains a legal choice clause, the law chosen by the parties will apply to the contract. If there is no law selected, the legal relationship between the customer and the issuing bank is generally regulated by the law in the country where the most characteristic performance is to be used, or where the party perform performance (achievement) domiciled, which is usually the country in which the location of bank provides credit
- b) In accordance with the issuing bank, the advising bank and the beneficiary, the applicable law shall be the law of their choice. If there is no law of choice, so the applicable law shall be the law of the country in which the credit is cashed. This is the law in the country where the beneficiary or seller receives the document and receives the payment, which is usually the state of the advising bank or the confirming bank.
- c) If there is no law chosen by the bank, so the relationship between the issuing bank and the advising bank shall be governed by the law in which the issuing bank is located. This usually applies to the relationship between the advising bank and the beneficiary. It is difficult to accept if different legal systems are applied to two aspects of the same transaction.

Uniform Customs and Practice (UCP) 500 and 600

The International Chamber of Commerce (ICC) has issued provisions on documented credit such as Uniform

³ *Ibid.*, page 134

⁴ Gunawan Wijaya dan Ahmad Yani, *Business Law Series, International Business Transactions, (Export-Import and Rewards*, (Jakarta: Rajagrafindo Persada, 2000), page 24

⁵ Ramlan Ginting, *Letter of Credit, Review of Business Legal Aspects*, (Jakarta: Publisher Salemba Four, 2002), page 11

⁶ Huala Adolf, Huala. *International Trade Law*, Ed.1. Jakarta: PT. Raja Grafindo Persada, 2005, page 145

Customs and Practice for Documentary Credit (UCPDC). UCP is a custom compilation and international practice on L/C, so that the rules contained therein are codified from international trade practices and banking practices. UCP was first published by ICC in 1933. This UCP was only adopted by banks in several European Countries excluding United Kingdom.

UCP has several revisions. The first revision was made in 1951, which was later adopted by banks in America. Then in 1962 a second revision was adopted by the British and Commonwealth Countries. The third revision was made in 1974, whose results were adopted by almost all international banks. Subsequently, the fourth revision of UCP in 1983 which still adopted by international banking, and the last revision of 1993, which until now became a role model of international banking in L/C transactions known as UCP 500 which came into force on 1 January 1994. This revision is intended to accommodate technological developments, especially in the transportation sector. Similarly in the implementation of documentary credits in banks, more than 170 countries have referred to this UCP.

Furthermore, by the issuance of UCP 600 by ICC, this provision is the main reference point for all countries in the world in the implementation of international trade contract, especially in the use of L/C. UCP 600 is a revision of UCP 500. UCP 600 is *Lex Specialist*, a uniform habit in the practice of documentary credits, which used to provide a sense of security for the parties in international trade. Because it sources from the habits used in the practice of international trade contract, it has become commonplace for all parties involved so as to facilitate more transactions.⁷

⁷ Gunawan Widjaja dan Ahmad Yani, *Op.cit*, page 30-62.

Although UCP 600 has been implemented in many countries, UCP itself has several disadvantages as follows:⁸

- 1) UCP in principle shall apply only or as long as the issuing bank selects UCP expressly as a rule governing L/C.
- 2) UCP does not regulate the fraud issues in L/C transactions. According to Ginting, this element of fraud is a legal reason for the issuing bank or its attorney to refuse the L/C payment to the recipient even if all required documents are in accordance with the requirements.
- 3) UCP does not contain any legal choice rules. It is mentioned above that countries sometimes have national legal rules governing documented credit. In the event of a legal conflict, UCP does not contain strict rules regarding its resolution.

Base on the description above, some of the things underlying the issuing bank/opening bank to issuing L/C for the interest of importers are:

- 1) The agreement between the exporter and importer as stipulated in the sales of contract, that the Importer must open the L/C through the opening bank by first applying for the opening of L/C to the bank concerned.
- 2) Is one of banking tasks (especially commercial banks) as regulated in Article 6 section (4) of Act Number 10 Year 1998 on Banking, that “the bank guarantees its own risks as well as for the interest and on the orders of its customers”. One kind of such guarantee is to issue a letter of guarantee in the form of L/C as a instrument of payment in international trade transactions.
- 3) Article 2 Uniform Customs and Practice (UCP) for Documentary Credit 600 states that L/C is an agreement with any name and formulation that requires a bank to act upon a client’s request and instruction to:

⁸ Huala Adolf (2), *op.cit.*, page. 149, see Ramlan Ginting, *op.cit.*, page 3

- a. Conducting payments to a third party (beneficiary) or accepting a draft drawn by such third party, or
- b. Authorize other banks to conduct payments, approve or negotiate drafts on the submission of documents specified in accordance with the requirement of the credit.
- c. Because the function of the bank itself as a place to save money, the bank also serves as a media in trading transactions, both domestic trade transactions and foreign trade transactions, that involving exporters and importers as their parties. Therefore, to facilitate the implementation of its trade transactions, so its needed the role of the opening bank/issuing bank to open L/C is to be used as a instrument of payment between exporters and importers of different nationalities, and in generally the importer requesting the issuing bank to open L/C. That previously has owned funds in the bank which will be used as collateral in the opening of L/C.

The Role of Bank in Payment Implementation of International Trade Contracts.

Various problems or risks that may occur in international trade, not only related to the issue of payment and delivery of goods, but also with legal and political issues, language, currency, and risk of goods transport and geographical location that differs from country to country . Therefore, the parties should be able to identify all these issues, so that can be formulated the mechanism effectively, efficiently and safety the mechanism of making and implementation of international trade contracts.

To anticipate payment problems in international trade contracts, the role of banks is needed by exporters and importers as an institution that provides guarantees

of funds to facilitate payments of goods. Thus, the bank in addition to functioning to collect funds from the community in the form of savings and distributing back to the community in the form of credit in an effort to improve the welfare of the community,⁹ in addition, the bank also serves as one medium that will bridge the payment process in international trade contract between the importer (buyer) with the exporter (seller). It is agreed in the Sales Contract that the foreign exchange bank (Opening Bank / Issuing Bank) will issue a guarantee letter of payment known as Letter of Credit (L/C).

Therefore, to understand the role of banks in payments of international trade contract can be explained below:

a. Legal Relationship of the Parties in the Issuance of Letter of Credit as a Payment Instrument in International Trade Contracts

1) Parties Involved in the Issuance of Letter of Credit

The parties involved in issuing an L/C as a payment Instrument in the International Trade Contract are as follows:¹⁰

(1) Exporter or Beneficiary

An exporter is a party who sells or exports goods abroad, or is also called a beneficiary as the recipient of the L/C opening on his behalf, and is given the right to withdraw the money from the available L/C funds called as the recipient of L/C or Beneficiary.

(2) Importer or Opener / Applicant

Importer (buyer) is a party who imports goods from abroad, who apply to the opening bank L/C (Opening / Issuing bank) as a foreign exchange bank for the purpose of seller or exporter, or also called as the Opener or Applicant of the L/C .

(3) Opening Bank or Issuing Bank

⁹ Article 1 number (2), Act number 10 Year 1998 on Amandement of Act Number 7 Year 1992 on Banking

¹⁰ *Ibid.*, page 3-4

Opening Bank is a foreign exchange bank that is requested by an importer to open an L/C for an exporter, or called an Issuing Bank. It is this foreign exchange bank that guarantees exporters of L/C payments. Therefore, the “value” of L/C depends greatly on the reputation of the foreign exchange bank opening the L/C.

(4) Advising Bank or Correspondent Bank

Advising Bank is a bank located in the exporting country which is a correspondent of Opening Bank in the importer country, also known as the Correspondent Bank. The Bank is obliged to deliver the mandate contained in the L/C to the exporter. Therefore, the Correspondent Bank shall also be referred to as the Bank of the Trustee.

(5) Negotiating Bank

Negotiating Bank is a bank that serves to monetize (negotiate shipping document) of L/C in accordance with Beneficiary request, may be through any bank which Beneficiary likes as long as it meets L/C requirements. The bank paying the document is referred to as the Negotiating Bank.

b. Legal Relationship of the Parties in Issuance of Letter of Credit (L/C)

In accordance with typical characteristics, such as geographic and political barriers, in international trade contract, so its implementation more emphasis on the movement of goods and supporting documents. These conditions affect all aspects of international trade transactions, including the payment aspects. The buyer (importer) usually can not directly obtain credit from the producer. Therefore, it requires a third party (bank) that enroll as a provider of funds the

transaction.¹¹ Similarly, that happens in international trade transactions using L/C as a payment instrument.

Therefore, it is necessary to know how the legal relationship between the parties involved in trading transactions using L/C as a means of payment, gives birth to the rights and obligations for the parties as follows:

(1) Legal Relationships Between Buyer (Importer) By Seller (Exporter)

The legal relationship of parties in international trade contract, between the buyer and the seller, ie the buyer is obliged to pay the price of the goods and the seller is obliged to deliver the goods sold. Parallel to the obligation both parties also have rights, the buyer is entitled to receive the goods that he bought and the seller is entitled to get the payment. These are in accordance with the definition of the sale and purchase according to Article 1457 Civil Code which states that “the sale is an agreement, whereby the one party binds himself to surrender goods, and the other to pay the promised price”.¹²

In international trade transactions using L/C, the legal relationships between buyers (in L/C as applicants) and sellers (in L/C as beneficiaries) happened base on a sales contract. In a sales contract, the parties agree to use a payment method with an L/C that will create an obligation for the buyer to apply for the issuance of L/C to the bank. Furthermore, it will incur an obligation for the seller to use L/C as a way of payment of the transaction from the buyer through the bank. Thus there is no direct payment by the buyer to the seller. In the contracts are generally also included banks that issue / forward L/C to the seller.¹³ The issuing bank or the successor bank shall conduct the L/C

¹¹ Gunawan Widjaja dan Ahmad Yani, *op.cit.*, page 19

¹² *Ibid.*, page 19-20

¹³ Adrian Sutedi, *Juridical Review of Letter of Credit and Syndicated Credits*, (Bandung: Alfabeta, 2012). page 142

payment to the seller of the power of the buyer.

(2) Legal Relationship between Buyer (Importer) and Issuing Bank / Opening Bank)

The legal relationship between the applicant (buyer) and the issuing bank is based on the L/C issuance agreement. Requests for the issuance of L/C are required in realizing the way of payment as regulated in the sales contract. If the issuing bank agrees to implement the request of the applicant, the issuing bank issues the L/C. The demand for issuance of L/C and sales contracts are also separated from each other, because the contract of sale, the legal relationship that occurs is a commercial relationship formed between the imputer (buyer) and the exporter (the seller).¹⁴

The legal relationship between the buyer and the Issuing Bank may be viewed as a *lastgeving* with the wage as referred to in Article 1792 of the Civil Code. But there are some jurists who consider the legal relationship more appropriate to come from an agreement that has mixed elements between *lastgeving* agreements and agreements to do some work.¹⁵

Accordingly, the obligation of the issuing bank to comply with the contract is to issue the L/C in accordance with the requirement and conditions set by the buyer and to pay if the seller submits documents in accordance with the requirement and conditions in the L/C. The buyer's obligation is to reimburse (repay) the L/C issuing bank that has issued buyer instructions to make payments to the seller. A repayment by the buyer is made if the issuing bank or successor bank has made payment on the L/C filed by this seller.¹⁶

¹⁴ Joko, Juridical Review on Payment Transactions Using Bankers Letter of Credit (L/C), *Article: Tanggal 2 Juli 2007*

¹⁵ Gunawan Widjaja dan Ahmad Yani, *op.cit.*, page 20

¹⁶ Adrian Sutedi, *op.cit.*, page 142

After issuance of L/C for the interests of the exporter, then opening of the bank will obtain a wage for the issuance of L/C from the importer as the applicant in the issuance of the L/C. Other benefits gained by the banks if able to provide good service in the implementation of export-import payment services, this will increase the role of banks in international trade activities, as well as increasing the trust of customers both exporters and importers.

Therefore, the issuing bank issuing the L/C to the recipient (the seller) must not deviate from the issuance request of L/C. If the issuing bank makes a deviation, the issuing bank is responsible for the negative impact (risk) that may arise from its actions. The applicant is only responsible for the content of the L/C issuance request. The applicant has the right to refuse repayment to the issuing bank against the L/C issued by the bank that deviates from the request for issuance of L/C. This attitude is in line with the Trust Theory which states that "the fund of the applicant paid directly to the issuing bank is a special fund intended to be used as payment to the notes holder whether the beneficiary or the encapsulating bank that has made the L/C payment to the issuer of the issuing Bank acting as trustee (trustee)."¹⁷

(3) Legal Relationship between the Issuing Letter Bank of Credit with the Seller (Receiver)

The legal relationship between the issuing bank and the seller is born on an L/C basis issued by the issuing bank approved by the recipient. Approval of submission of L/C is realized through the submission of documents required by L/C to the issuing bank. The issuing bank signs the L/C for the benefit of the seller.¹⁸ The legal relationship between

¹⁷ Ramlan Ginting, *op.cit.*, page 85-86

¹⁸ Gunawan Widjaja dan Ahmad Yani, *Op.cit.*, page 21

the issuing bank and the recipient (seller) occurs because the issuing bank takes over the credibility of the buyer in making payments to the seller and ensures payment from the buyer. The legal relationship between the L/C and the seller depends on the legal nature of the L/C. The theory that we can read in the literature is first, the legal construction that considers the bank as the guarantor (*borg*) for the buyer. Second, which regards the bank as an *avail* guarantor for buyers, and the third is a legal construction that considers undocumentated credit as fulfillment of obligations.¹⁹

The obligation of L/C issuing bank to guarantee payment to the seller arises since the seller receives the L/C but the issuance of the L/C is not yet binding on the seller. Seller has the freedom to use or not to use the L/C. Seller is deemed to grant approval and is bound by a party in an L/C contract at the time of filing a document to a designated bank in the L/C and therefore, is entitled to obtain a payment. In case the L/C that is not in accordance with the sales contract, the seller must request a change of L/C (amendment L/C) or immediately refuse the L/C. The seller is not entitled to request a L/C change to the L/C issuing bank considering the bank acts only on the instructions of the buyer.²⁰

Rights and obligations of issuing bank and recipient are set in UCP as long as L/C is subject to UCP. However, even if the L/C is subject to UCP does not mean that all UCP provisions should apply to the L/C. Therefore L/C may contain separate clauses regardless of whether or not the regulation is in UCP. If those clauses are contrary to the provisions of UCP, the applicable clauses shall apply. However, in the case of such clauses not regulate in UCP then these clauses apply to L/C. The regulation of such clauses in L/C is in

accordance with the principle of freedom of contract known internationally.

However, as long as the rights and obligations of issuing and receiving banks are primarily concerned with L/C issues not regulated in UCP and L/C subject to national law. The determination of the national law is made on the basis of the legal choice clause in the L/C or based on the theory of the national legal determination applicable to the L/C conducted by the judge. Regardless of L/C subject to or not to UCP or L/C subject at the same time to UCP and national law, the nature of the L/C is the “promise of payment” from the issuing bank to the recipient. The issuing bank conduct payments to the recipient as long as it submits the documents required by L/C. This is in line with Agency Theory and Seller’s Offer Theory.²¹

(4) Legal Relationship Between Bank Issuing Bank and Advanced Bank/ Advising Bank

Legal relationship between the issuing bank and the successor bank is similar to between a principal and an agent. In this case, the issuing bank acts on behalf of and for the issuing bank. If the issuing bank has paid amount of fund to the recipient in accordance with its mandate, or has received a bill of exchange drawn by the recipient, then he / she is entitled to payment from the issuing bank.²²

The legal relationship between the issuing bank and the successor bank is based on the instruction of the issuing bank in the successor bank approved by the successor bank. The issuing bank instructs the successor bank to forward the L/C. So the legal relationship between the issuing bank and the successor bank is the “agency relationship” in which the issuing bank acts as the principal and the successor bank acts as an agent. The

¹⁹ Adrian Sutedi, *op.cit.* page 142-143

²⁰ Ramlan Ginting, *op.cit.*, page 86

²¹ *Ibid.*, page 86-87

²² Roni, *Letter of Credit in International Trade Contract*, <http://roniqueenet.blogspot.com>, 05, 2012.

rights and obligations of both banks are stipulated in the instruction of the issuing bank contained in the L/C. In addition, the rights and obligations of both banks are also regulated in UCP, if the L/C is subject to UCP. UCP regulates the rights and obligations of issuing bank and successor bank in forwarding and changing L/C to the recipient. As a successor bank only this bank is not obliged to make payment, negotiation, or acceptance to receipt receipt.

If the successor bank in L/C is also requested by the issuing bank to increase its confirmation on the L/C, the successor bank also performs the function of confirmation bank, so that the bank's obligation is equal to the issuer's obligation to make payment, negotiation or acceptance of draft to receiver. Consequently, the confirmation bank shall also undertake research on the suitability of the documents submitted by the L/C as a condition for making payments, negotiations or acceptances.²³

The occurrence of cooperation between the issuing bank and the successor bank may be due to the seller as the beneficiary and the issuing bank as the issuing bank located in a different country and the issuing bank has no branch in the country where the seller is located. Therefore is needed another bank in the country where the beneficiary (the seller) is required to be an advising bank and is responsible for informing the beneficiary that the L/C has been issued for him/her.

a) Legal Responsibility of the Parties in Using of Letter of Credit

In international trade contracts, the legal relationship of the parties that breeds the rights and obligations is not sufficient to ensure the security of the parties without any legal responsibility to anticipate the occurrence of unforeseen risks. Legal liability of the parties in

relation to the use of L/C as a instrument of payment in international trade contract is intended to anticipate the risk of loss which may be experienced by the parties, whether experienced by the beneficiary or the applicant or the banks involved such as issuing bank / opening bank, and advising bank / corresponding bank.

Given the possibility of risks in international trade transactions that are paid by Letter of Credit, the parties involved shall be liable to the following legal responsibilities:

b) Legal Responsibility of the Exporter Party (Seller)

Responsibilities of the exporting party (Seller) or called to as beneficiary: in addition to the obligation in the delivery of goods to the importer (buyer), the exporter is also responsible for guaranteeing the quality and quantity standards of goods in accordance with the agreement, and must insure the goods sent. It is supported by documents such as, bill of lading, trade invoice, packing list, and list of cubic/weight of goods, statements of origin, insurance policies, quality certificates, and inspection truth reports. These documents shall be sent by exporters via bank (advising bank) to be forwarded to the opening bank (opening bank) in the importer country to be forwarded to the importer.

c) Legal Responsibility of the Importer (Buyer).

The Importer party is obliged to pay the price of the imported goods; therefore he/she is responsible to ensure that the funds for the payment of the price of goods can be safely received by the importer. The form of importer responsibility is to open L/C for the interest of Exporter through foreign exchange bank in his country (Issuing / Opening Bank). Thus Issuing Bank will guarantee the payment of imported goods in accordance with the price and time and currency agreed upon as stated in the L/C. With the issuance of

²³ Ramlan Ginting, *Op.cit.*, page 87

L/C by Issuing Bank as guarantee of export payment, the importer is also obliged and responsible to issuance the L/C payment and transfer fee (*reimbursement*) to the Advising bank to be forwarded to the beneficiary party.

d) Legal Responsibility Opening Bank

L/C Opening Bank is a bank trusted by the importer, obliged to issue L/C (L/C) as a form of responsibility to guarantee payment of imported goods prices. For that Opening Bank does not work alone but relates to other banks in the selling country (exporter) that is Advising Bank / Corresponding Bank which will further forward L/C to the exporter.

e) Legal Responsibility of the Successor Bank (Advising/Corresponding Bank)

The Advising/Corresponding Bank is obliged as the successor of L/C to the exporter; therefore it is responsible to confirm L/C (Confirmed L/C) in accordance with the agreed price of goods and currency. Payment of the price of new imported goods will be implemented if the imported goods have been in accordance with the documents of goods already received by the importer.

Based on liability, the parties shall avoid the risks described above. In addition, the parties will obtain security in the implementation of import and export transactions, whether related to the completeness of documents of goods, delivery of goods, certainty of goods payment, and receipt of goods.

c. Process of Opening and Payment of L/C (Letter of Credit Process)

1) Requirement of Letter of Credit (L/C Requirements)

The requirements that must be completed in opening of L/C are:²⁴

- a) L/C must be a commercial documentary L/C so that the importer can specify the requirements specified in the L/C as required, for the security of the

administration and the requirements of the issuance of Import License Requirements:²⁵

- (1) Name and address of L/C Recipient
 - (2) The amount of funds and credit available
 - (3) The requirement of the L/C receiver (exporter) to withdraw the money order
 - (4) Types of money orders, for example: Demand/Sight Bill of, or Time Draft or Long Bill of Exchange,
 - (5) Documents along with their duplicate amounts: duplicate for duplicate 2, triplicate for duplicate 3, quadruplicate for duplicate 4
- b) Document Completeness.

Although there are different forms and rules in each bank, generally that included in the Documentary Credit are as follows:²⁶

- (1) Name of Issuing Bank, and type of credit with number and date;
- (2) The date of issued credit, the latest date for delivery can also be explained;
- (3) On whose credit it is issued (applicant/buyer);
- (4) Amount (including currency used);
- (5) Whether gradual delivery an /or transshipment is permitted;
- (6) Because a beneficiary is required to create a Bill of Exchange (generally called a "draft" in Documentary Credit) regarding:
 - (1) Provisions in the draft;
 - (2) Will the draft be withdrawn at a designated bank or buyer.
- (7) Ports of the delivery and purpose of the goods (sometimes only the written country);
- (8) A brief definition of the goods;
- (9) Shipping price and terms, CO/ CIF (Destination Port);
- (10) Documents required;
- (11) Other applicable conditions for credit;

²⁴ Adrian Sutedi, *Op.cit.*, page 54-55

²⁵ *Ibid.*

²⁶ *Ibid.*, page 57

- (12) The period specified after the date of issuance of the Bill of Lading or other documents proving the transport. The documents shall be indicated for payment, acceptance, or negotiation;
- (13) The requirement that the document is the subject of the UCP provisions;
- (14) The certificate which is the responsibility of the issuing bank is published; it can be implied from the type of credit indicated therein.
- c) The description of the goods in brief but clear.
- d) Requirements required by authorized institution, such as: import license number, export license number, order number, sales contact number and trade mark of goods.
- e) Clause on whether or not L/C recipient has the right to transfer L/C to other party or other supplier, by assigning assignable L/C or transferable L/C.
- f) The validity period of L/C must be longer than the last shipment time, must be at least equal to the last shipment date.
- g) Delivery requirements of goods, for example: Loading port and destination port (destination or discharging port).
- (1) The period determined after the date of issuance of the Bill of Lading or other documents proving of transport during which the documents shall be indicated for payment, acceptance or negotiation;
- (2) The requirement that the document is the subject of the UCP provisions;
- (3) The certificate that is the responsibility of the issuing bank is published; it can be implied from the type of credit indicated therein.

e. Proses of Opening Letter of Credit

The Proses/Stages of Opening Letter of Credit consist of:²⁷

- a. There are agreement between the exporter and importer contained in the sale's contract which requires the

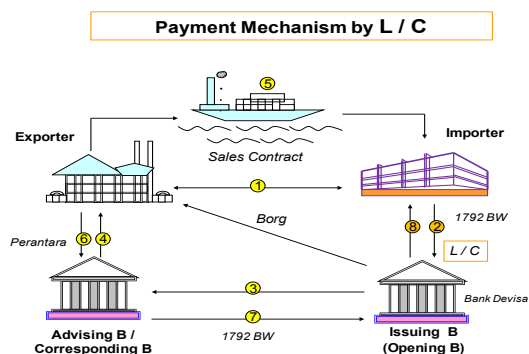
- importer to be paid by L/C) to the foreign exchange bank in the country.
- b. The Importer shall submit an application to its foreign exchange bank in the country (opening bank / issuing bank) to open an L/C as a fund prepared to repay its debts to the exporter in accordance with the agreed amount and the requirement of disbursement referred to in the sale's contract.
- c. The Bank issues L/C and then sends it to the Exporter (beneficiary) through the bank in the exporting country which is called Advising Bank / Corresponding Bank). After the Advising Bank analyze the validity of the L/C opening order received from the opening bank, then forward the mandate of L/C opening to the exporter entitled to receive by a letter of introduction from an advising bank called L/C Advise.
- d. After the exporter receives the L/C, and then sends the agreed goods in the sales contract through the port in his country to the importer; while all original documents and copies of those items are submitted by exporters through Advising Bank. Furthermore, Advising Bank passes the document to Opening Bank to be sent to the Importer (beneficiary).
- e. Further Advising Bank examines the completeness of such documents, and in accordance with the type, quantity, weight and condition of the shipped goods, then Advising Bank completes the payment of the goods to the exporter; then all the Issuing Bank services are paid by Advising Bank, and the advising bank service is paid by the importer. With the expiration of all bank service payments in the L/C process then the L/C process ends.

As for the payment mechanism by using L/C can be seen in the picture below:²⁸

Picture : International Trade Contract Payment Process with L/C

²⁷ *Ibid.*, page 55

²⁸ Muhammad Sood, *Materi Kuliah Hukum Kontrak Perdagangan Internasional*, 2010



f. Classification of Letter of Credit (L/C)

Letter of Credit can be classified into several types, as follows:²⁹

1) Types of Letter of Credit by Nature

(1) Revocable Letter of Credit.

Revocable L/C is a L/C that can be revoked at any time by the importer without requiring exporter approval. This L/C poses a big risk to the exporter, because the repayment of the shipped goods may be delayed. Revocable L/C is usually delivered to L/C recipient exporters with special message from opening bank to advising bank as follows: "When advising the recipients in a friendly manner, explaining to them that the credit may be canceled, and therefore subject to the acceptance of the beneficiary on cancellation with or without prior notice".

(2) Irrevocable Letter of Credit

Irrevocable L/C is an L/C opened by a foreign exchange bank for exporters, where the opening bank binds itself to pay of the bill notes withdrawn within the validity period of L/C. This L/C cannot be canceled during the intended period, except with the consent of all parties involved. On the front page of L/C must be clearly stated "revocable" or "irrevocable". According to UCP 600 Article 6 (c), if this word does not exist, the L/C shall be deemed "irrevocable"

(3) Irrevocable and Confirmed Letter of Credit

Irrevocable and Confirmed Letter of Credit is a Letter of Credit which:

(1) It can not be canceled or modified for the duration of their term of entry, unless the parties have the consent of all parties involved with the L/C.

(2) It having multiple repayment guarantees on the bill or delivery of shipping documents provided by Opening Bank with Advising Bank.

(3) It is the safest way of payment to be viewed from the point of view of the exporter's interest in receiving L/C.

2) Types of L/C base on Payment Method

a) Sight Letter of Credit

Sight L/C is L/C which, if all the requirements are fulfilled, then negotiating bank shall pay L/C nominal to exporter the longest within 7 working days.³⁰ On the Sight L/C, the day of payment is made when beneficiary submits shipping documents to the bank. An L/C may be called sight L/C if the L/C is required to hand over sight draft that paid at the moment the recipient of the draft shows it to the advising bank/negotiating bank. Advising bank / negotiating bank is instructed by the bank to do payment to the beneficiary on the basis of complete documents in accordance with the credit requirement that submitted in conjunction with the sight draft. Documents submitted by the beneficiary are the basis of payment of L/C by the bank. Payment on the basis of document is called document against payment (D/P).

b) Usance Letter of Credit

Usance L/C is the L/C whose payment can be settled only if the L/C has already the last limit several days from the date of

²⁹ Amir MS (1), *op.cit.*, page 9-10

³⁰ Gunawan Widjaja dan Ahmad Yani, *International Business Transaction: Export-Import and Purchase, First Edition* (Jakarta: PT. RajaGrafindo Persada, 2006), page 28

shipment (Bill of Lading date).³¹ Usance L/C is an L/C which requires exporter of L/C receiver to withdraw the Long Bill of Exchange not as Sight-Draft as usual. It means that exporters receiving L/C provide short-term credit to importers for a period of between 90 days and 180 days. Usance L/C is intended to enhance competitiveness in order to increase exports. Exporters may still withdraw this money order, by discontinuing it to the bank, so as not to disrupt liquidity.³²

c) Red Clause Letter of Credit

The term “red clause” is taken from a customary way of writing a clause in red ink where it is stated that the seller/exporter may receive the money first from the buyer/importer before the goods are shipped or before the shipment documents are handed over to the bank to be negotiated by the seller. Red Clause L/C is a Payment Instrument in the form of a Letter of Credit issued by a Bank (Issuing Bank) from an Overseas Buyer (Importer), containing a Payment Order in advance of a maximum of 30 % from Issuing Bank abroad to a Negotiating Bank within country where the Exporter has not done any export activity at all, this L/C is an advance payment from the Importer (down payment) to the exporter, the L/C is very liquid applicable in the banking system, since all risks have been borne by the issuing bank abroad and definitely paid on time.

According to Amir MS, Red Clause L/C is an L/C that:³³

- 1) Provide the right to the exporter receiving L/C to withdraw a certain portion of the L/C funds as advance money, with the submission of a regular receipt and a letter of fulfillment of the promise.
- 2) Take the remaining funds available by giving complete shipping documents.

- 3) It is very beneficial for exporters receiving L/C because they obtain interest-free Buyer 'Credit, which can be used to start the production of goods ordered.
- 3) Types of Letters of Credit base on the Requirements

Type of L/C base on the requirement can be categorized as follows:³⁴

a) Open Letter of Credit (open L/C)

Open L/C is an L/C that entitles exporters receiving L/Cs to negotiate shipping documents through any bank desired. In the L/C usually the sentence is stated, “This Letter of Credit is negotiable”³⁵

b) Restricted Letter of Credit

Restricted L/C is the opposite of Open L/C where negotiating banks are restricted to certain banks. According to Amir MS, Restricted L/C is an L/C that limits the right of L/C recipient exporters to negotiate shipping documents at a particular bank that Opening Bank prefers in the L/C, and is usually limited to Advising Bank only. Inside the L/C is usually listed sentence: Negotiable under this credit are restricted to Bank XYZ only³⁶

c) Documentary Letter of Credit.

The L/C Documentary is the L/C requiring the recipient of the L/C to submit the shipping documents proving the ownership of the goods and other supplementary documents as a requirement for obtaining payment.

d) Revolving Letter of Credit.

Revolving L/C is an L/C in which the available credit can be reused without the need to make changes in terms of both time and money. To understand this L/C Amir MS explained that:³⁷

³¹ *Ibid.*

³² Amir MS (2), *op.cit.*, page 14-15

³³ *Ibid.*, page 11

³⁴ Gunawan Widjaja dan Ahmad Yani, *op.cit.*, page 28

³⁵ Amir MS (1), *op.cit.*, page 9

³⁶ *Ibid.*, page 10

³⁷ *Ibid.*, page 12

- (1) Credit available can be reused without the need to make changes to the requirement.
- (2) Reusing of credit can be done for “time and value”, for example credit is provided for US \$ 15,000 a month, with a period of 6 months. This means that monthly credit is automatically available for US \$ 15,000 for 6 consecutive months, regardless of whether the credit is used or not. By itself this kind of credit is “Cumulative” or “Non-Cumulative”. If a “Cumulative” credit means any unused amount in the previous month can still be used in the following month. If a “Non-Cumulative” credit means any unused amount of credit in the preceding month automatically becomes void.
- (3) Reuse can also be done for “value” only. For example credit is provided for US \$ 100,000. The credit score will be automatically updated whenever the amount is used provided, it is still within the validity period of the credit (validity). This kind of credit is certainly very easy for L/C credit recipients, but Opening Bank is an unpredictable risk. If the frequency of taking credit increases, this means that the amount taken by the L/C is also higher. Therefore, the Revolving Credit usually sets the maximum value that can be drawn.

e) Back to Back L/C

Back to Back L/C is the L/C that can be reopened by the first L/C recipient exporter to the second L/C receiving exporter by guarantying the L/C it receives, this L/C is commonly used in triangular trade.

According to Amir MS, if the exporter of L/C receiver is unable to undertake the delivery of goods because it does not have, then this transaction can still be forwarded through 2 ways:³⁸

- a. Exporters will operate the L/C to exporters or other producers. This may be done if the L/C is transferable
- b. The first L/C recipient exporter opens his/her own L/C for the second exporter or producer, by guarantying the L/C it receives. This method is called Back to Back L/C, and is usually used in transit or triangular trading.

f) Transferable Letter of Credit (Assignable Letter of Credit)

Transferable L/C is an L/C which entitles the recipient Exporter to transfer or authorize his/her right to the L/C to another party or other authorized exporter. This happens for example because the first L/C recipient is not the producer himself.

CONCLUSION

The regulation of Letter of Credit (L/C) as a requirement of payment beside is regulated in the International Civil Code, also regulated in the provisions of Uniform Custom and Practice (UCP). The regulation in the International Civil Code in the relationship of importers (customers) and issuing banks refer to the legal choices of the parties. If there is no legal choice, then based on the achievements of the parties, the principle of the most characteristic performance is based on the country where the bank provides credit. The relationship between the issuing bank, advising bank and beneficiary, also refers to the law they choose. If there is no legal choice, then the applicable law is the law in the country where the credit is disbursed, namely the law of the seller (beneficiary). While the regulation in

³⁸ *Ibid.*, page 13

UCP 600, the L/C is an agreement that requires a bank to act on the request and instructions of a customer to conduct payment to the beneficiary) or authorize another bank to make payment, approve or negotiate a draft on the submission of documents determined according to credit requirements. Similarly, in the Banking Act Number 10 Year 1998 that “banks must provide guarantees at their own risk and for the benefit and on the orders of their customers”. One form of such guarantee is to issue securities in the form of L/C as a requirement of payment in international trade transactions.

The role of banks in the implementation of payment services in international trade contracts is to guarantee the payment of goods sent by exporters to the importers in accordance with the agreed price, and to ensure the completeness of the shipment documents. Therefore, the bank is in addition to the obligation and responsible for issuing the L/C, this is done by the Issuing Bank at the request of the importer for the interest of the exporter (beneficiary). In addition, the bank is also obliged and responsible for continuing the L/C, which is carried out by the Advising Bank to the exporter. The role is based on an agreement set forth in an international trade contract

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