Credit Arrangements

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Financing of International Sale of Goods

The importance of credit arrangements in international trade transactions

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International trade transactions can be regulated for their payment in various ways: by means of letters of credit or by cash and kind. Therefore, credit arrangements are a common and protection against risk solution.

One of the most important challenges for traders involved in a transaction is to secure financing so that the transaction may actually take place. The faster and easier is the process of financing an international transaction, the more trade will be facilitated.

The method of payment is crucial for the decision about the opportunity of the trading. Therefore, the arrangements for credit in international trade, play an important role, by which parties tend to minimize their risks and maximize their financing. Those are reached considering the exigences of both parties.

A party that intend to develop a business relationship with another foreign party should proceed with an open mind but always bearing in mind that risk is an inevitable element in all business.

Traders use various types of credits that have been developed via commercial practice over the years. The choice is often based on financial reasons and also risk control.

Letter of credit is probably the most common methods of payment used in the world of import-export trade and have been described by Kerr LJ as “the life blood of international commerce”. Risks differentiate the methods of payment and letters of credit seems to be the one which balance at the best the risk of both parties, the buyer and the seller.

The issuing of credit, is often accompanied by guarantees, indemnities or bonds issued by a bank on behalf of their customers. The scope of seeking such a a guarantees is to ensure that a seller or a buyer performs his part of the contractual obligation. The differences between a guarantee and an indemnity, is that a guarantee is a written instrument (document from a bank) providing that if a customer fails to honor his obligations to perform a particular function or service , the bank will pay a named party a specified sum of money on behalf of that customer; whereas an indemnity, is an instrument through which a bank takes the responsibility to ensure that payment is made when a valid claim may be presented to a bank under that indemnity.

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1  RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd [1978] QB 146 at 155
A letter of credit substitutes the credit of a bank for the credit of an applicant. Specifically, it is a written instrument issued by banks stating that payments will be made on behalf of applicants to beneficiaries, provided that the beneficiary fulfills all of the conditions described in the letter of credit. The typical bank customer for a letter of credit is someone engaged in international trade and who is a buyer of international goods. According to the Uniform Customs and Practices for Documentary Credits (the “UCP”): a letter of credit is “an arrangement, however named or described, whereby the issuing bank acting at the request and on the instructions of its customer (the applicant for the credit).

It is vital, of course, that this credit facility opened by the issuing bank (the buyer's bank) cannot be stopped halfway through the transaction (e.g. when the goods have been shipped), otherwise the seller would be left in an exposed position, having parted with the goods, but having no security for payment. To cover this point, the banking community has developed the “irrevocable” letter of credit, the intention of which, as the name implies, means it cannot be recalled once given, and the autonomous nature of credit relationships was underlaid by Lord Diplock in Investment v The American Accord [1983]. It is, of course, possible to have a “revocable” letter of credit, as stated in the UCP art 6(b). “All credits should state clearly whether they are revocable or irrevocable, otherwise they will be irrevocable”, but the value of such a document is, to say the least, limited as it can be stopped at will, as in UCP, art. 8(a): “A revocable credit may be amended or canceled by the issuing bank at any moment and without prior notice to the beneficiary”, and art 8 (b):” but issuing bank must reimburse paying bank if they paid before notice of cancellation”, leaving the seller with his right to sue, which, of course, was what he was trying to avoid in the first place.

There are a number of variations in the terms of letters of credit to meet the needs of businessmen, depending upon the requirements of any given transaction.

The more usual form is the credit that is both “irrevocable” and confirmed”; and UCP 600 does not provide for “revocable” and “not confirmed” credits. In addition a form of credit that is used often is the “revolving” letter of credit. This is opened with the buyer's bank where the buyers needs an on going facility, up to an agreed

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2 UCP has been revise since 1993, 1951,1962,1974,1983,1993 and UCP 600 of the 2007
3 e.g. of a revocable credit, Cape Asbestos Co v Lloyds Bank [1921] WN274
4 United City Merchants (Investment) Ltd v Royal Bank of Canada, (The American Accord) [1983] AC 168 HL, he said: “The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in the international trade is to give the seller an assured right to be paid before he parts with control of the goods that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment”.
5 UCP 500 provides for “revocable” credits, whereas UCP 400 provides for “revocable” and “unconfirmed” credits.
6 it is possible to confirm a credit issued by an entity which is not a bank: Barclays Bank Ltd. v Mercantile National Bank [1973] 2 Lloyd's Report 541
maximum, which will, without any further formality be renewed over and over again in favor of a
named seller to the total agreed value of the facility. This is similar to an installment credit, which
is, however, less flexible, and where the schedule of shipping and payment is exactly the same as
any other form of such a facility.

Then again, where the goods are to be sold and re-sold through several middle-men (sometimes
referred as string contracts), it is common to find that each party opens a credit dependent on the
others on a back-to-back basis. Letters of credit can, of course, be made transferable, as UPC, art 48(a), that is, they can be drawn stating clearly that the seller (being the ultimate beneficiary under the credit) has the right to transfer the benefit of the credit to some third party, who will receive the money instead of the seller.

Payment under a letter of credit is based on a documents only: as documents are the only objective
link between the issuing bank, specialized in finance, and commercial parties, specialized in trade.
Goods must be detailed in every document precisely, often by a package list, and in the same words.
Under this perspective, Lord Summers said: “there is no room for documents which are almost the
same, or which will do just as well”\footnote{in Equitable Trust Co of New York v Dawson Partners Ltd [1927] 27 Lloyd's Rep 49 (HL)}. That is to say that \textit{de minimis} rules does not apply to the tender of documents under a letter of credit\footnote{Soproma SpA v Marine & Animal By-Products Corporation [1966] 1 Lloyd's Rep 367.}. The compliance of documents is strictly applied: rightly because banks are not expected to know all kind of products and subtleties between different meanings, as reminded in \textit{JH Rayner v Hambro's Bank}. When banks proceed to payment despite discrepancies between document, they will be at risk\footnote{JH Rayner & Co Ltd v Hambro's Bank Ltd [1943] 1 KB 37 (CA): “It is quite impossible to suggest that a bank is to be affected with knowledge of the customs and customary terms of everyone of the thousand of trades for whose dealings he may issue letters of credit”}. UCP is a rare successful attempt at unification of the law relating to documentary credits, has almost universal application and applied by English Banks since 1962 so that their standard forms invariably incorporate the UCP provisions. However, the UCP does not have the force of law in England, unless specifically incorporated into the contracts which form the basis of the credits\footnote{In Forestal Mimosa Ltd v Oriental Credit Ltd [1986] 1 WLR 631 CA, an insertion in the left hand margin was held by the Court of Appeal to be sufficient to incorporate the provisions of the UCP.}.

\footnote{sometimes called “countervailing” credits, e.g. see in \textit{Ian Stack Ltd v. Baker Bosley Ltd} [1958] 2 QB 130}
Letter of credit is a valid financial instrument, but specification of importers are stronger, and some discrepancies in documents may cause delays in obtaining payment or prevent making payment.

In conclusion, credit agreements are essential in financing the business of the international traders, they form the basis of the legal relationship between a business and its customers.
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