

INTERNATIONAL SALES TRANSACTIONS
CONFIRMED IRREVOCABLE LETTERS OF CREDIT

by

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Background

In international sales transactions, the problem often arises as to how to satisfy the seller's desire for payment to be made prior to transferring the purchased goods and the buyer's concern that payment not be made until the buyer is assured that it will receive the goods purchased and that the purchased goods will comply with the specifications set forth in the sales contract. Documentary letters of credit have been devised to satisfy the concerns of both parties.

This article will deal with a specific type of documentary letter of credit, the Confirmed Irrevocable Letter of Credit (the "CILC"). The international rules governing documentary letters of credit have been established by the International Chamber of Commerce and are referred to as the Uniform Rules and Practice for Documentary Credits, ICC Publication No. 500 (the "UCP"). The UCP must be specifically incorporated into the documentary Letter of Credit in order for the UCP to apply.

This article contains a brief description of a typical international sales transaction utilizing a CILC, and only covers some of the major considerations with regard to such a transaction. It is not meant to be an in depth discussion of the subject or a primer on the drafting of CILC's. For purposes of this article, the assumption shall be that the buyer and its bank are in a third world developing country and the seller is in an advanced industrial country thereby necessitating the use of a CILC which provides for a highly rated bank to undertake the same obligations as the buyer's local issuing bank with regard to the issuing bank's obligations as set forth in the CILC.

Definitions

Letter of Credit ¹	Any arrangement pursuant to which a bank makes a written undertaking at the request of its customer. For the purposes of this article, the undertaking by the bank to make payment on behalf of its client, the buyer, to the seller upon presentation by the seller of the documentation described in the letter of credit.
Issuing Bank ²	The bank that acting upon its customer's request issues the Letter of Credit.
Applicant ³	The customer (the buyer) requesting the Letter of Credit.

¹ UCP Article 2

² UCP Article 2

³ UCP Article 2

Beneficiary ⁴	The party (the seller) that is to receive the payment to be made pursuant to the Letter of Credit.
Confirming Bank ⁵	A bank bound by the terms of the Letter of Credit to the same extent as the Issuing Bank.
Nominated Bank ⁶	The bank that will actually make payment to the Beneficiary in accordance with the terms and conditions of the Letter of Credit.

Basic Provisions of a CILC

Every Letter of Credit will vary depending upon the terms and conditions of the sales contract; however, some characteristic provisions of a CILC are as follows:

- The irrevocable obligation by the Issuing Bank to make the payment of the purchase price upon compliance by the Beneficiary (the seller) of the terms and conditions of the CILC which will include providing to the Nominated Bank with the documents referred to in the CILC.
- The confirmation by a Confirming Bank, a bank that has a credit rating at least as high as that required in the sales contract, that the Confirming Bank will be bound to the same extent as the Issuing Bank with regard to the obligations of the Issuing Bank under the CILC.
- The designation of a Nominated Bank, a bank most likely located in the same area as the seller, that will actually make payment to the Beneficiary (the seller) if the Beneficiary complies with the terms and conditions of the CILC.
- The requirement that the Beneficiary provide certain original documentation to the Nominated Bank, such as an onboard bill of lading, commercial invoice, and/or inspection certificate as specified in the CILC prior to the expiry date set forth in the CILC in order to receive the amount set forth in the CILC.

Basic steps in a sales transaction involving a CILC

- Buyer and seller enter into a sales agreement that includes price, detailed specifications of the goods being purchased, and the requirement that payment be made in accordance with a CILC to be obtained by the buyer and to be in such form and substance as is acceptable to the seller. Although the buyer has agreed to obtain an irrevocable letter of credit from a local bank, the seller usually requires that such an irrevocable letter of credit be confirmed by an international bank having a higher credit rating than the local bank.
- The buyer, as Applicant, requests its bank to prepare a CILC in accordance with the requirements set forth in sales contract, including making the Letter of Credit

⁴ UCP Article 2

⁵ UCP Article 9B.

⁶ UCP Article 10B.

irrevocable and requiring that the Letter of Credit be confirmed by a Confirming Bank with a credit rating equal to or better than that stipulated in the sales contract. As required in the sales contract, the CILC will refer to a Nominated Bank located in the country of the Beneficiary that will actually make payment on presentation of the required documents by the Beneficiary.

- The CILC is sent to the Beneficiary to review, and if the CILC is acceptable, the Beneficiary ships the goods to the location set forth in the sales contract.
- Upon shipping the goods, the Beneficiary obtains the required documents, i.e., on board bill of lading, commercial invoice, inspection certificate, etc. to be presented to the Nominated Bank.
- The Beneficiary presents the documents to the Nominated Bank with a demand for payment, and if the Nominated Bank finds the documents to be in compliance with the CILC, the Nominated Bank makes payment to the Beneficiary.

Important considerations regarding all letters of credit, including CILC's

When drafting or reviewing any Letter of Credit, including a CILC, there are a number of important issues that should be considered, including the following:

- Banks are only required to examine documents listed in a Letter of Credit with "reasonable care" to determine whether or not "on their face" they are in compliance with the Letter of Credit.⁷ It is therefore necessary to clearly identify all documents which the Beneficiary will be presenting to the bank making payment in accordance with the Letter of Credit.
- Vague terms such as "first class", "well known", "qualified" and "independent" should not be utilized to describe the issuers of documents required to be presented by the Beneficiary to the bank making payment. If such terms are included, they will be disregarded with regard to documents which otherwise comply with the terms of the Letter of Credit.⁸
- Unless the Letter of Credit specifically prohibits it, partial drawings on the Letter of Credit and partial shipments will be allowed.⁹
- All letters of credit must state an expiry date and place for the presentation of the documents required to be presented for payment.¹⁰
- If the Beneficiary is to be prohibited from assigning proceeds under the Letter of Credit, the prohibition must be stated in the Letter of Credit, otherwise the Beneficiary will have the right to assign.

⁷ UCP Article 13

⁸ UCP Article 20A.

⁹ UCP Article 41

¹⁰ UCP Article 42

Conclusion

This article only contains a general description of a typical transaction involving the issuance of a CILC and some areas of concern with regard to the drafting of a CILC. Each transaction involving the issuance of a CILC will vary depending upon the terms and conditions of the sales contract, and the drafting of the applicable CILC will necessitate great care to make sure that the CILC complies to the specific provisions of the sales contract and fully complies with the requirements of the UCP. However, a properly drafted CILC is a very effective method for protecting the interests of both the buyer and seller in an international sales transaction.

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