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DOCUMENTARY CREDITS  
IN CONTEXT OF IMPORT AND EXPORT FINANCING

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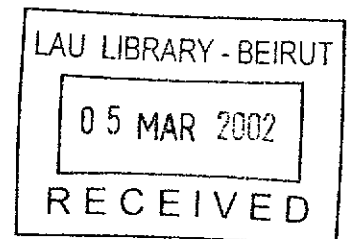
A Research Topic  
Presented to Business Division  
Beirut University College

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In Partial Fulfillment  
of the Requirements for the Degree  
Master of Science in Business  
Management

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By  
Souhair Arslan  
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LAU 19900

BEIRUT UNIVERSITY COLLEGE

P.O. BOX 98 13-5053

BEIRUT, LEBANON

APPROVAL OF RESEARCH TOPIC

CANDIDATE: Souhair Arslan DATE: July, 1984

DEGREE: Masters of Science ADVISOR: Dr. M. Singh

TITLE OF RESEARCH TOPIC: Documentary Credits in Context of  
of Import and Export Financing

The following professor nominated to serve as the advisor of the above candidate has approved this research topic.

ADVISOR: Dr. M. Singh

Name



Signature



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## Chapter 1

### INTRODUCTION

Import financing, a traditional role of American banks, is probably the only aspect of international banking, as it is conducted today, for which there exists a comprehensive body of background literature. The involvement of American banks in import financing goes back to the early days of the United States when merchant houses, with European connections, found it more profitable to lend their good names to other, less well known merchants than to incur the merchandise risk themselves. In this fashion, merchant banking, commercial letters of credit and banker's acceptances were born. Private banks were the pioneer American firms in the business of accepting drafts and issuing letters of credit, and such banks dominated the financing of the U.S. import trade until the 20th century.

In fact, national banks were not thought to have the power to create banker's acceptances until the passage of the Federal Reserve Act in 1913. At the outbreak of World War I a \$20 million (large for that time) acceptance credit for the Republic of France was put together by American private banks for the very reason that the national banks were not experienced in such financing.

The principles of import financing have changed little



from the early days of the 19th century when a Liverpool merchant might draw drafts under an American banker's letter of credit covering a shipment of linen to a Philadelphia correspondent of the American banking house and send the related shipping documents to the United States. However, the documentary basis of the relationship between a bank, its correspondents and customers, respectively, has changed significantly over the years, particularly in the last ten years or so during which the Uniform Commercial Code has been in effect in most of the United States. In addition to this legal development, the past decade has witnessed more sophisticated credit techniques, the wider use of commodity exchanges to hedge purchase and sale of imported commodities, and dramatic fluctuations in worldwide commodity prices.

It is generally accepted among banks' international lending officers that the pattern of United States involvement in world trade has gone "full cycle". In the space of two decades they have witnessed the world marketplace change from a simple center where export-import trade was conducted freely and an American bank could service it from home shores to the present complex situation. For nationalistic and economic reasons, foreign countries have discouraged imports either by placing tariff barriers within their own boundaries or by joining regional trading groups such as the European Common Market which offers distinct advantages to trading among members.

Under these changing circumstances, the United States'

approach to the development of trade must always be flexible if it is to meet successfully the challenge to its cherished position as the world's number one trading nation. Recognition of this need for flexibility is evidenced by American companies that no longer rely on servicing world markets from stateside. The multinational corporation, through an organizational structure of overseas subsidiaries, affiliates and joint ventures, is able to operate manufacturing and sales distribution outlets directly in the overseas marketplace.

United States banks, too, have expanded their operations to a multibank structure abroad to compete with local foreign banks for the retention of the international services they formerly provided corporate customers only from the bank's home base. This change initially brought a decline in bank export financing at home.

The impact of this migration resulted in a substantial outflow of dollars and a drastic negative effect on the American balance of trade and payments. This prompted the federal government to place restrictions on both banking and industry to prevent the further flow of funds overseas. Ultimately, controls were removed and the United States dollar devalued.

The need to increase exports has become important so that additional dollar exchange can be created to meet the threat to the United States' balance of payments brought on by the energy crisis.

Thus, the cycle is completed and, once again, American international bankers have the opportunity and challenge to finance the export needs of their customers from home shores.

#### STATEMENT OF THE PURPOSE

The purpose of this Research is to provide the customers and bank's personnel, depending on their experience level, with a greater insight and understanding of the bank products collectively known as "International Trade Services", and fundamentals of letters of credit.

The understanding of International Trade Services will help to promote and facilitate cooperation between responsible people (bankers) and the companies. It will also contribute to smooth settlement of payments to the bank, and a clear understanding of documentary credits to the customer.

The Research is designed to encompass, in historical sequence, the development of the relevant bank products, their variations and uses.

~~The subject has been approached mainly from the point~~  
of view of a bank engaged in letter of credit financing. While letters of credit are technical by their nature, this discussion of them is based on the practical aspects encountered in their handling.

#### STATEMENT OF THE PROBLEM

The problems that face banks engaged in letters of credit are:

1. Customers may not be fully aware of the:

- 1.1 Principles or fundamentals of "International Trade Services".
  - 1.2 Banks' Information Services.  
Banks supply valid and reliable information as to reputation and credit worthiness of the Seller/Buyer.
  - 1.3 Extent to which the bank is liable.  
Banks deal with documents only and not with merchandise.
  - 1.4 Uniform Customs and Practices for Documentary Credits.
2. The senior officers of the Letters of Credit Department waste a lot of their time explaining to customers how a documentary credit works from a trade, marketing credit, and financial point of view.
  3. Personnel and customers may not be fully acquainted with the system of "financing letters of credit".

#### PERFORMANCE OBJECTIVE

The main objective is to:

1. describe and examine the needs of documentary letters of credit and other instruments extensively used in financing international trade, and
2. provide practical hints on resolving questions and difficulties that may arise for both parties, the customer and the bank, in international transactions.

#### METHODOLOGY

In the Research, letters of credit will be discussed

as to definitions, transactions and forms of letters of credit. Import and export letters of credit will be analyzed. Other forms of credit such as "Documentary Collections" will be discussed. Amendments in "terms and conditions of letters of credit" and discrepancies between documents and merchandise will all be briefed.

The main emphasis in the study will be on "financial letters of credit" - import financing and export financing.

In the method of dealing with documentary credits, the researcher will present first definitions and theories, then will examine the real application of the instrument. To achieve this goal there will be extensive use of real examples and illustrations.

Specimen forms and tables will also be used in the discussion for the purpose of clarity and full understanding of all aspects of documentary credits.

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## Chapter 2

### A. PRESENTATION AND ANALYSIS OF RESULTS

Because of the worldwide interrelationships in international trade, it frequently happens that buyers and sellers enter into contracts under which, for one reason or another, neither prepayments nor supply of the goods on a credit basis are possible.

With their world-circling networks of branches and correspondents, banks have been contributing to the settlement of such contracts since the early years of modern world trade.

How do they do it?

The buyer instructs his bank to issue a documentary credit in favor of the seller. The documentary credit is a ~~commitment on the bank's part to put an agreed sum at the~~ seller's disposal on behalf of the buyer under precisely defined conditions. However, the bank only makes payment if the seller submits the prescribed documents to it on time. Usually these documents consist of an invoice, evidence of dispatch (bill of lading, way bill, etc...) as well as other possible proofs, showing that exactly described goods have been delivered in accordance with the terms and time limits agreed upon.

When the seller receives such a documentary credit, then he knows that a party independent of the buyer will make payment as soon as he has shipped the goods and delivered the prescribed documents to the bank. On the other hand, the buyer is sure that the purchase price will only be released against receipt of the documents he has specified.

Thus, the bank acts as a fiduciary agent between buyer and seller. Even though the goods are purchased abroad, the bank makes it possible to settle the transaction step by step without delay. In effect, it helps to bridge both distance and time.

#### The Bank as Fiduciary

As explained, the bank assumes an extremely important fiduciary function between the parties. On the one hand, it must see that the guaranteed sum is released only when the credit stipulations have been complied with to the letter. On the other hand, the bank should endeavour, within the limits of the given possibilities, to safeguard the interests of the beneficiary (seller) vis-à-vis the buyer should the documents fail to meet the credit stipulations in any respect.

#### The Uniform Customs and Practice for Documentary Credits

In the course of time a number of practices, expressions and terms have evolved between banks dealing with documentary credits. To ensure uniformity of interpretation in international trade, the International Chamber of Commerce in Paris has worked out the "Uniform Customs and Practice for Documentary Credits". These have been revised and brought up

to date several times in the past. They are now applied by banks in over 175 countries.

For the sake of simplicity, we shall refer to these rules in the research with the abbreviation UCPDC.

### Some Important Principles

1. Only the wording of the credit is binding on the bank.<sup>1</sup>

Credits are separate transactions from the sales or other contracts on which they are based. As far as customers are concerned, this means that the banks are bound only to the text of the credit itself in carrying out the transaction, and cannot take into account any contractual stipulations that may differ from the credit wording. The same applies to contracts modified at a later date without a corresponding amendment being made in the credit text. In the latter case as well, the bank will act exclusively in accordance with the valid credit wording when taking up and checking the documents.

2. Banks deal exclusively with the documents. In documentary credit operations all parties concerned deal in documents and not in goods (UCPDC, Art.8). The banks check exclusively, on the basis of documents presented to them, whether the terms of the credit are fulfilled. They are not in a position to verify whether the goods

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<sup>1</sup>Herman N. Finkelstein, Legal Aspects of Commercial Letters of Credit (New York: Columbia University Press, 1930),



supplied actually agree with those specified in the credit. The banks cannot be held liable for differences, say, between the goods invoiced and those actually delivered, nor do they have to answer for buyer's complaints. It is up to buyer and seller to settle questions of this nature between themselves.

3. Banks assume no responsibility for authenticity, form or validity of the documents.<sup>2</sup> It goes without saying that the bank will examine the documents it receives under a credit with reasonable care. It checks whether they appear, on their face, to comply with the specified terms and conditions. In view of the multiplicity of documents issued in international trade, however, it is understandable that banks decline any examination or liability over and above this (UCPDC, Art.3).
4. Banks assume no responsibility for the acts of third parties taking part in any way in the credit transaction.<sup>3</sup>

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Banks are not responsible for delays in the transmission of information over which they have no control. Neither do they assume liability for the consequences of acts of God or any other causes beyond their control (UCPDC, Art.10 and 11). Nor do they assume responsibility for the acts of correspondent banks (i.e. foreign banks) whom they have instructed to carry out the

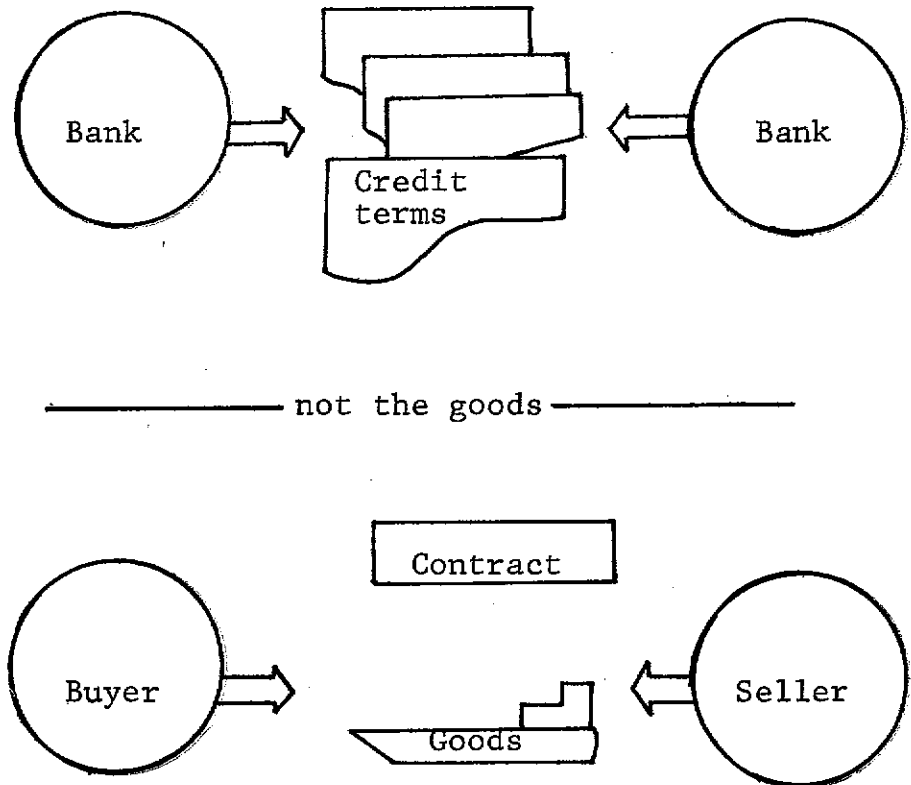
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<sup>2</sup>Ibid.

<sup>3</sup>Ibid.

the documentary credit transaction (UCPDC, Art.12).

Figure 1:



How does a documentary credit work?

The buyer's rate is that of applicant for the credit towards the issuing bank. The seller is the beneficiary of such a transaction.

Based on the terms and conditions of the contract entered into with the seller, the buyer instructs his bank to issue a corresponding credit.

Before the bank issues a credit on behalf of a customer, it checks whether the customer's balances or other existing arrangements will permit the committed payment to be made on

availment. If the bank is asked to issue a credit in favor of a foreign seller, it generally does not enter into direct contact with the beneficiary. Instead, it utilises the services of a correspondent bank in the seller's country, and if possible in his city. This second bank is referred to as the "advising bank". It transmits the issuing bank's communication to the beneficiary (seller).

Now the beneficiary, i.e. the seller, knows that the payment is secured by a bank, provided of course that he holds precisely to the terms and conditions of the credit. After having shipped the goods, he assembles the documents specified by the credit, delivers them to the advising bank and demands payment in return.

The advising bank checks the documents to see whether the terms and conditions of the credit have been complied with completely. Then it will make payment in the manner specified in the credit and forward the documents to the issuing bank. In return it will be covered for the equivalent of the payment made.

To protect the buyer's interests the issuing bank makes its own check of whether the terms and conditions of the credit are actually fulfilled.

Finally it will deliver the documents to the applicant for the credit (buyer) and charge his account for the payment made.

Figure 2:  
Opening the Credit:

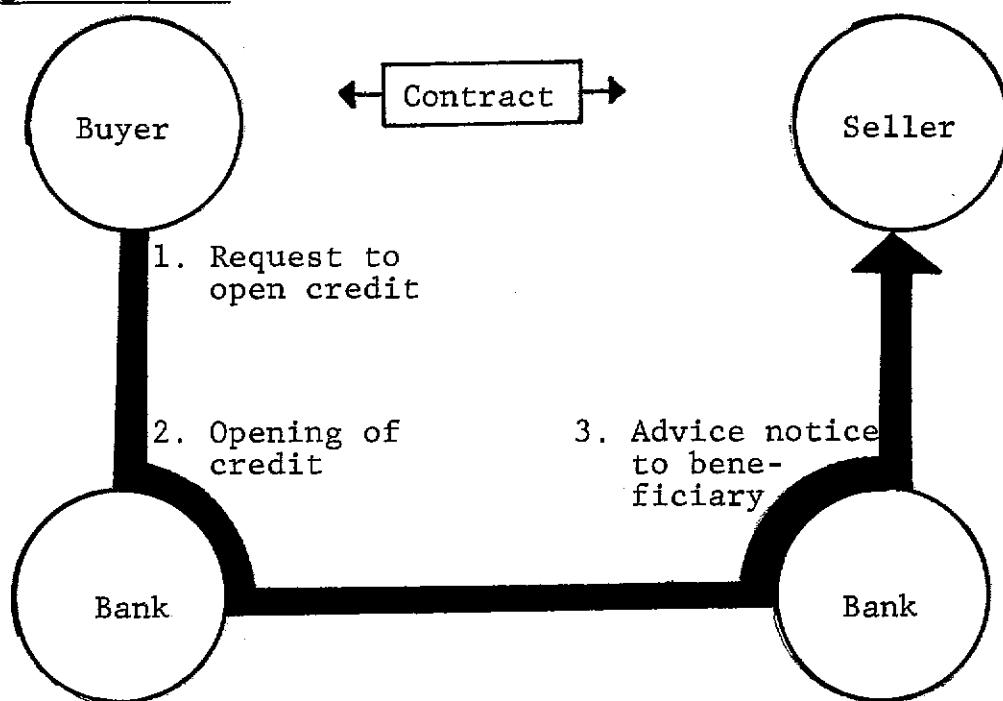
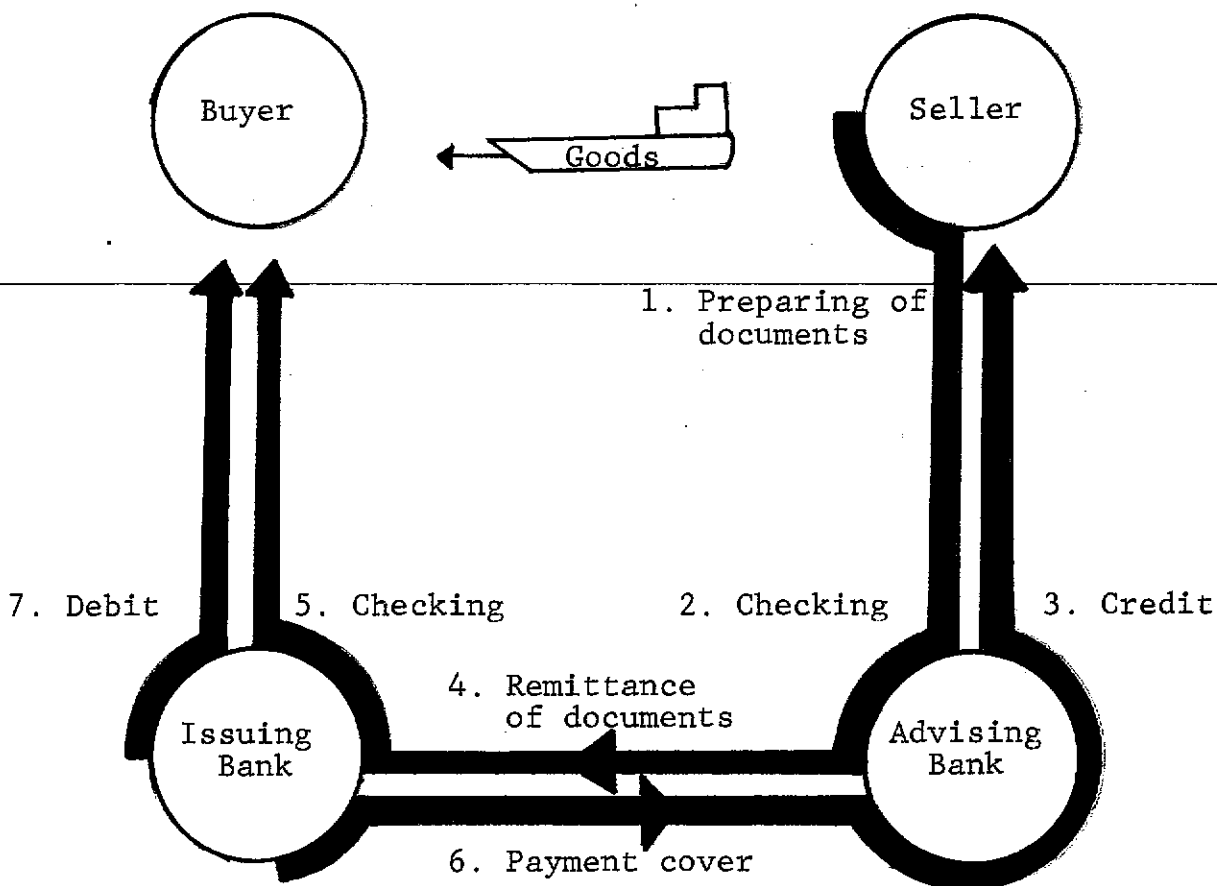


Figure 3:  
Utilizing the Credit:



Definition

The letter of credit is a written instrument issued by the buyer's bank, authorizing the seller to draw in accordance with certain terms, and stipulating in legal form that all such bills (drafts) will be honored. It sets forth under what terms and conditions the person in whose favor the letter has been opened may draw drafts against such credit, at the same time guaranteeing the payment or acceptance<sup>4</sup> of such drafts if they comply with the letter's terms.

## B. DOCUMENTARY CREDITS

Forms of Documentary Credits<sup>5</sup>

## 1. The Revocable Credit:

This does not constitute a legally binding undertaking of the banks concerned (UCPDC, Art.2) and may be modified or cancelled at any time. Because it offers little security, this form is hardly ever used.

## 2. The Irrevocable Credit:

The issuing bank commits itself irrevocably to honour its obligation under the credit, provided that the beneficiary complies with all terms and conditions (UCPDC, Art.3a). Thus the beneficiary receives a firm undertaking of the issuing bank that cannot be modified without the consent of all parties.

As already mentioned, two banks are normally involved in a documentary credit transaction. While the liability of the issuing bank always exists in the case of an irrevocable credit, the advising bank is liable to the extent of the

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<sup>4</sup>Frank Henins, Dictionary of Foreign Trade, 2nd ed. (New York: Prentice-Hall, Inc., 1947).

<sup>5</sup>Swiss Bank Corporation, Documentary Operations (Switzerland, Nov. 1978).

mandate it is given. This mandate can direct it:

- a) Not to confirm the credit.

In this case, the advising bank assumes no responsibility; it merely acts on behalf of the issuing bank. Nevertheless, it will normally endeavour to honour the payment commitments of the issuing bank. Such credits are called "irrevocable credits not confirmed by the advising bank".

- b) To confirm the credit.

By confirming the credit, the advising bank assumes a firm and independent obligation to make payment, just as does the issuing bank (UCPDC, Art.3b). The confirming bank must make payment even if the issuing bank should later on -for one reason or another- not be able to remit the required cover for the payment. This type is called "irrevocable, confirmed credits".

Of course, the credit that affords an exporter the most security is one issued irrevocably by a foreign bank and confirmed by a domestic bank.

#### Types of Availability<sup>6</sup>

1. The Sight Credit:

The amount is released as soon as the prescribed documents have been submitted and checked by the bank. This means that the beneficiary of such a credit normally can dispose of the sales price immediately.

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<sup>6</sup>Jules I. Bogen, Financial Handbook (New York: The Ronald Press Company, 1950).

In the case of credits in foreign currencies, or in some other instances, a few days can pass between the surrender of the documents and the moment the funds are actually paid. Normally this is the period required by the banks to remit the amount of the credit.

2. The Deferred Payment Credit:

The amount availed of is not put at the seller's disposal immediately upon surrender of the documents, but only after a specified period has elapsed.

The credit wording always specifies the duration of the period and the time at which it starts. A deferred payment credit allows the buyer a grace period. On the other hand the seller is sure that a bank will make payment on the due date.

3. The Credit Available Against Time Drafts (Usance Credit):

The text of such a credit authorises the beneficiary to draw a draft on a specified bank together with the documents to be remitted. In return for the documents surrendered he receives the draft after it has been accepted by the drawee bank.

The wording of the credit states on which bank the draft is to be drawn (i.e. issuing, advising, or a third bank) and the period for which it must run. If the beneficiary wishes to have the amount of the draft at his disposal prior to maturity, he can usually

discount this bank acceptance at favourable terms. This puts the sales price at the seller's disposal immediately. On the other hand, the buyer will be charged with the draft amount at maturity only.

#### Forms of Notification

For traditional reasons documentary credits are issued in externally differing forms from country to country and bank to bank.<sup>7</sup> The main categories found in actual practice are:

1. Notification by letter from bank to bank. The issuing bank sends notification to the advising bank that the credit has been issued, with the request to inform the beneficiary accordingly. The advising bank then advises the seller in turn by means of another notification. To simplify this procedure, the International Chamber of Commerce has developed a special standard form that includes both the notification to the advising bank and that to the beneficiary. The advising bank can simply stamp it and forward it on to the seller.
2. The commercial letter of credit.  
Banks in most of the English-speaking countries tend to issue their credits in the form of a "Commercial letter of credit". This is issued directly in the name of the beneficiary, who normally receives it through

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<sup>7</sup>Swiss Bank Corporation, Documentary Operations (Switzerland, Nov.1976).



a bank in his own country. The beneficiary is authorized to draw a draft on a specified party (either the bank or the buyer) and to present it, together with the prescribed documents, to a bank for negotiation (which means the purchase of the documents by the intermediary). In the text of the letter of credit, the issuing bank guarantees that bills of exchange will be honoured if accompanied by documents in conformity with the credit terms. The letter of credit must be submitted to the negotiating bank along with the documents because amounts paid out or drafts accepted have to be entered on it for checking purposes.

#### C. IMPORT LETTERS OF CREDIT

It must be kept in mind that every import is an export and every export an import, the term used depending on the position in the transaction of the person speaking.

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Assume now that Universal Bank (New York) has a customer named General Trading Company which wants to buy 200 bolts of cloth from Wholesale Linen Co. in England. At the request of General Trading Co., Universal Bank has obtained credit information on Wholesale Linen Co. which indicates it is a reputable concern, although not very large.

General Trading Co. does not want to send cash with the order but is prepared to pay after it knows the cloth is ready for shipment. Wholesale Linen Co. does not want to

wait for payment until the cloth is delivered in New York; it wants payment when shipment is made from London. In any purchase or sale between two countries having different currencies there is, of course, also an exchange transaction. In this transaction the question arises as to whether the sale should be made in U.S. dollars or pounds sterling. General Trading Co. wants to pay in its own currency but Wholesale Linen Co. wants to receive pounds sterling. As payment can, of course, be made in only one currency, in this instance assume Wholesale Linen Co. agrees to accept payment in U.S. dollars and have the dollars converted into pounds sterling; therefore the exchange transaction will take place in England.

The terms of payment are "Irrevocable letter of credit of a New York bank for \$10,000 covering 200 bolts of gray cloth C&F (cost and freight) from London to New York, insurance covering the ocean voyage to be arranged by General Trading Co.". In other words, the Wholesale Linen Co. agrees to arrange shipment of the cloth to New York and that the cost of the merchandise, plus the cost of the ocean freight will not exceed U.S. dollars 10,000.

The General Trading Co. agrees to provide an irrevocable letter of credit which will permit Wholesale Linen Co. to receive payment when shipment is made from London.

#### Application

To obtain the letter of credit, General Trading Co.

must prepare an application as shown in Exhibit 1.

The information filled on the face of the application is based on the contract of sale. The contract undoubtedly includes more information than appears in this application. For example, it probably spells out the size, quality, etc., of the cloth. These details should, rightfully, be omitted from the credit.

With respect to numerous details appearing in a credit, the Committee on Foreign Banking, now known as the Committee on International Banking, of New York, in its release of January 10, 1944 said in part:

A commercial credit is issued primarily for the purpose of financing transactions involving the shipment of merchandise and it should not be used by a buyer for the purpose of incorporating therein numerous details which may be part of a sales contract. For that reason a commercial credit should contain only such conditions as can be readily determined from the documents to be presented and if applications are received containing conditions which cannot be readily determined from the documents, the logical procedure would be to communicate with the applicant for the purpose of obtaining amended instructions in order that the credit may be issued in proper form.<sup>8</sup>

In other words, a letter of credit is designed to finance a transaction, not to police it. Should there be a dispute on the terms of the contract, it should be settled between buyer and seller. Should the General Trading Co. wish to assure itself that the merchandise shipped will be as

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<sup>8</sup>Paul V. Horn, M.S., Ph.D., International Trade Principles and Practices, 3rd ed. (New York: Prentice-Hall Inc., 1951).

ordered, it could arrange for an inspection company to check the cloth prior to shipment and issue a certificate of inspection attesting to the quality, quantity, color, etc... The letter of credit could then require the presentation of the certificate of inspection.

The remaining portion of the application is the agreement between General Trading Co. and Universal Bank. These pages of small print have "only one objective - (to assure) reimbursement for the opening bank under any and all possible circumstances". In consideration of the establishment of the credit, General Trading Co. agrees in part in the application:

- To reimburse Universal Bank for all drafts honored under the credit and to pay all charges and commissions.
- That Universal Bank has a lien on the documents and the merchandise they represent and the pledge of all property, including deposit balances, which Universal Bank may have in its possession.
- That documents which, on their face, appear to comply with the credit may be honored at the absolute discretion of Universal Bank or its correspondents, even if the documents should prove to be insufficient, defective or forged.
- To sign trust receipts and statements of trust receipt financing as may be required and to make available proceeds of sales of merchandise obtained against trust receipts as Universal Bank may request.

- That the goods shall be insured at all times with insurance coverage satisfactory to the Bank.
- That the credit shall be constructed in the light of laws, regulations and recognized commercial practices, domestic and foreign, as may be applicable to the credit.

Issued Under Line of Credit or Secured

When General Trading Co. presents the application, Universal Bank must decide promptly whether it does or does not wish to issue the letter of credit and, if the credit is to be issued, whether it should be secured by some form of collateral. Usually, letters of credit are issued under a line of credit and in this case Universal Bank has a line for General Trading Co. for the issuance of credits up to a total of \$100,000.

It is assumed for the moment that either the line of credit is being fully utilized or the Bank feels its customer's ~~credit standing does not warrant a line of credit.~~ In any case, the Bank feels it should receive collateral before issuing the credit.<sup>9</sup> In such event the Bank may desire 100% collateral, 50% collateral, or some other percentage depending on the type of merchandise and on the customer's credit standing. The Bank could ask for cash collateral which would be segregated to cover this credit specifically,

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<sup>9</sup>John Mathis, Offshore Lending by U.S. Commercial Banks (Bankers' Association for Foreign Trade, Robert Morris Associates, Nov.1978).

or it could ask that satisfactory securities be deposited as collateral. As payments are made under the credit, the cash collateral or securities normally would be reduced or released proportionately.

The line of credit for the Bank's customer, in addition to specifying the dollar limit, would probably restrict the merchandise to be financed to cloth as that is the merchandise with which the customer usually deals. Furthermore, the line of credit would probably require that shipping documents convey title to the bank. This could be done by requiring bills of lading to be issued to the order of the shipper and endorsed in blank or to the order of the bank. If endorsed in blank, the bank would be able to obtain the merchandise, if necessary, by presenting the bills of lading to the carrier. If the bank did not require that the shipping documents convey title to it, it could permit the bills of lading to be issued "to the order ..." (buyer) or "straight to ..." (buyer). In the latter case, the carrier would not require that the bills of lading be surrendered before releasing the merchandise as "the consignee named in the bill of lading is prima facie the owner of the property".

#### Documentary - Secured and Unsecured

All letters of credit concerned in some measure with a merchandise transaction are called commercial credits. To define this further, letters of credit calling for original shipping documents are called documentary credits. If the

bills of lading permit the opening bank to obtain title to the merchandise, the credits are considered "secured documentary". If the bills of lading do not permit the opening bank to obtain title, the credits are considered "unsecured documentary". Should a bank have to sell the merchandise to obtain reimbursement for its payment under the credit, a "secured documentary" credit would permit it to obtain the merchandise by surrendering the bills of lading to the steamship company. Under an "unsecured" credit the bills of lading may be made out straight to the customer, to the order of the customer or perhaps a forwarder. In any event, the bank could not obtain the merchandise through the bills of lading as presented.<sup>10</sup> Obviously an "unsecured" credit increases the opening bank's credit risk.

Occasionally a credit will permit payment against invoices and non-negotiable copies of bills of lading, or invoices only, or will merely require a statement of the negotiating or paying bank that the original bills of lading and the other required documents have been sent by it directly to the importer or perhaps to the importer's forwarder. Whenever the opening bank does not receive documents of title from the paying or negotiating bank, the letter of credit should be looked on as "unsecured".

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<sup>10</sup>Ernest W. Hotchkiss, The Law of Bills of Lading (New York: The Ronald Press Company, 1978).

U.S. Dollar Credit

The letter of credit with which we are concerned will be issued under a line of credit and will be a "secured documentary" credit, since the bills of lading will be issued to the order of Universal Bank. Based on the application, credit No. 0001 has been issued. Wholesale Linen Co. is the beneficiary and is authorized to draw on Universal Bank at sight for \$10,000. The buyer, or account party, is the bank's customer, General Trading Co. The drafts of Wholesale Linen Co. must be accompanied by complete sets of the specified documents. The words "complete sets" are important from a collateral point of view, as they refer to all the signed original documents. For example, ocean bills of lading are issued in a set of three signed originals with a notation reading along the lines of: "In witness whereof 3 bills of lading have been signed, one of which being accomplished, the others to stand void".

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The merchandise can be obtained by surrendering any one of the three original bills of lading to the steamship company. This automatically voids the remaining originals; consequently, the bank must always insist on the full or complete set when it has a financial interest in the shipment.

Bills of lading are still frequently issued in sets of three as a result of a practice started years ago. At one time one original bill of lading was sent with the steamer



carrying the merchandise and the remaining two originals each in separate mails on separate following steamers. Today, at least one original is almost invariably sent by airmail.<sup>11</sup>

When issuing a credit, the bank is always interested in knowing who is arranging the insurance coverage because, should the bank have to take over the shipment to reimburse itself for the payment, it wants to be able to recover under the insurance for any insured loss. Marine insurance certificates are still usually issued in a set of two originals bearing the clause: "This Certificate is issued in Original and Duplicate, one of which being accomplished, the other to stand null and void".

The statement "Negotiation charges are for your account" puts Wholesale Linen Co. on notice that the charges of the negotiating bank for its services must be paid by Wholesale Linen Co.. General Trading Co. will pay only the charges of Universal Bank.

The credit under discussion is a negotiable or circular credit. Drawings under it may be negotiated by any bank and, consequently, negotiations must be recorded on the reverse side of the credit application. When Wholesale Linen Co. negotiates drafts under this credit it will be selling the dollars to the negotiating bank for pounds sterling. The negotiating bank will negotiate because it believes all the

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<sup>11</sup>Ibid.

documents conform to the credit and that it will be reimbursed by the drawer bank.

Let us assume that Wholesale Linen Co. takes the credit, draft and documents to London Bank Ltd. for negotiation. London Bank Ltd. will be willing to negotiate because of Universal Bank's credit standing and the clause in the credit reading: "We hereby engage with the drawers, endorsers and bona fide holders of the drafts drawn under and in compliance with the terms of this credit that these drafts will be duly honored by the above drawer". This clause is the bank's commitment and its indication of having added its credit standing to that of the account party, General Trading Co.

London Bank Ltd. agrees to negotiate the draft for \$10,000 at the rate of exchange at which it is buying U.S. dollars in exchange for English pounds. In quoting the rate, London Bank Ltd. must give consideration to covering its operating expenses on the transaction and interest for the use of its funds for the period between the time of its payment to Wholesale Linen Co. and the estimated time of credit to its account at Universal Bank. London Bank Ltd. will endorse the credit and return it to the beneficiary with a check for, say, £3,571 ( $\$10,000 \div 2.80$ ). The draft and documents are then sent by airmail to Universal Bank for payment. Universal Bank will compare the documents to the terms of the credit and, if found in order, will credit

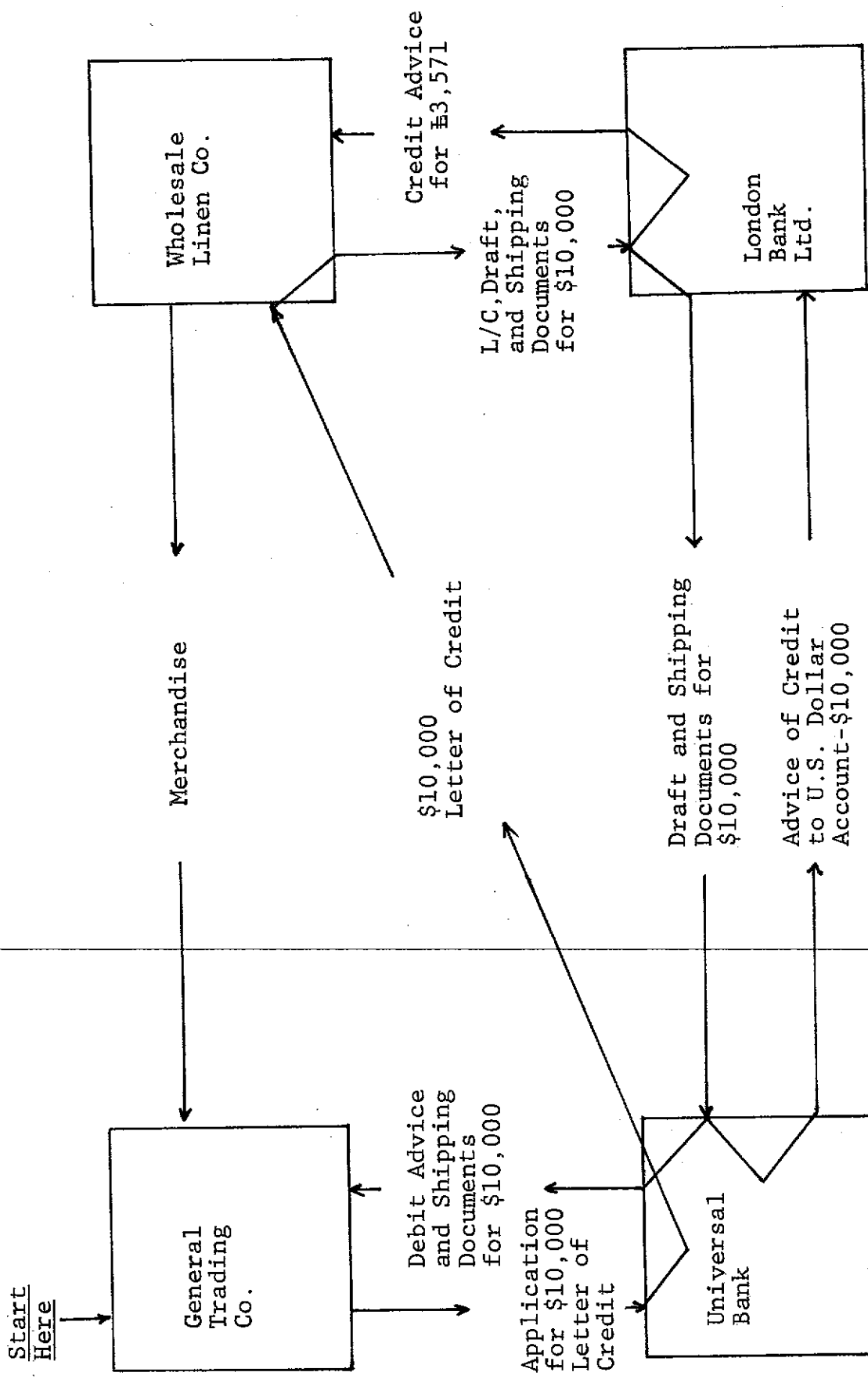
London Bank Ltd. under airmail advice. The account of General Trading Co. is debited and the shipping documents are sent to them with the debit advice. The General Trading Co. is then in a position to obtain the cloth when it arrives as Universal Bank will have endorsed the bills of lading to the order of the General Trading Co.

When the bank issued this credit, it recorded a contingent liability for \$10,000 under the name of General Trading Co. It is a contingent liability because there is the possibility the bank may not be requested to effect payment. This contingent liability is always taken into consideration when the bank reviews outstanding liabilities of its customers. Upon payment being effected, the credit expiring unused, or being reduced or cancelled by the agreement of all parties, the contingent liability is reduced accordingly, thus making the amount again available under the line of credit.

The transaction we have just reviewed is shown in the form of a flow chart on the next page.

In its commitment, Universal Bank agrees to honor drafts and documents drawn under and in compliance with the terms of the credit. What would be the bank's position if the documents conformed with the terms of the credit but the merchandise was not as represented by the documents? Philip W. Thayer's comments seem appropriate to such a situation when he says:

Figure 4: ILLUSTRATION OF A U.S. DOLLAR SIGHT LETTER OF CREDIT COVERING AN IMPORTATION



The actual documents may conform exactly to the requirements of the letter of credit, yet the goods themselves may not correspond to the documents and for that reason may not be represented properly by them. In the case, *O'Meara v. The National Park Bank*, 239 N.Y. (1924), it was held that the interest of the issuing bank is purely in documents and not at all in goods, so that if the documents are superficially correct, the bank is obliged to accept them without reference to the actual goods themselves.<sup>12</sup>

With respect to the credit in favor of Wholesale Linen Co., when Universal Bank found the documents in order and effected payment to London Bank Ltd., Universal Bank automatically retired the draft. In the event Universal Bank had, through oversight, honored documents which did not conform to the credit (for example shipment from Liverpool instead of London) and General Trading Co. refused them, Universal Bank would not have recourse to the Wholesale Linen Co. or London Bank Ltd. under the letter of credit. In practice, however, Universal Bank would undoubtedly call on its customer, the negotiating bank, and the beneficiary in an effort to settle the matter.

In the event Universal Bank noticed the bills of lading evidenced shipment from Liverpool instead of London, it would have telephoned General Trading Co. to ask whether the discrepancy may be waived. If General Trading Co. agreed to waive the discrepancy, such action would be equivalent to amending the credit to conform to the documents as presented.

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<sup>12</sup>Philip W. Thayer, The Comparative Law of International Commerce (Canada, 1938), p. 63.

If General Trading Co. did not wish to waive the discrepancy, Universal Bank would so inform London Bank Ltd. and hold the documents at the latter's disposal. London Bank Ltd. may instruct Universal Bank to present the documents to another buyer on a collection basis.<sup>13</sup> Most frequently, though, the original buyer and seller reach an agreement, and thus Universal Bank may be instructed by London Bank Ltd. to reduce the draft and invoice value by, say, 5% provided General Trading Co. will instruct Universal Bank to honor the drawing at the reduced figure. In such a case, since London Bank Ltd. would have retained recourse to the beneficiary when it negotiated the draft, it would demand a refund of the equivalent of \$500 from the beneficiary. Had Universal Bank's letter of credit been for pounds sterling with drafts to be drawn on London Bank Ltd., London Bank Ltd. would not have had recourse to the beneficiary had it honored a drawing for documents not in conformity with the credit. An example of a foreign currency credit with drafts on London Bank Ltd. follows.

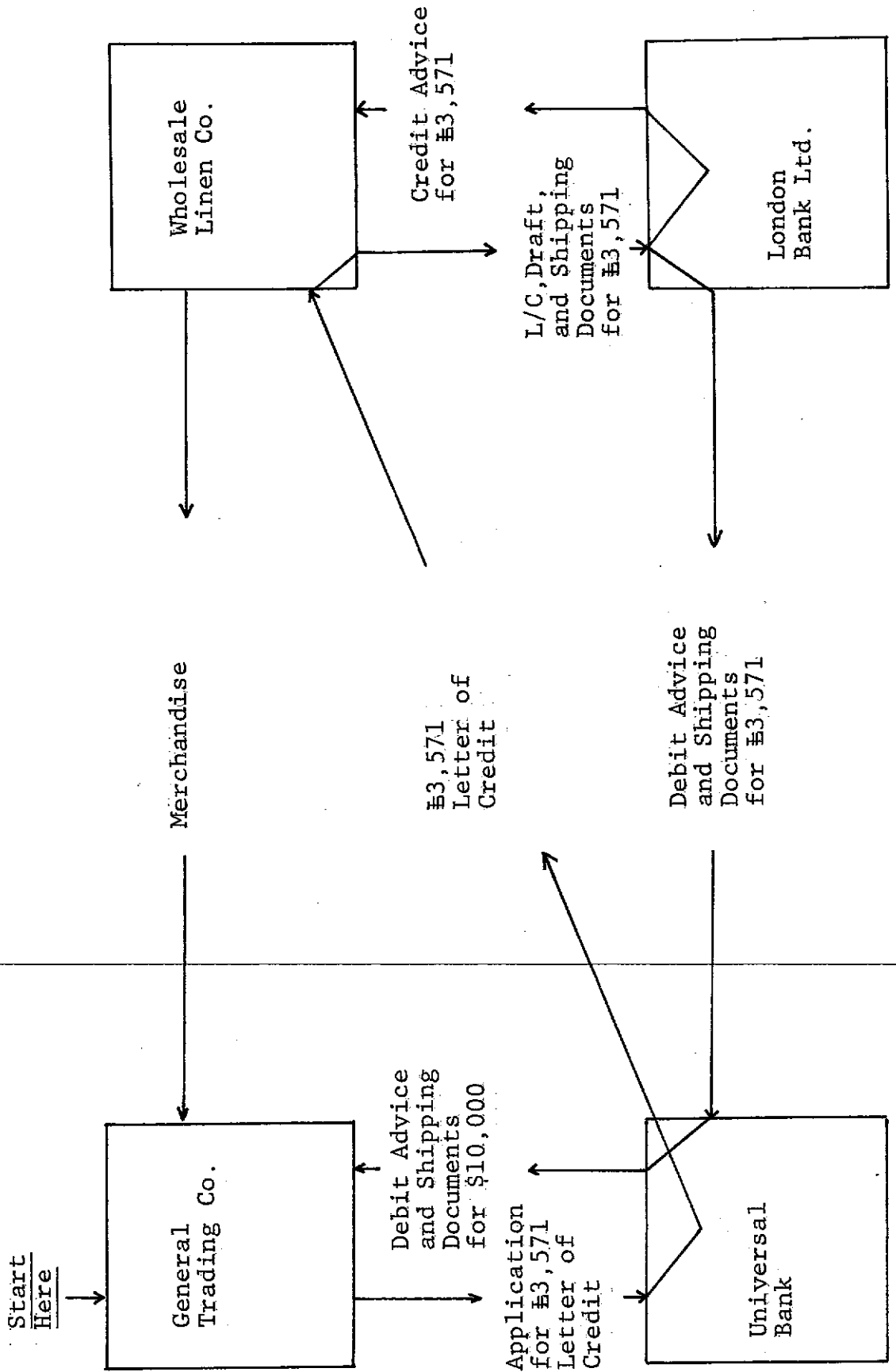
#### Foreign Currency Credit

Assume the terms of sale had been in pounds sterling instead of dollars. The exchange transaction would have taken place in New York and a letter of credit would have been issued. This credit is similar to the dollar credit with

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<sup>13</sup>Paul V. Horn, M.S., Ph.D., International Trade Principles and Practices, 3rd ed. (New York: Prentice-Hall, 1951).

Figure 5: ILLUSTRATION OF A POUND STERLING SIGHT LETTER OF CREDIT COVERING AN IMPORTATION



certain important exceptions. The credit is for £3,571 instead of \$10,000, the drafts are on, and must be presented to, London Bank Ltd. instead of Universal Bank and, consequently, as is customary, all charges including those of London Bank Ltd. are for the account of General Trading Co. A credit such as this is sometimes called a "straight" credit which is a term applied to credits payable with a named bank in the country of the seller and not of the buyer.

The two import credits discussed bear Universal Bank's commitment only. It is possible for another bank to add its commitment to Universal Bank's by confirming the credit. In such a case the beneficiary acquires rights against the confirming bank similar to its rights against the issuing bank under an irrevocable credit. However, in view of the credit standing of Universal Bank, or any other major United States bank, and the economic situation in the United States, this is seldom requested.

#### Issuing Credits on Behalf of Domestic Banks

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In discussing import credits, General Trading has been referred to as Universal Bank's customer. Let us now assume General Trading Co. is located in Anytown, New Jersey, and is not known to Universal Bank but is well known to Universal Bank's correspondent, the First National Bank of Anytown. For General Trading Co. to arrange for the issuance of a letter of credit they would complete an application, addressed to the First National Bank of Anytown. This bank does not issue



letters of credit; however, while the application is addressed to them, it requests them to establish an irrevocable credit through Universal Bank. The First National Bank of Anytown may obtain collateral from General Trading Co. or make use of a line of credit, if any, extended to this customer.

As "national banks are not authorized to act as guarantors or to give guarantees on behalf of their clients", and many other banks are similarly restricted by their characters,<sup>14</sup> there is attached to the application, signed by the General Trading Co., a form to be signed by the First National Bank of Anytown appointing Universal Bank as its agent to establish the credit.

Universal Bank would record the contingent liability for such a credit under the name of the First National Bank of Anytown since Universal Bank would look to them first for reimbursement of any funds disbursed in connection with the credit. The agreement signed by the buyer does, however, give Universal Bank the right to demand reimbursement from the buyer. This right would be exercised only in the remote event Universal Bank could not obtain reimbursement from the First National Bank of Anytown.

#### Third Party Credits

The credit, as issued by Universal Bank, would not mention the name of the First National Bank of Anytown. Consequently,

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<sup>14</sup>Irving Trust Company, Practical Aspects of Commercial Letters of Credit (New York, 1975).

from the wording of the credit itself it would appear that the General Trading Co. is Universal Bank's customer. Such a credit is considered a third party credit since it shows an account party other than the account party to whom the opening bank would look primarily for instructions and reimbursement.

Assume that the relationship between the First National Bank of Anytown and the General Trading Co. deteriorated without Universal Bank's knowledge. Also, that deposit balances maintained by General Trading Co. with the First National Bank of Anytown dropped below the unused amount of the credit and collateral was not held by the First National Bank of Anytown. Further, assume that documents were presented covering one complete shipment although the credit required two equal shipments. Before refusing the documents, Universal Bank would ask its correspondent bank whether it wished to waive the discrepancy. The correspondent would ask General Trading Co. for instructions and would presumably insist that funds must be made available before Universal Bank would be authorized to honor the documents. If funds were not forthcoming the correspondent would, undoubtedly, instruct Universal Bank to refuse the documents. Assume Universal Bank were so instructed but, at the same time, received a letter from the General Trading Co. (indicating a copy had been sent to the beneficiary) instructing Universal Bank to honor the documents despite the discrepancy. This places Universal Bank in an embarrassing position since, from the point of view of

the beneficiary, General Trading Co. is Universal Bank's customer. While the situation is embarrassing, Universal Bank can refuse to follow the instructions of General Trading Co. because the agreement General Trading Co. signed as part of the application contains a third party clause which gives First National Bank of Anytown exclusive right to issue to Universal Bank all instructions on any and all matters relating to the credit. Universal Bank could, of course, so inform the beneficiary.<sup>15</sup>

Now and then customers other than banks request that credits be issued showing an account party other than themselves. Applications for such credits are made on the standard application form and are signed by the bank's customer but, in addition to the application, a third party agreement is required. This is on a separate form addressed to the bank and is signed by the third party joining in the request for the credit and authorizing its name to appear as the account party. Furthermore, the third party states that in consideration of the bank's issuing the credit the bank may accept from its customer all instructions on any and all matters relating to the credit.

#### D. EXPORT LETTERS OF CREDIT

Imports of merchandise were discussed. Now export of merchandise will be analyzed whereby we will consider, say,

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<sup>15</sup>H.C. Gutteridge and Maurice Megrah, The Law of Bankers' Commercial Credits (London:Europa Publications Ltd., 1955).

exportation of machinery from the United States to England.

Assume General Trading Co. and Wholesale Linen Co. have agreed on the sale and purchase of two knitting machines to be shipped from New York to London. Terms of payment are a U.S. dollar irrevocable credit payable at a New York bank.

#### Correspondent's Irrevocable Credit

Wholesale Linen Co. applies to London Bank Ltd. for an import letter of credit just as General Trading Co. applied to Universal Bank for the credit covering the importation of cloth. As there is some urgency to the transaction, London Bank Ltd. cables the details of the credit to Universal Bank. Universal Bank sends an advice to General Trading Co. (Exhibit 2). Note that it is an advice of the issuance of the irrevocable credit of London Bank Ltd.

Under import and export credits in foreign currency, the exchange risk is for account of buyer, and commitments ~~to honor the drawings have been made by the opening banks but~~ not by the drawee banks.<sup>16</sup>

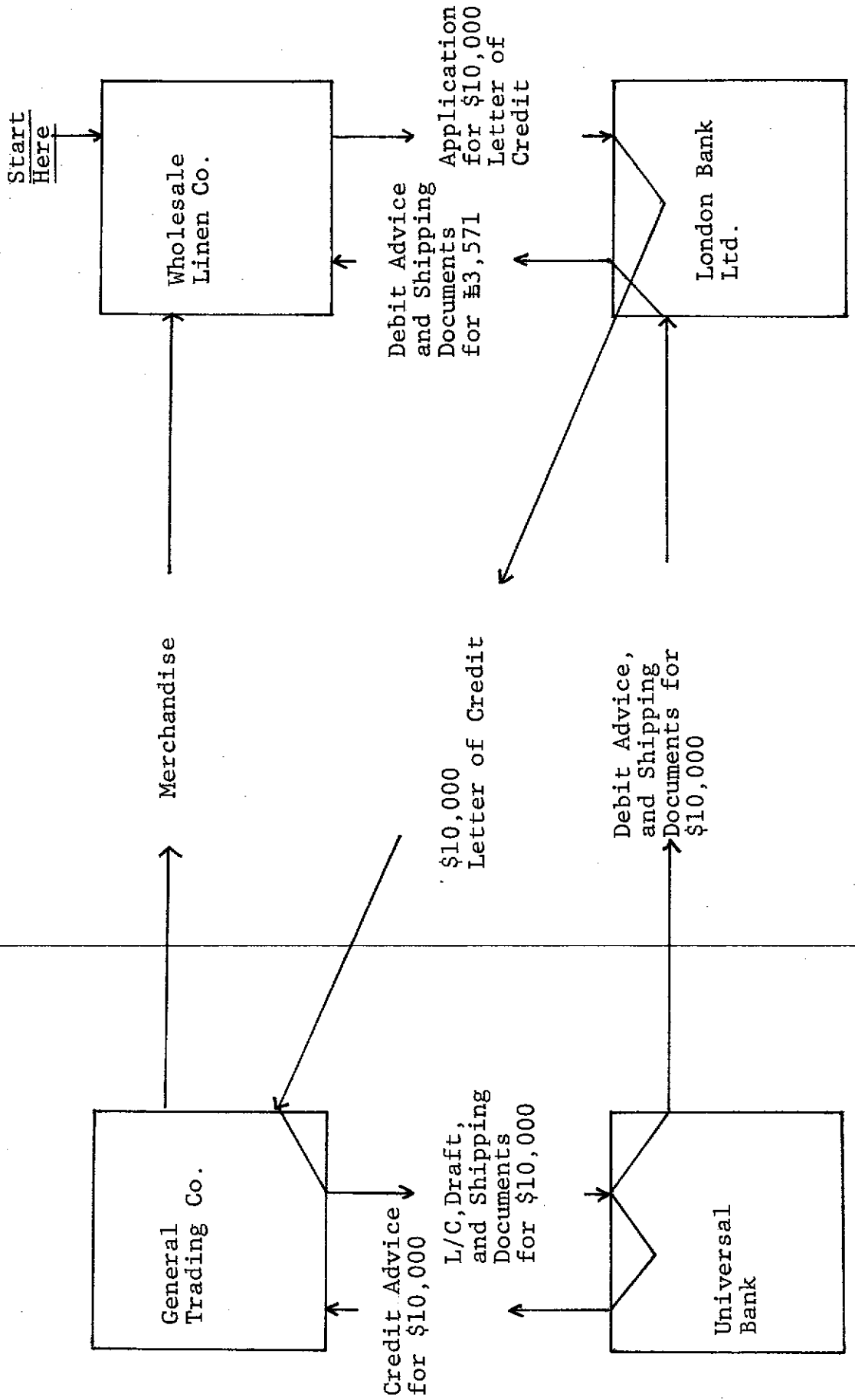
The flow chart on the next page is just the reverse of the "Chart of Import Credit". While it is the reverse, the steps are exactly the same because to Wholesale Linen Co. the credit is a foreign currency import credit.

The import and export credits that have been discussed

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<sup>15</sup>Exporters' Encyclopedia (New York: Thomas Aswell & Co. Inc., 1958).

Figure 6: ILLUSTRATION OF A U.S. DOLLAR SIGHT LETTER OF CREDIT COVERING AN EXPORTATION



so far are irrevocable on the part of the opening bank, and from the point of view of the paying or negotiating banks the credits are considered "correspondents' irrevocable credits" or "irrevocable unconfirmed credits". The import credit discussed previously is irrevocable on the part of Universal Bank, and the export credit is irrevocable on the part of London Bank Ltd. Both credits provide for payment by the drawee banks; however, neither drawee bank is obliged to effect payment.

For example, when Wholesale Linen Co. presented drafts and documents to London Bank Ltd. under the irrevocable credit of Universal Bank, London Bank Ltd. had no obligation to pay even though the documents conformed to the credit. With respect to the irrevocable credit of London Bank Ltd., Universal Bank has no obligation to effect payment and this is made clear in the last paragraph with the statement, "This advice conveys no engagement or obligation on our part". ~~Nevertheless, under normal conditions, drafts are practically~~ always honored if the terms of the credit have been met and the opening bank has funds on hand with the paying bank.

Assuming funds are not on hand, one of two things is done: the account of the opening bank is overdrawn which is tantamount to lending the funds to the opening bank, or payment is refused and a cable is sent to the opening bank so informing them, thus giving them the opportunity to remit funds promptly to enable payment to be effected. As all international banks want their letters of credit accepted

without question, they are careful to keep sufficient funds on deposit with paying banks, or to make advance arrangements with the paying banks for the financing of the drawings under their letters of credit.<sup>16</sup> (Various methods of financing drawings under credits will be discussed under a separate item).

Assume General Trading Co. presents documents to Universal Bank, under an export credit, and Universal Bank refuses payment on the grounds that the documents do not comply with the credit. General Trading Co. believes they do conform and threatens to sue if payment is not made. It would not have a case since Universal Bank has not committed itself to effect payment. General Trading Co. could send its documents directly to London Bank Ltd. and could bring suit if payment were refused. Unfortunately for General Trading Co., the legal action would have to be conducted about 3,000 miles away.

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#### Confirmed Irrevocable Credit

General Trading Co., let us assume, is enjoying a seller's market and can insist on receiving a credit which bears the commitment of a New York bank in addition to that of the opening bank. The beneficiary's wishes would be met by Wholesale Linen Co. instructing London Bank Ltd. to request Universal Bank to add its confirmation to the irrevocable

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<sup>16</sup>William S. Shaterian, Export-Import Banking (New York: The Ronald Press Company, 1947).

credit. A confirmed irrevocable credit would then be issued by Universal Bank. The only significant, but very important, difference between this credit (confirmed irrevocable) and the correspondent's irrevocable credit is the paragraph reading:

At the request of our correspondent we confirm their irrevocable credit and engage with you that all drafts drawn under and in compliance with the terms of this credit will be duly honored.

In other words, General Trading Co. has the commitment of both banks that payment will be made if the terms of the credit are met.

Such a credit may be confirmed under a line of credit held at the disposal of the opening bank or against some form of security. In any event, a contingent liability is recorded in the name of London Bank Ltd., and for adding its commitment Universal Bank receives a commission from London Bank Ltd.

General Trading Co. is now assured of payment by Universal Bank whether London Bank Ltd. does or does not have funds on hand at the time of payment. Also, if General Trading Co. presents documents which they feel comply with the credit and Universal Bank refuses them, the beneficiary can sue through local courts. While mention is made from time to time of legal action, it is merely to highlight a beneficiary's or bank's position. Although a few disputes concerning letters of credit actually are tried in courts, most are settled amicably by the parties concerned.



### Revocable Advice

If the relationship between General Trading Co. and Wholesale Linen Co. were excellent and the exchange and political conditions were excellent also, a revocable advice may be a satisfactory substitute for an irrevocable credit.

Although a revocable advice is referred to as a letter of credit, the most important element of a credit is missing, namely, the credit standing of the opening or paying bank is not added to that of the account party. Instead, the banks concerned expressly disclaim any obligation.<sup>17</sup> A paragraph of the revocable credit reads:

This advice, revocable at any time without notice, is for guidance only in preparing drafts and documents and conveys no engagement or obligation on our part or on the part of our abovementioned correspondent.

Dr. Paul V. Horn, in writing about a revocable advice, says:

In fact, it is hardly worthy of being termed a letter of credit, as there is no guarantee that drafts will be honored when presented, since revocation may have occurred without notice to the beneficiary. The exporter, therefore, has no assurance that, after he prepares the merchandise for shipment, the credit will be honored by the bank. Consequently, this form of document is not favored by exporters and is rarely used.<sup>18</sup>

It is true the revocable advice is seldom used today, but it does have some advantages. Once a beneficiary has received payment under a revocable advice, there can be no

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<sup>17</sup>Paul V. Horn, M.S., Ph.D., International Trade Principles and Practices, 3rd ed. (New York:Prentice-Hall Inc., 1951).

<sup>18</sup>Ibid.

recourse to him by banks concerned. Also, if a shipper has the choice of sending documents for collection or of receiving payment under a revocable advice, it is to the shipper's advantage to select the latter method. If a shipper sends documents for collection and obtains an advance or loan on the documents for his local bank, he is arranging the financing. When a revocable advice is issued, the financing is arranged by the buyer.

It would appear that a bank opening a revocable advice assumes no responsibility whatsoever. This is correct if the opening bank is also the paying bank. Should the paying bank be other than the opening bank and a payment is made before cancellation instructions are received by the paying bank, the opening bank must reimburse the paying bank. For example, suppose Universal Bank made a payment yesterday under a revocable advice to London Bank Ltd. to the debit of the latter's account and today Universal Bank receives a cable stating the advice has been cancelled. These instructions would cancel any unused portion but would not affect the payment made prior to receipt of cancellation instructions. This is borne out by Article 2 of the Uniform Customs and Practice which says, in part, about a revocable advice:

When, however, a revocable credit has been transmitted to and made available at a branch or other bank, its modification or cancellation shall become effective only upon receipt of notice thereof by such branch or other bank and shall not affect the right of that branch or other bank to be reimbursed for any payment,

acceptance or negotiation made by it prior to receipt of such notice.<sup>19</sup>

Since the opening bank is responsible to the paying bank for payments made prior to receipt of notice of cancellation, the opening bank should record a contingent liability. If the opening bank is also the paying bank, contingent liability is not recorded.

Uniform Customs and Practice for Documentary Credits

Letters of credit are used to finance shipments to and from almost every country of the world and cover merchandise of countless trades. With so many different trade customs involved, it is understandable that certain terms may be interpreted differently depending on the custom of the trade concerned.<sup>20</sup> For example, credits frequently are for an approximate dollar value and quantity. Credits which allow such a leeway are preferable, but how much leeway is allowed on a letter of credit for "about U.S. dollars 10,000" covering "about 10,000 yards of cloth"?

If the beneficiary ships 8,500 yards and draws U.S.\$9,500, should the documents be honored? What if he draws U.S. \$12,000 and ships 12,000 yards? Obviously the question to be settled is how much leeway do the words "approximately" or "about" allow? In one trade it may be 3%, in another 15%. It would be most difficult for banks to be guided by the practices of the many trades. Article 32 of the "Uniform

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<sup>19</sup>Ibid.

<sup>20</sup>Ibid.

Customs and Practice for Documentary Credits" establishes the leeway to be allowed. It reads in part:

The words "about", "circa", or similar expressions are to be construed as allowing a difference not to exceed 10% more or 10% less, applicable, according to their place in the instructions, to the amount of the credit or to the quantity or unit price of the goods.

Consequently, all doubt is removed as to the percentage to be allowed when terms such as "about" are used. Through these regulations, uniformity of interpretation is obtained for many terms.

The present "Uniform Customs and Practice" originated through a committee of the International Chamber of Commerce. The regulations were adopted by the Seventh Congress of the International Chamber of Commerce in Vienna in 1933. Banks in the United States subscribed to them on October 1, 1938. Subsequently, the regulations have been revised twice; the most recent revision having been instituted by the Nineteenth Congress of the International Chamber of Commerce in 1962 and subscribed to by United States banks on July 1, 1963. Banks in most of the principal countries of the world have adopted these regulations. (See Exhibit 5).

Revised American Foreign Trade Definitions - 1941

Everyone dealing in the financing of foreign trade should know the responsibilities of buyer and seller when the sale is on terms such as F.O.B. vessel New York, C&F, or C.I.F. While there are other definitions, the "Revised American Foreign Trade Definitions-1941" are probably the most frequently

used in this market. To be certain that the definitions govern a particular shipment, it is customary for the buyer and seller to mention these definitions by name in the contract of sale.

While the definitions are not a part of the credit, banks in New York usually interpret the terms of sale mentioned in a credit in accordance with the "Revised American Foreign Trade Definitions-1941". (See Exhibit 6).

#### E. THE DOCUMENTARY COLLECTION

The seller will often be prepared to deliver goods without requiring payment to be guaranteed in advance by means of a documentary credit. However, he may wish to cover himself up to a certain point for some of his shipments. For instance, he may want to make sure that the buyer can only obtain possession of the documents of title after he has paid the purchase price or - depending on the case - has accepted a bill of exchange or provided for cover in some other agreed form.

The service offered by the bank in such cases is the documentary collection. The seller remits the shipping documents to his bank (remitting bank) with instructions to have them presented through a collecting bank in the buyer's country. The collecting bank delivers the documents to the buyer only after he has satisfied the requirements prescribed by the seller.

If a transaction is settled by means of a documentary collection, the supplier can dispose of the sales proceeds only after the buyer has paid for the documents or honoured the accepted bill of exchange and even then only after the proceeds have been transferred. As compared with the documentary credit, the seller will generally have to wait longer before he actually has the proceeds at his disposal.

This bank service is appropriate mainly for securing payment of deliveries, not made on open account, to less well known but trustworthy buyers in countries with stable economic conditions. Nevertheless, the seller should duly take into account the economic and political conditions in the particular buyer's country.<sup>21</sup>

How is a documentary collection carried out?

After the goods have been shipped, the seller (remitter) assembles the documents agreed upon with the buyer and remits them to his bank (remitting bank) with a collection order. The collection order must contain instructions specifying the conditions under which the documents may be released to the buyer (drawee).

The remitting bank transmits the documents to a correspondent bank (collecting bank) in the country and if possible in the town of the buyer, indicating under which conditions the documents may be released to the drawee.

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<sup>21</sup>Swiss Bank Corporation, Documentary Operations (Switzerland November, 1976).

On the basis of the collection order received, the collecting bank will then notify the drawee that documents have arrived. It informs him about the conditions under which he can dispose of them.

If the documents were to be released against payment, the collecting bank transfers the amount to the remitting bank which, in turn, credits the sum to its customer (remitter). If the documents were to be released against acceptance, the collecting bank will, depending on the instructions received, either return the accepted draft to the remitting bank for forwarding to the remitter, or hold the bill of exchange in trust until maturity and then pay the proceeds to the remitting bank after collection. The latter then, in turn, credits the amount to the remitter.

#### The Various Kinds of Collections

The instructions of the seller (remitter) to the remitting bank can differ, depending on the terms of the sales contract, in regard to the conditions under which the documents may be released by the collecting bank abroad to the buyer. Basically there are three types of collections:

1. Release of the documents against payment (D/P).

The collecting bank may release the documents to the buyer only against cash payment.

2. Release of the documents against acceptance (D/A).

In this case, the supplier remits the shipping documents to the remitting bank together with a bill

of exchange and instructions to release the documents to the buyer through the collecting bank only after the buyer has accepted the bill of exchange with the agreed maturity. This means that the buyer can dispose of the documents only after having signed an internationally recognised "acknowledgement of indebtedness" that will make it easier for the seller to take legal action in the courts in case of non payment.

A seller intending to have the shipping documents released against acceptance must realise that the bill of exchange represents his only security after the documents have been released.

3. Collection with acceptance - release of documents only against payment (Acceptance D/P).

In this case, the seller remits the documents to the remitting bank together with a bill of exchange. The accepted bill remains at the collecting bank together with the documents. However, the documents may be released to the buyer only upon payment of draft.<sup>22</sup>

#### Liability and Responsibility of the Bank

A bank that accepts a documentary collection order is responsible to the customer for the orderly execution of his instructions. On the other hand, it does not examine the documents submitted to it for collection, nor does it assume

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<sup>22</sup>Ibid.



any responsibility for their form and regularity (Uniform Rules for the Collection of Commercial Paper, Art. 1).

If a bank is commissioned to see to an acceptance, it is only responsible for verifying that the form of the acceptance appears to be complete and correct. It is, however, not responsible for the genuineness of the signatures or for the authority of any signatory to sign the acceptance (URCCP, Art.8).

The bank cannot be made liable for the consequences of acts of God or for delays in the transmission of messages or documents, unless the bank itself is at fault. Neither does it assume any liability for the acts of other banks involved in the documentary collection (URCCP, Art.16-18).

#### F. AMENDMENTS - DISCREPANCIES IN DOCUMENTS

##### Amendments

If the terms of a credit are not satisfactory to a beneficiary an amendment should be requested. For example, if General Trading Co. requires additional time to manufacture the machinery it should request Wholesale Linen Co. to arrange to have the credit amended through London Bank Ltd. and Universal Bank.

##### Non-Negotiable Credits

Requests for amendments do not always originate with the beneficiary. If Wholesale Linen Co. discovers it has no use for two knitting machines until July, it may request

London Bank Ltd. to instruct Universal Bank to amend the credit to require that bills of lading be dated after June 30, 19\_\_ . In advising General Trading Co. of this amendment, Universal Bank would request written consent to it since it is restrictive. A beneficiary has the option of accepting or refusing amendments to an irrevocable credit; however, a revocable advice may be amended or cancelled without the consent of the beneficiary.

#### Negotiable Credits

Restrictive amendments to negotiable credits are treated somewhat differently. Since negotiable credits require that the letter of credit be presented with the documents, all amendments must be presented as well. If a letter of credit is increased by amendment, the beneficiary will surely present such an amendment, but can we be certain a beneficiary will present to a negotiating bank an amendment decreasing the amount of credit, even though the opening bank holds the beneficiary's agreement to the amendment? To eliminate any doubt, such an amendment could be sent through a correspondent bank with the request that the beneficiary's agreement be obtained and the amendment then could be endorsed on the reverse of the letter of credit.

Since a beneficiary of an irrevocable credit has the option of accepting or rejecting amendments, it is most important to all the parties concerned that a letter of credit be complete and correct when it is issued.<sup>23</sup>

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<sup>23</sup>Irving Trust Company, Practical Aspects of Commercial Letters of Credit (New York, 1975).

### Discrepancies in Documents

The bank's duty to examine documents is determined by the rule that bank and beneficiary must comply strictly with the terms of the letter of credit. In the absence of strict conformity to these terms, the beneficiary cannot enforce payment and the bank pays at its peril.

In an endeavour to assist beneficiaries in obtaining payment promptly, banks are constantly reminding them that:

As documents must conform strictly to the requirements of the letter of credit, it is important that you review the conditions of each credit immediately upon receipt. If you are unable to comply with any of the terms, communicate with us or your customers at once to arrange for the necessary amendments before documents are presented.

Many sets of documents are presented to banks which do not conform to the terms of the credits.

One large New York bank has claimed that over 40 percent of the documents presented under letters of credit contain discrepancies; that is to say, in some way or other, the documents are at variance with the conditions of the credit.

Fortunately, it is possible to correct the majority of the discrepancies. For example, if a credit requires signed invoices and they are presented unsigned, the bank telephones the beneficiary requesting that he arrange to come in and sign them. Alternatively, the beneficiary has a messenger call them, has them signed, and then returns them. If the beneficiary is not nearby, a letter has to be written returning the invoices for correction. In any event, a discrepancy even as simple as this requires additional work

and therefore expense for the bank and delay in payment to the beneficiary. Frequently, while the correction is being made, the bills of lading become stale and the credit expires.

When the credit expires before payment is made, nothing can be done at this end; however, there are several ways a beneficiary may be able to arrange for payment.<sup>24</sup>

#### Obtaining Permission to Pay

If General Trading Co. had presented documents to Universal Bank after the expiration of credit, General Trading Co. could have cabled Wholesale Linen Co. requesting either an extension of the credit or approval of the particular drawing. If Wholesale Linen Co. wished to grant General Trading Co.'s request, Wholesale Linen Co. would ask London Bank Ltd. to cable the necessary authorization to Universal Bank.

Instead of cabling direct, General Trading Co. could have asked Universal Bank to cable London Bank Ltd. for an extension to the credit or authorization to pay the particular drawing. London Bank Ltd. would have then asked Wholesale Linen Co. whether it wished to authorize an extension or payment and, if so, would have cabled instructions to Universal Bank.

Instead of cabling, General Trading Co. may request Universal Bank to send the documents to London Bank Ltd.

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<sup>24</sup>Ibid.

with the request they authorize Universal Bank to effect payment. If authorization to pay is received, all is well; however, Wholesale Linen Co. has the option of saying "Yes" or "No". If the answer is "No", General Trading Co. will have to arrange to dispose of the merchandise which may be en route to England when notice of the refusal is received.

If the terms of sale require payment against a letter of credit, it is most important that the credit's terms be met. If they are not met and the beneficiary has to obtain the permission of the buyer before payment can be effected, the protection of the credit is lost.

#### Guarantees for Discrepancies

Although the credit may be expired, General Trading Co. may want Universal Bank to pay without obtaining the approval of the account party through London Bank Ltd. To induce Universal Bank to pay, General Trading Co. agrees to indemnify Universal Bank against any loss or damage whatsoever by reason of payment being made although the credit expired. Also, they agree to repay Universal Bank plus interest and expenses at any time on demand.

Had the payment been made under the credit, there would have been no recourse to General Trading Co. If Universal Bank accepts the guarantee of General Trading Co., the latter loses all the protection the credit offered them. Payment against a guarantee is equivalent to making a 100% advance

on a documentary collection. except that the paying bank uses the funds of a correspondent bank instead of its own.

If from a credit point of view the guarantee were acceptable, Universal Bank would debit the account of London Bank Ltd. and pay General Trading Co. The debit advice accompanying the documents to London Bank Ltd. would state, "We hold guarantee because the credit has expired". Upon receiving the documents, London Bank Ltd. would inquire of Wholesale Linen Co. whether it wished to accept the documents under the credit in spite of the discrepancy. If the documents were accepted, London Bank Ltd. would authorize Universal Bank to release the guarantee. If Wholesale Linen Co. does not want to waive the discrepancy, London Bank Ltd. would cable Universal Bank that the documents are held at its disposal and request their account be re-credited. Universal Bank then obtains a refund from General Trading Co. and its documents are then handled as though they had been sent on a collection basis.

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As mentioned in Article 8 of the "Uniform Customs and Practice", it is standard that, in documentary credit operations, all parties concerned deal in documents and not in goods. Consequently, Wholesale Linen Co. would not be permitted to wait until the machinery arrived and had been inspected before making a decision as to whether the discrepancy should be waived.

When a bank pays against a guarantee, it does so knowing

the opening bank may demand that its account be re-credited. Obviously, before accepting a guarantee, the credit standing of the beneficiary must be examined closely by the paying bank. If the beneficiary's guarantee is not acceptable, the paying bank could suggest that the documents be withdrawn and be re-presented through the beneficiary's bank with the latter's guarantee which may be acceptable.

## G. FINANCING LETTERS OF CREDIT

### I. Import Credits

In viewing import financing it is useful to identify and analyze the principle risks involved.

#### 1. Political Risks:

The tendency of foreign governments unilaterally to devalue (or revalue) their currencies creates a foreign exchange risk for the importer even if he is invoiced in the importer's local currency.

#### 2. Shipping Risks:

Once the goods are en route there are the normal hazards of the voyage. Usually these are recognizable and insurable risks to be covered by either the importer's blanket policy or alternatively by shipper-arranged insurance evidenced by certificates which accompany the required title documents.

Nevertheless, it's important to review the importer's insurance arrangements from time to time. This is necessary to make sure that they are adequate and

that any blanket policies contain the so-called "Banker's clause" (loss payable to the bank).

### 3. Dockside Risks:

Once landed at the docks, the merchandise is subject to the added risk of pilferage and, in some waterfront areas, the depredations of organized crimes.

Sometimes merchandise may arrive in advance of the documents or the latter may be received incomplete with one out of three original bills of lading missing. Under such circumstances banks usually issue the so-called "steamship guarantees" upon request of their customer, who is naturally interested in moving the merchandise off the docks to avoid finance charges, costly demurrage and other risks.<sup>25</sup>

### Advances for Payments Under Credits

Referring to the example we used in Section III, General Trading Co. opened an import credit with Universal Bank and it wants to buy cloth from Wholesale Linen Co. of England.

Assuming Universal Bank has agreed to finance the payment on an advance basis, when drafts and documents are received from London Bank Ltd. Universal Bank will debit

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<sup>25</sup>John Mathis, Offshore Lending by U.S. Commercial Banks (Bankers' Association for Foreign Trade and Robert Morris Associates, November, 1978).



an advance account in the name of General Trading Co. and credit the account of London Bank Ltd. The advance would be for a specified time or be repayable as the merchandise is sold, but in any event not later than a specified date.

When Universal Bank debits the advance account, the shipping documents would be released to General Trading Co. or, perhaps, Universal Bank may wish to retain the documents as collateral until the vessel arrives. In either event the documents would be released against trust receipts (trust receipts will be covered in some detail later in this chapter).

#### Acceptance Credits

When a bank makes an advance in connection with a payment under a letter of credit, it is of course using its loanable funds. In many cases this can be obviated by the issuance of an acceptance credit.<sup>26</sup>

Let us return to our same example. This credit could be changed to an acceptance credit in the same fashion by substituting "90 days sight" for "sight". Before changing this credit to an acceptance credit, the credit risk would have to be appraised carefully because Universal Bank would be committed for a longer period of time, and the shipping documents representing its collateral would have to be re-cased to General Trading Co. before the maturity of the acceptance.

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<sup>26</sup>Wilbert Ward and Henry Harfield, Bank Credits and Acceptances, 3rd ed. (New York: The Ronald Press Company, 1948).

The shipment is made under this import credit and Universal Bank receives the 90 day draft from London Bank Ltd., finds the documents in order, and accepts the draft. London Bank Ltd. may ask Universal Bank either to hold the acceptance for them until maturity or discount it and credit their account with the proceeds.

When Universal Bank accepts the draft, it reduces the contingent liability in the name of General Trading Co. and records an actual liability in their name for the outstanding acceptance. This would be offset by Universal Bank's liability to the holder of the acceptance to make payment at maturity. The basic liability entries are the same for all acceptances.

When Universal Bank sends the notice of acceptance to General Trading Co., shipping documents may be released to them at that time against trust receipt or, alternatively, the documents may be held until the carrying vessel arrives and then be released to General Trading Co. on trust receipt.

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#### Refinancing Sight Payments on an Acceptance Basis

There are some instances where the parties concerned prefer a sight letter of credit but nevertheless wish some form of refinancing after shipment is made but on other than an advance or loan basis. Such payments can frequently be refinanced on an acceptance basis. You may wonder how it is determined whether an advance should be made or an acceptance created. Much has to do with the rates to be charged. For example, if the rates charged for an acceptance credit plus

discount, or for a sight credit and refinancing on an acceptance basis plus discount, are less than the cost of a sight credit and advance interest for a specified period, it would be preferable to create an acceptance. From a banker's point of view, acceptance financing is usually more desirable, particularly in a tight money market since prime banker's acceptances may be rediscounted.

Using an import credit as an example, the procedure for refinancing on an acceptance basis would be the same as for the export credit (this will be discussed in Section G, Part I) except the draft would be drawn by the importer. There would be one additional step, however; the release by Universal Bank of the shipping documents to the importer against trust receipt, as in the case of the import acceptance credit.<sup>27</sup>

#### Trust Receipts

It has been mentioned that when an importation is financed on an advance or acceptance basis, the shipping documents are delivered to the customer against a trust receipt. One form of trust receipt is shown in Exhibit 3.

It will be recalled that when Universal Bank was considering opening the import credit, it required that the bills of lading be made out to its order. Now Universal Bank is going to endorse and deliver the bill of lading to General Trading Co. to permit them to obtain the cloth from

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<sup>27</sup>Ibid.

the steamship company, dispose of it, and remit the proceeds to Universal Bank. Thus, funds will be available to retire the acceptance at maturity. As Universal Bank is going to deliver to General Trading Co. the collateral for the acceptance, it must have complete faith in its customer.

A few comments of Mr. George B. McGowen will be helpful:

It stands to reason that if people, who would be unable to handle their business requirements without trust receipt facilities, are enabled to do so because of the trust receipt device, the banker whose assistance is given by way of these trust receipt facilities also benefits through the resulting increase in the use of his services. In order to be safe, however, the banker must be much more careful in judging the character of his customer than he would have to be if he were making a loan against security which would remain in his possession until the loan was paid.

The signing of the trust receipt won't prevent the dishonest misuse of the goods or the proceeds of their sale. Dishonest action of the trustee is a credit risk.<sup>28</sup>

## II. Export Credits

In financing export letters of credit, the lending officer should consider the following four basic factors:

- 1) sound credit judgement, 2) self liquidity of the loan,
- 3) profitability, and 4) security.

### Sound Credit Judgement

The lender must have a reasonable assurance that the foreign buyer has the ability to repay according to the terms of the sales contract. The borrower may be the exporter or the buyer, but in either case the standard credit analysis

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<sup>28</sup>George B. McGowan, Trust Receipts (New York: The Ronald Press Company, 1914).

as to the character of management, financial strength and capacity to pay must be applied. If the borrower fails, in the credit officer's judgement, to pass these basic tests, "don't make the loan". Since the proceeds from the bank loan are being used for sales in foreign countries, the lending officer must carefully consider two added elements: the political and the economic conditions that exist in these countries. Although political and economic conditions are often beyond the control of the buyer, the seller, and the bank, they must be explored before a banker can consider an analysis complete.

#### Self Liquidity of the Loan

The lending officer must recognize that the buyer is physically located in a distant country and that sales must be made to him on a continuous basis because the merchandise he imports is replacing his own need to manufacture the product. Therefore, the customary "30-day clean-up" enjoyed in domestic situations must be waived and emphasis placed on the self-liquidity of the transaction. This factor applies particularly on short term export sales, but it can be readily applied in medium transactions too.

#### Profitability

As a private business, bank management seeks to provide a return on investment to its investors. Being mindful of that fact, the lender should evaluate all cost factors - direct and indirect- to the bank in determining whether to

grant the credit and, if the credit is granted, the loan rate should reflect those costs plus a reasonable profit. The cost of funds, labor, machinery and space have become important expenses. The intangible benefits, such as accounts from other companies or individuals related to the borrower, are so often difficult to measure but should be appraised.

### Security and Shipping Documents

In trade finance, the bank deals in documents, not in merchandise. The customer is responsible for the merchandise under the terms of the sales contract. Control of the shipping documents and, in particular, the document of title is vital to the bank. The lending officer or an available staff member must be knowledgeable in documentation because, as the various methods of export financing are discussed, their importance will be recognized. The basic shipping documents include the draft, invoice, insurance certificate and bill of lading. A specific situation may require additional documents, such as an inspection certificate, consular invoice or certificate of origin; however, the basic documents are required in almost every transaction.<sup>29</sup>

### Advances for Payments Under Credits

Returning back to our example, when Wholesale Linen Co. applied to London Bank Ltd. for an import letter of credit whereby Wholesale Linen Co. wants to purchase knitting

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<sup>29</sup>John Mathis, Offshore Lending by U.S. Commercial Banks (Bankers' Association for Foreign Trade and Robert Morris Associates, November 1978).

machines to be shipped from New York to London. If London Bank Ltd. did not wish to have its dollar balances reduced when the documents were honored by Universal Bank under the credit, it might request Universal Bank to lend it the amount of the drawing for, say, one month from the date of payment.

Instead of debiting London Bank Ltd.'s regular account at the time of payment, Universal Bank would debit a loan account probably entitled "Advances for payments under letters of credit, London Bank Ltd.", and issue an official check to General Trading Co. The contingent liability for the letter of credit would be replaced by an actual liability representing the loan and the shipping documents would be mailed to London Bank Ltd. immediately.

Before issuing a credit against which the bank agrees to make an advance for thirty days at the time of payment, the credit standing of the opening bank and the conditions abroad must receive careful consideration. This is actually a case of the bank committing itself to make a one month loan starting as far in the future as the last valid day of the credit. Additionally it is a loan against which the bank cannot use the shipping documents as collateral as they are sent to the correspondent bank abroad when payment is made so that the shipment may be cleared on arrival.

At maturity, the loan, plus interest, would be charged automatically to the correspondent's account. Alternatively, the correspondent may instruct the bank to retire the loan

earlier, or may ask for an extension of time at maturity. If the latter, the request will be reviewed in the light of current conditions as though it were a new transaction.

#### Acceptance Credit

Referring back to our example, the difference between the "advance for payments under credits" and "acceptance credits" is a clause reading: "available by your drafts drawn on us at sight" to "available by your drafts drawn on us at 90 days sight".

If the documents of General Trading Co. are in order, Universal Bank will accept the draft, thus committing itself to pay 90 days from the date of its acceptance. The accepted draft will be handed to General Trading Co. who will either hold it until maturity and then present it to Universal Bank for payment or have it discounted prior to maturity. General Trading Co. can discount the accepted draft by selling it to any bank, but probably to the accepting bank. In return, General Trading Co. will receive the face amount less discount charges. Unless General Trading Co. has allowed for the discount charges in the price, an acceptance credit will not be as favorable as a sight credit.

When Universal Bank added its confirmation to the acceptance credit, it did so with the full knowledge that up to the last day of the credit it might be called on to accept a draft thereby incurring an actual liability for an additional 90 days. Upon confirming the credit, a contingent



liability was recorded in the name of London Bank Ltd. but when the draft was accepted, the contingent liability was reduced and an actual liability was recorded. This latter entry represents London Bank Ltd.'s liability to Universal Bank for payment of the acceptance at maturity and is offset by Universal Bank's liability for the outstanding acceptance. At maturity, when the acceptance is returned to Universal Bank for payment, London Bank Ltd's regular account will be debited and its liability for the acceptance will be reduced. Universal Bank will then pay the presenter of the acceptance and retire its own liability.

If General Trading Co. raises its price to include the cost of discounting when it sells on an acceptance credit basis, why would Wholesale Linen Co. arrange for such a credit? The answer is that they may be quite willing to pay the extra cost to have the privilege of delaying payment until maturity of the acceptance. During the life of the acceptance there should be sufficient time for the machines to be received in London, be installed, and be turning out material which could be sold to produce the funds to meet the acceptance at maturity.

In the event General Trading Co. did not want to be concerned with discounting the acceptance, Wholesale Linen Co. may be able to induce them to draw under an acceptance credit by agreeing to absorb the discount charges. In such a case, an additional clause would be added to the credit stating

that, upon acceptance, the draft will be discounted by Universal Bank but the discount charges will be for the account of the buyer. Thus, Universal Bank would pay General Trading Co. the face amount of their drawing and debit London Bank Ltd's account for the discount charges.

Even though General Trading Co. would receive the same amount as though they drew a sight draft, they may be reluctant to draw a time draft because of the obligations they assume as drawer.

A definition of the banker's acceptance follows:

A banker's acceptance is a time bill of exchange (time draft) drawn on and accepted by a banking institution. By accepting the draft the bank signifies its commitment to pay the face amount at maturity to anyone who presents it for payment at that time. In this way the bank provides its name and credit and enables its customer, who pays a commission to the accepting bank for this accommodation, to secure financing readily and at a reasonable interest cost.<sup>30</sup>

#### Refinancing Sight Payments on an Acceptance Basis

If London Bank Ltd. had, in connection with our example, arranged for Universal Bank to refinance the payment on an acceptance basis, the following would have taken place. When London Bank Ltd. asked Universal Bank to advise and confirm its credit they would have sent to Universal Bank a supply of 90 day sight drafts drawn by London Bank Ltd. on Universal Bank and payable to the order of Universal Bank. The amount

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<sup>30</sup>Wilbert Ward and Henry Harfield, Bank Credits and Acceptances, 3rd ed. (N.Y.:The Ronald Press Company, 1948).

and date would be left blank.

When conforming documents are presented, Universal Bank would fill in the amount of General Trading Co.'s drawing, then date the draft, accept it and discount it, debiting London Bank Ltd. for the discount charges. The proceeds from discounting the acceptance plus the discount charges would equal the amount of General Trading Co.'s drawing and payment would be made to them accordingly.

The procedure for retiring the acceptance would be the same as though it had been accepted under a credit.

#### H. FINANCING THE BENEFICIARY

##### Transfers

In the example of export credit, General Trading Co. (beneficiary) has agreed to ship two knitting machines to Wholesale Linen Co., London. It so happens that General Trading Co. does not manufacture knitting machines but has contracted to buy them from the Standard Machine Co., Anytown, N.J.

General Trading Co. has arranged for Standard Machine Co. to ship the machines on a C.I.F. basis for \$10,000. Wholesale Linen Co. is aware the machines are being bought from Standard Machine Co. and is paying General Trading Co. a commission for arranging the sale.

Unless General Trading Co. pays Standard Machine Co. \$10,000, General Trading Co. will not be able to obtain the machines, ship them, and present the documents required by

the credit. As General Trading Co. is not in a position to make such a payment, they have requested a transferable credit which will permit them to transfer it to Standard Machine Co.

To make the credit transferable, the approval of the buyer must be obtained. On the instructions of Wholesale Linen Co. this credit could have been issued in transferable form, or could not be amended to be transferable. On the assumption it has been amended placing it in transferable form, we shall review two different types of transfers to Standard Machine Co. (Art.46 of the "Uniform Customs and Practice").

#### Without Substitution of Invoices

In this case, Wholesale Linen Co. is aware the machines will be purchased from Standard Machine Co., and they will pay General Trading Co., independently of the credit, a commission for its part in the transaction.

~~General Trading Co. can avoid the necessity of having~~  
to borrow or use its own funds to buy the machines if it transfers the credit to Standard Machine Co. This is accomplished by General Trading Co. completing a form "Transfer with no substitution of invoices" (specimen form on Exhibit 4). Universal Bank will then write to Standard Machine Co. sending them a copy of the credit and informing them it has been transferred to them, also authorizing them to draw in accordance with the credit's terms. For all

practical purposes, Standard Machine Co. becomes the beneficiary. This form of transfer is called non-substitution since the invoices of General Trading Co. are not substituted for those of Standard Machine Co.<sup>31</sup>

#### Substitution of Invoices

Frequently, beneficiaries of transferable credits do not wish the buyer to know a transfer has been made since they buy the merchandise at a lower price from a source they do not wish to disclose.

If a substitution of invoice transfer had been to Standard Machine Co., General Trading Co. would have completed a transfer instructions form addressed to Universal Bank. In this case the amount transferred is only \$9,000! The difference of \$1,000 represents the profit of General Trading Co.

Under this form of transfer, instead of sending a copy of the credit to Standard Machine Co., Universal Bank writes them a letter authorizing them to draw under the transferred portion of the credit and includes all the details of the credit with three exceptions. These exceptions are that a lower price is shown, the buyer is indicated as General Trading Co. instead of Wholesale Linen Co., and the validity is reduced by a few days to allow ample time in which to substitute invoices.

Standard Machine Co. will make the shipment and, upon presenting documents conforming with the notice of transfer,

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<sup>31</sup>Irving Trust Company, Practical Aspects of Commercial Letters of Credit (N.Y., 1975).

will receive payment of \$9,000. At the same time, Universal Bank will substitute the invoices of General Trading Co. for \$10,000, giving them the invoices made out to them by Standard Machine Co. for \$9,000. Universal Bank will then pay General Trading Co. \$1,000. The off-set to both payments will be one debit to the account of London Bank Ltd. for \$10,000.

As it can be seen, neither London Bank Ltd. nor Wholesale Linen Co. would be aware a transfer had been made. Additionally, Standard Machine Co. would not learn the name of the buyer in London.

Through this substitution of invoice transfer, General Trading Co. has passed along to Standard Machine Co. the irrevocable commitments of London Bank Ltd. and Universal Bank. Furthermore, at no time has General Trading Co. incurred any liability insofar as the letter of credit or transfer are concerned. However, they benefited by this method of financing, which was furnished by the buyer through the transferable letter of credit, and thus were able to obtain the merchandise from Standard Machine Co.

Unfortunately, not all transferable credits lend themselves to substitution of invoice transfers. The most frequent obstacle is the consular invoice requirement. Only one consular invoice can be obtained for each shipment and, of course, it must be at the higher or final export price. Consequently, this document must be obtained by the

beneficiary and not the transferee. The transfer of letters of credit is a speciality and the best advice is to consult the drawee bank's letter of credit department whenever any questions arise.<sup>32</sup>

#### Back to Back Credits

Sometimes beneficiaries of export credits, who are not the suppliers of the merchandise, do not wish to ask for a transferable credit as such a request places the buyer on notice that the beneficiary is most likely buying the merchandise elsewhere and, of course, at a lower price.

Referring to our same exportation example, and without amending it to be transferable although it is preferable that it be in transferable form, Universal Bank could issue a back to back credit for General Trading Co. in favor of Standard Machine Co. General Trading Co. would first have to assign the export credit to Universal Bank for collateral purposes. Additionally, they would have to complete an application for a credit in favor of Standard Machine Co. The same form of application could be used, adapted to cover an exportation. Through the signing of the application, General Trading Co. commits itself to reimburse Universal Bank for payments under the back to back credit.

The back to back credit will be the same as the export credit except for the four features: 1) the beneficiary's name will

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<sup>32</sup>Ibid.

be Standard Machine Co., 2) the account party will be General Trading Co., 3) the amount will be \$9,000, and 4) the validity will be reduced by a few days to allow time for substituting invoices.

As Universal Bank has now issued a new credit which shows no reference to the credit opened by London Bank Ltd., a contingent liability will be recorded in the name of General Trading Co. As a contingent liability for \$10,000 was recorded in the name of London Bank Ltd. for the export credit, a total of \$19,000 has been recorded against which a maximum of \$10,000 can be drawn. As back to back credits are not numerous, this inflation of contingent liability is of no important consequence. When payment is made for \$10,000 liability will be reduced by \$19,000.

After shipment by Standard Machine Co. and upon presentation by them of the required documents, Universal Bank will pay them \$9,000 under the back to back credit. At the same time General Trading Co. will hand Universal Bank invoices for \$10,000 to be substituted for the invoices of Standard Machine Co. and will request payment of the difference, \$1,000. To offset both payments, one debit for \$10,000 will be made to the account of London Bank Ltd.

The steps taken in effecting a payment under a back to back credit and a substitution of invoice transfer are similar. Also, if an export credit calls for a document such as a consular invoice which would reveal information which should



not be disclosed, a back to back credit may not be possible as the consular invoice would have to be completed by the beneficiary of the export credit at the higher price.

A true back to back credit must be issued against the issuing bank's irrevocable or confirmed export credit and must not have other than the four exceptions from the underlying credit mentioned earlier. If there are other exceptions, the bank issuing the so-called back to back credit increases its risk. An example will show why.

A frequent request of beneficiaries of export credits who wish financing by means of a back to back credit is that the secondary credit permit payment against railroad bills of lading. However, upon presentation and payment for the railroad bills of lading the bank would be advancing funds on behalf of the exporter. The railroad bills of lading would then be delivered to the exporter against trust receipts to enable him to obtain the merchandise and place it on ~~board an ocean vessel.~~ After the ocean documents are obtained, they would be presented under the export credit. The advance would then be retired and the exporter would receive reimbursement for the ocean freight, insurance, and his profit.

The foregoing appears to be a practical solution when the exporter's supplier will not sell if he has to wait until he obtains ocean documents. From the banker's point of view, however, there are a few reservations. If, after payment against railroad bills of lading, space cannot be obtained

on any ocean vessel and the export credit expires, how will the advance be repaid? Also, how will the advance be repaid if a shipping strike is called and the export credit expires while the merchandise is waiting for the vessel on which space has been booked?

With these thoughts in mind, it is obvious that any credit issued on the strength of another credit must be a true back to back credit or it must be issued on the credit standing of the beneficiary of the underlying credit.

#### Assignment of Proceeds

Occasionally suppliers will be quite willing to sell to beneficiaries of letters of credit, provided they receive an assurance from the paying bank that they will be reimbursed for their merchandise when shipment is made under the credit.

In the event Standard Machine Co. were willing to accept such an assurance, General Trading Co. would instruct Universal Bank irrevocably to pay a percentage, in this 90%, of the proceeds of their drafts drawn to their order and honored by Universal Bank under export credit. They would also ask Universal Bank to notify Standard Machine Co. of their instructions and would request Universal Bank to include its undertaking to be bound thereby. For making such a commitment the Bank would receive a commission.

The bank's letter to Standard Machine Co. would pass along the instructions of General Trading Co. as requested, and its commitment would be along the lines, "When, as and if such drafts are honored by us, we hereby undertake to

comply with the foregoing instructions".

As it can be seen, this is not an assignment of the credit, but only of the proceeds. Consequently, the question of whether the credit is or is not transferable does not govern whether such an assignment can be made. Obviously, an assignment of proceeds can be made in connection with almost any credit. It is important to stress that this assignment becomes effective only "when, as, and if" there are proceeds under the credit. Should documents be presented which do not conform to the credit and be returned to the presenter, no payment would be made to the assigned as no proceeds would be available. An assignee of an assignment of proceeds must have full faith in the beneficiary of the credit because, if the beneficiary does not present conforming documents, payment will not be made to the assignee.

on the following page, shows parties in the four methods we have just reviewed of financing the beneficiary. ~~The dollar amounts indicated are the amounts received by~~ the particular parties after drafts and documents have been honored.

#### Red Clause

There is an additional method of financing the beneficiary. This is through the incorporation of a "red clause" in a credit, though this method is seldom used today.

#### Advances:

Where the buyer has sufficient confidence in the prime

Figure 7: PARTIES IN FOUR METHODS OF FINANCING THE BENEFICIARY

Non-substitution of Invoice Transfer

<u>Account Party</u>	<u>Opening Bank</u>	<u>Paying Bank</u>	<u>Beneficiary</u>	<u>Transferee</u>
Wholesale Linen Co.	London Bank Ltd.	Universal Bank New York	General Trading Co. (\$0)	Standard Mach- ine Co. (\$10,000)

Substitution of Invoice Transfer

Wholesale Linen Co.	London Bank Ltd.	Universal Bank New York	General Trading Co. (\$1,000)	Standard Mach- ine Co. (\$9,000)
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Back-to-Back Letter of Credit

<u>Account Party</u>	<u>Opening Bank</u>	<u>Paying Bank</u>	<u>Beneficiary</u>
Wholesale Linen Co.	London Bank Ltd.	Universal Bank New York	General Trading Co. (\$1,000)
General Trading Co.	Universal Bank New York	Universal Bank New York	Standard Machine Co. (\$9,000)

Assignment of Proceeds

<u>Account Party</u>	<u>Opening Bank</u>	<u>Paying Bank</u>	<u>Beneficiary</u>	<u>Assignee</u>
Wholesale Linen Co.	London Bank Ltd.	Universal Bank	General Trading Co. (\$1,000)	Standard Mach- ine Co. (\$9,000)

beneficiary to authorize an assignment, the parties may profitably consider utilization of the so-called "red clause". The Red Clause is a device which originated in the China trade where the seller was most frequently an agent of the buyer. In the fur trade, for example, the persons in China who dealt with American buyers were, in the main, either buyers' representatives or traders who went into the hinterland and bought raw furs, a little here and a little there, assembled them at a port and packed and shipped them. They dealt, too, with persons who wanted cash on the barrelhead before they parted with the furs.

Accordingly, opening banks began the practice of endorsing on their credits in red ink (hence the name) a clause authorizing the confirming or negotiating bank to pay the beneficiary against his drafts alone, coupled with his simple promise to provide the documents in the future.

Sometimes Red Clause credits are called "packing credits" as the merchandise bought in the interior is shipped to the ocean port, assembled, and packed for overseas shipment.

Red Clause letters of credit, from a credit point of view, are of more concern to the opening bank than to the bank making a loan based on a Red Clause. Therefore, we shall refer first to an import credit opened for account of General Trading Co.

Referring again to our import example and to use a more modern application of the Red Clause, if Wholesale Linen Co.

were not financially able to buy the 200 bolts for shipment to New York, General Trading Co. might be willing to lend them at least part of the funds needed. This could be done through the addition of a clause to the credit reading:

The negotiating bank is hereby authorized to make advance to you to the extent of \$5,600 or the unused balance of this credit, whichever is less, against your receipt for the amount advanced which must state the advance is to be used to pay for the purchase and shipment of the merchandise for which this credit is opened and be accompanied by your written undertaking to deliver documents in conformity with the credit terms to the negotiating bank on or before the latest date for negotiation. The advance, with interest, is to be deducted from the proceeds of the drafts drawn under this credit. We hereby undertake the payment of such advances, with interest, should they not be repaid to the negotiating bank by you on or before the latest date of negotiation.

Upon receiving this credit, Wholesale Linen Co. would apply to London Bank Ltd. for an advance in English pounds of the equivalent of \$5,600 against a receipt prepared as required by the Red Clause. If we assume that each pound is worth \$2.80, Wholesale Linen Co. would receive £2,000. It would be receiving the advance, not on its credit standing but on the credit standing of Universal Bank since Universal Bank has committed itself to repay the advance with interest.

After shipment is made, Wholesale Linen Co. would present its draft for \$10,000 with ocean documents to London Bank Ltd. for negotiation. Wholesale Linen Co. would receive the equivalent of \$10,000 in pounds less the amount of the advance and interest.

What would happen, however, if the loan were not repaid by the beneficiary? At the expiration of the credit, London Bank Ltd. would request reimbursement from Universal Bank of £2,000 plus interest. Assuming that each pound is now worth \$3.00, it will cost Universal Bank \$6,000 to buy £2,000. As General Trading Co. agreed to advances up to only \$5,600, are they responsible for the additional \$400 resulting from exchange fluctuation? The answer is "Yes". When they signed the application for the credit, they would have signed also a supplementary application and agreement loan covering Red Clause advances. In this supplementary form they would have agreed in part as follows:

The applicant hereby guarantees the repayment to you of all such advances and agrees to reimburse you at your office on demand in United States currency for all amounts so advanced together with accrued interest as charged by the negotiating bank, and if the advance was made in local currency to pay you the United States dollar equivalent of such currency at your then prevailing rate for cable transfers to the place of payment even though the dollar value of such currency exceeds the amount of the dollar advances herein authorized, or exceeds the amount of the letter of credit.<sup>33</sup>

Before agreeing to Red Clause advances the buyer must have full confidence in the seller, and the opening bank must have full confidence in the buyer. An application for a credit permitting Red Clause advances must be considered, at least for the Red Clause advance portion, in the same light as an unsecured credit.

I. ELEMENTS OF RISK TO BE ASSURED BY BANKS

The analysis from a credit grantor's point of view of the financial statements of importers may seem to place undue emphasis on inventory factors. This is a natural consequence of the fact that capital investment is almost entirely in trading assets (i.e. "working capital").

Net Working Capital Ratios

To a bank lending officer accustomed to traditional 2-to-1 current ratios or 1-to-1 debt/equity ratios, a 1.25-to-1 current ratio or a 3-to-1, 5-to-1, or even 7-to-1 (or higher) debt/equity ratio seems excessive; yet these figures are not unusual in the case of dealers in imported commodities.

For years some banks, pioneers in the financing of imported wool, employed a so-called "wool formula" in setting credit facilities for its import customers. The formula, which was based on net working capital, gave rise to a credit line of three times net working capital with the added proviso that the net unsold inventory, including forward purchase and sale commitments, would not exceed the working capital amount. While these figures were fairly arbitrary, they did recognize that the importer's liquid capital is the bank's cushion against loss. In the example cited, other things being equal, total asset values would have to decline 25 percent or net unsold inventory would have to be wiped out completely for the bank's loan to be jeopardized.



### Audits and Supervision

In the regular arrangements for the receipt and review of financial statements of importing customers, some banks require not only fiscal audits by independent CPA's (long form where possible), but also interim figures, which may be unaudited, and periodic inventory positions. Again, the ability to obtain such details is affected by competitive factors; however, the supervising bank examiner has been a strong ally. In the last analysis, banks have usually been able to obtain interim dollar-volume and profit-and-loss indications even where it was contrary to the company's policy to publish detailed income statements at other than fiscal dates.

### Supplementary Protection

One of the most critical developments in the financing of importer-dealers in the past decade has been the failure of capital formation to keep pace with the increases in commodity prices during this period. Dealers, particularly, tend to think in terms of a certain number of bales or tons or pounds or barrels of the commodity in question rather than in dollar terms, and it follows that an ever increasing amount of bank funds have been called upon to finance a constant volume. Bankers, seeing their margin of protection eroded in this fashion, have been forced either to accept lower standards or higher leverage or to look for supplementary protection in the form of marketable securities or outside

guarantees.

#### Third-Party Guarantees

Some bank experience with third-party guarantees, while not generally resulting in outright loss for the bank, has nevertheless not proved particularly satisfactory in liquidations. Regardless of how well the documentation is drawn up, for practical reasons it is usually necessary to exhaust all remedies against the borrower before proceeding against collateral or guarantees of third parties. In either event, the bank makes no friends.

#### Avoidance of Financing "Losers"

While such considerations apply equally to domestic trade, it is characteristic of import houses that they are often family-owned, moderate-size businesses with all that this implies in terms of restrictions on additional equity formation and consequent reliance on family-owned collateral or guarantees. Banks have often felt that the true profitability of such a business was masked by the evident ability of the principals, usually officers, to adjust their withdrawals to the earning capacity of the business in any one year. Alternatively, banks have seen businesses which were perpetuated as losing propositions beyond any rational point of time, perhaps for sentiment's sake or to provide employment for long-time employees. The scalpel, leading to termination, merger or sale of the business is often the best solution, as the banker should be careful to avoid a situation where

he is financing a "loser" into bankruptcy.

#### Joint or Outright Ownership by Foreign Interests

To some extent also, the ownership of United States import firms has been transferred abroad, in a number of instances into the hands of United Kingdom companies. While this trend has been fairly pronounced in recent years, it is not new, as the early history of the United States bears out.

Another recent development is the tendency for producing countries to acquire an interest, either outright or jointly with the United States citizens, in import houses domiciled in the U.S.A. Perhaps the most significant aspect of the multinationalization of American import trade is the fact that foreign banks find these companies natural prospects and, through their agencies and branches in the U.S.A., compete effectively by offering facilities on more liberal terms or accepting less rigid credit standards than their domestic counterparts. To some extent these terms may be justified by the nature of the commodities markets themselves; however, the possibility of future shake-outs arising from an overextension of credit to commodity importers is not to be ignored.

#### "Cash and Carry"

The wider availability of the various commodity exchanges as hedges for the purchase or sale of actuals has given rise to broader financing possibilities for importers. Specifically,

loans against a commodity in warehouse sold forward (and deliverable) under an exchange contract are relatively risk-free and generally attractive from the lender's point of view.

However, a bank that finances such "cash and carry" business must be prepared to lend additional sums to meet calls for variation margin when the exchange price moves away from the contract price. While these additional loans are necessarily unsecured, the bank may take some comfort from the fact that the collateral in warehouse should be worth correspondingly more. The bank should be alert, however, to the possibility that grade or quality differences can give rise to fluctuating price differentials between the actual commodity financed and the exchange "basis", thus introducing an element of additional risk for both borrower and bank.

#### Capital Turnover Ratios

~~In the framework of a dynamic business no importer can~~ afford to let his capital lie idle. How much business volume a given amount of importer capital can sustain is the product of a number of factors including (but not limited to) money-market conditions and the market for the commodity itself. Longer shipment periods, other things being equal, require more capital and bank facilities relative to a given volume, whereas buying and selling titel documents requiring no physical carry at all represent the other extreme. Somewhere

in between lies the more typical relationship between sales, capital and inventories. Only experience will determine whether a meat importer, for instance, is overtrading if he turns his capital in excess of 60 times a year for low margins whereas an importer of high-priced oriental rugs sells only 10 or 15 percent of his stock in one year. The prudent bank credit officer will want to know the underlying cause behind any marked changes in these ratios from year to year.

## Chapter 3

### CONCLUSIONS, RECOMMENDATIONS AND SUMMARY

#### A. CONCLUSIONS

Documentary credits generate benefits to both parties, banks and customers.

##### Benefits to the Bank

The commissions a bank earns when it handles letters of credit of average size are small in relation to the handling costs and, in addition, a bank assumes risks which are sometimes considerable.

Although the commissions are small they are a significant part of earnings. The collateral advantages, however do at times help offset the low rates of commission.

When a bank issues a credit payable at another bank's office, it is necessary that the opening bank maintains a balance in its accounts with the negotiating bank which is, of course, to that bank's (negotiating bank's) advantage. At the same time, the buyer had to maintain balances (collateral) with the opening bank to meet any drawings under the credit. Balances are, of course, the life-blood of every bank.

Commissions charged should be sufficient to compensate for the work involved and, at least in part, for the risk to the opening or confirming bank. Our discussion has been confined to simple letters of credit but many complicated credits are issued as a service to importers and exporters.

To accommodate customers, banks frequently issue credits which require more attention on their part than the normal merchandise credits. Any customer so accommodated should be prepared to pay a higher commission for the special service. In the final analysis, however, it is the bank's customers who receive the greatest benefit from letters of credit since they are enabled to complete merchandise transactions by having the credit standing of the bank added to their own.

In addition to all these benefits, the bank generates earnings from interest on letters of credit. When documents are negotiated, the negotiating bank debits the account of the opening bank for the value of the documents plus charges. The opening bank then debits an advance account in the name of the buyer, awaiting receipt of the documents.

The fact that a bank furnishes letter of credit services enables it to solicit and serve more effectively ~~the accounts of firms engaged in exporting and importing.~~ Many export credits are obtained in favor of firms who are not customers of the paying bank. Through the letter of credit, the exporter has the opportunity to sample the services of the paying bank; the paying bank has the chance to prove to the exporter how well it can handle his business. Many mutually profitable relationships can develop from just such an introduction.

As the bank has opportunities to obtain new relationships

through export credits, so do its correspondents abroad through the bank's import credits. Whenever possible, import credits are sent through banks abroad for delivery to the beneficiary. The advising banks have the opportunity to request they be given the chance to negotiate the drawings under the credit. If successful, the negotiating bank will be able to handle an exchange transaction if the credit is in a currency other than its own, and to demonstrate its services to the beneficiary. It is only natural that a bank abroad will send the bulk of its business of all kinds to the banks which reciprocate.

The advance under a letter of credit is a loan granted to the buyer, this loan being an investment that generates revenue, in the form of interest, for the bank.

#### Benefits to the Customer

Documentary credits ensure a smooth relationship between the buyer and the seller. They make sure that both parties will be satisfied to their best convenience; the buyer will receive the merchandise and the seller will get his money.

Both the buyer and seller can obtain, through their bank, information on each other as to market reputation and credit worthiness.

Besides all that, and most importantly, the buyer and the seller are financed by their banks.



## B. RECOMMENDATIONS

To solve the problems (stated in Chapter 1) that face the bank and customers engaged in documentary credits, it is recommended that banks issue a booklet explaining the fundamentals of letters of credit, International Trade Services, and financing of letters of credit.

This booklet should be made available to the bank's personnel and customers, thus providing them with a greater insight and understanding of the documentary credits.

A smooth relation between the bank and its customer can be ensured once the customer becomes familiar with the way banks deal with documentary credits.

### C. SUMMARY

The research dealt with definitions of forms and types of documentary credits. Import and export credits were also briefed.

It also dealt with amendments that can be made on a letter of credit, and discrepancies that may be faced in documentary transactions.

Financing of letters of credit, from an import and export standpoint, were explained and detailed with illustrations.

Elements of risk that should be assured by a bank engaged in documentary transactions have been stated and clarified.

In summary, the research explained the fundamentals of letters of credit, International Trade Services and financing of letters of credit.

EXHIBIT 1

APPLICATION FOR OPENING OF DOCUMENTARY CREDIT

Applicant [ ]

Sent to **Universal Bank sal**  
P.O.Box 113-5024 Beirut, Lebanon

Gentlemen :

\_\_\_\_\_ 19\_\_\_\_\_  
PLACE & DATE

Subject to general terms of our Letter Contract Relating to the opening of Commercial Credits dated \_\_\_\_\_ and subject to which terms this application is governed, we request you to open for our account and risk an irrevocable and without recourse commercial credit as follows :

In favor of \_\_\_\_\_

Up to the aggregate amount of \_\_\_\_\_

Available by their drafts at \_\_\_\_\_ for \_\_\_\_\_ invoice value when accompanied by the following documents, as checked : (indicate instructions by placing x in appropriate box).

- Full set of clean "on board" ocean bills of lading made out to the order of the UNIVERSAL BANK or to order and blank endorsed, evidencing shipment on or before \_\_\_\_\_ from \_\_\_\_\_ to \_\_\_\_\_ marked freight \_\_\_\_\_ and notify \_\_\_\_\_ and stating that the carrying vessel is not Israeli and that it is not scheduled to call at any Israeli port,
- Insurance policy or certificate (full set) /in negotiable form covering goods for the invoice amount plus \_\_\_\_\_ insurance to include \_\_\_\_\_
- Certificate of origin in \_\_\_\_\_ issued or certified by the chamber of commerce stating. That the goods are of \_\_\_\_\_ origin.
- Commercial invoice in \_\_\_\_\_ duly signed, one of which must be certified by the chamber of commerce and legalized by the Lebanese consulate.
- Other documents \_\_\_\_\_

STATING THAT THEY COVER THE FOLLOWING GOODS : \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Terms of sale \_\_\_\_\_

Special condition : \_\_\_\_\_

Partial shipments : \_\_\_\_\_ transshipments \_\_\_\_\_  
Credit valid until \_\_\_\_\_ inclusively  
Advise credit by  Air Mail  Cable

Except as otherwise expressly stated, this credit is subject to the Uniform Customs and practice for Documentary credits (1974 Revision) International Chamber of Commerce. Brochure No. 290.

FOR BANK USE ONLY
LINE
OUTSTAND.
INITIALS

*SPECIMEN*

\_\_\_\_\_  
APPLICANTS SIGNATURE

# طلب فتح اعتماد مُستند

المرسل

المرسل اليه

يونيفرسال بنك ش.م.ل  
صندوق بريدي ٥٠٢٤-١١٣ بيروت، لبنان



وفقاً للشروط العامة الواردة في كتاب العقد المتعلق بفتح اعتمادات وثائق بتاريخ \_\_\_\_\_ والتي تشكل مع مضمون هذا الكتاب جزءاً، لا يتجزأ، نرجو ان تفتحوا حسابنا وعلى مطلق مسؤوليتنا اعتماداً لقاء وثائق غير قابل النقص كما يلي :  
لصالح \_\_\_\_\_

بمبلغ \_\_\_\_\_

يستعمل بموجب سحبيات بمبلغ \_\_\_\_\_ بالمائة من قيمة الفاتورة عند تسليم الوثائق التالية (المشار اليها بعلامة )

مجموعة كاملة لبوالص الشحن منظمة لأمر يونيفرسال بنك أو منظمة لأمر ومحيرة على بياض تثبت الشحن بتاريخ \_\_\_\_\_ او قبله من \_\_\_\_\_

الى \_\_\_\_\_ مذكور عليها كيفية دفع مصاريف الشحن \_\_\_\_\_ وابلاغ \_\_\_\_\_ ومذكور عليها ان الباخرة الشاحنة ليست اسرائيلية ولن تمر في طريقها على اي ميناء اسرائيلي.

بوليصة أو شهادة ضمان في مجموعة كاملة منظمة قابلة التجيير تضمن البضاعة لغاية مبلغ الفاتورة يضاف اليه \_\_\_\_\_ ضد الاخطار التالية : \_\_\_\_\_

شهادة مصدر في \_\_\_\_\_ نسخ صادرة عن غرفة التجارة ومصدقة منها تثبت ان البضاعة من مصدر \_\_\_\_\_

فاتورة تجارية في \_\_\_\_\_ نسخ موقعة من المستفيد نسخة منها مصدقة من قبل غرفة التجارة ومؤشر عليها من قبل القنصلية اللبنانية.

وثائق اضافية \_\_\_\_\_

جميع هذه الوثائق تتعلق بالبضاعة التالية : \_\_\_\_\_

شروط البيع \_\_\_\_\_

الشروط الخاصة :

الشحن الجزئي \_\_\_\_\_ النقل من سفينة الى اخرى \_\_\_\_\_

يقوم مفعول هذا الاعتماد لغاية \_\_\_\_\_

اعلام الاعتماد بالبريد الجوي / برقياً.

وفيما عدا الشروط الخاصة المذكورة اعلاه يكون هذا الاعتماد خاضعاً للشروط العامة المذكورة في نشرة الغرفة التجارية العالمية المتضمنة للشروط المتفق عليها (تعديل ١٩٧٤) نشرة غرفة التجارة العالمية رقم ٢٩٠.

الامضاء

**Universal Bank sal**Heliopolis Bldg., Verdun Street • P.O. Box 113-5024 Beirut, Lebanon  
R.C. Beirut 38861 • L.B. 42 • Tel. 315691, 315697

## Letter Contract Relating to the Opening of Commercial Credits

Dear Sirs,

In regard to all documentary credits which you may establish in the name of the undersigned, the undersigned agrees that such credits shall be subject to the following general conditions, it being understood that the specific conditions for any such credit shall be laid down in each individual case :

1. To pay you on demand, at your Beirut Office and in Lebanese currency, the amount of each draft, (whether **SIGHT** or **TIME**) which may be drawn in Lebanese currency under the Credit, or purport to be so drawn ; also, in any event and without demand, to effect such payment with respect to each such **TIME** draft sufficiently in advance of its maturity date to enable you to arrange (in the usual course of the mails) for cover to reach the place where such time draft is payable not later than **ONE (1)** business day prior to its maturity, it being understood that you will notify the undersigned of the amount and date of maturity of each such time draft.
2. To pay you on demand, at your Beirut Office and in Lebanese currency, the equivalent (at your then selling rate for cable transfers to the place where and in the currency in which such draft is payable) of the amount of each draft (whether **SIGHT** or **TIME**) which may be drawn **IN OTHER THAN LEBANESE CURRENCY** under the Credit, or purport to be so drawn ; also, in any event and without demand, to effect such payment with respect to each **TIME** draft sufficiently in advance of its maturity date to enable you to arrange (in the usual course of the mails) for cover to reach the place where such time draft is payable not later than **ONE (1)** business day prior to its maturity, or, at your option, to provide you then with the amount of currency in which such time draft is payable in such form and manner as shall be acceptable to you, it being understood that (i) you will notify the undersigned of the amount and date of maturity of each such time draft and (ii) the undersigned will comply with any and all government exchange regulations now or hereafter applicable to any foreign exchange provided you pursuant to this paragraph, and will indemnify and hold you harmless from any failure so to comply.
3. In event of any Lebanese Currency draft (s) being drawn by the undersigned on you whereby to refinance any obligation (s) set forth in "1" and "2" hereof and such draft (s) being accepted by you (at your option), the undersigned will pay you on demand, but in any event not later than **ONE (1)** business day prior to its maturity, the amount of each such acceptance. It is understood that each amount which may become due and payable to you under this agreement may, in your discretion and if not otherwise paid, be charged by you to any available funds then held by you for the account of the undersigned.
4. That, if the aforesaid Application requests the inclusion in the Credit of any provision for Clean Advance (s) to the beneficiary, you may place in the Credit such a provision in that respect as you may deem appropriate, under which any bank entitled to negotiate drafts under the Credit, acting in its discretion in each instance and upon the request and receipt in writing from the beneficiary, may make any one or more Clean Advances at any time on or prior to the date by which bills of exchange are to be negotiated under the Credit. The aggregate of such advance (s) shall in no event be more than the amount specified in the Application for Clean Advances, and in no event shall any such advance exceed the amount remaining available under the Credit at the time of the advance. While it is expected by the undersigned that each such advance will be repaid to the bank (s) that made the advance (s) by the beneficiary from the proceeds of any draft (s) drawn under the Credit, should any such advance (s) not be thus repaid, the undersigned will on demand pay you the amount (s) thereof as if such advance (s) were evidenced by draft (s) drawn under the Credit, together with interest on each such amount for the period that the same shall have been outstanding at such rate as you may find at the time of demand to be payable. It is understood that neither you nor any bank (s) which makes such advance (s) shall be obligated to inquire into the use that may be made thereof by the beneficiary and that you and each such bank shall be without liability for any wrongful use that may be made by the beneficiary of any funds so advanced.
5. To pay you on demand, with respect to the Credit, a commission at such rate as you may determine to be proper, and any and all charges and expenses which may be paid or incurred by you in connection with the Credit, together with interest where chargeable.
6. That, except as instructions may be given you by the undersigned in writing expressly to the contrary with regard to, and prior to the opening of, the Credit : (a) you and/or any of your correspondents may receive and accept as "Bills of lading" relative to the Credit any document (s) issued or purporting to be issued by or on behalf of any carrier which acknowledge(s) receipt of property for transportation, whatever the specific provisions of such document (s), the date of each such document shall be deemed the date of shipment of the property mentioned therein, if the credit provides for other than "On board" bills of Lading, and any such bill of lading issued by or on behalf of an ocean carrier may be accepted by you as "Ocean bill of lading" whether or not the entire transportation is by water ; (b) unless otherwise specified in the credit, Bills of Lading must show that the goods are loaded on board. Loading on board may be evidenced by an on board Bill of Lading or by means of a notation to that effect dated and signed or initialled by the carrier or his agent, and the date of this notation shall be regarded as the date of loading on board and shipment ; (c) partial shipments are allowed, unless the credit specifically states otherwise. Shipments made on the same ship and for the same voyage, even if the Bills of Lading evidencing shipment "on board" bear different dates, will not be regarded as partial shipments ; (d) part shipment (s), and/or shipment (s) in excess of the quantity called for

in the Credit, may be made and you may honor the relative drafts, the liability of the undersigned to reimburse you for payments made or obligations incurred on such drafts being limited to the amount of the credit; (e) if shipment by instalments within given periods is stipulated and any instalment is not shipped within the period allowed for that instalment, the credit ceases to be available for that or any subsequent instalment, unless otherwise specified in the credit; (f) you and/or any of your correspondents may receive and accept as documents of insurance under the Credit either insurance policies or insurance certificates which need not be for an amount of insurance greater than the amount paid by you under or relative to the Credit and, (g) you and or any of your correspondents may receive, accept or pay as complying with the terms of the Credit, any drafts or other documents, otherwise in order, which may be signed by, or issued to, the administrator or executor of, or the trustee in bankruptcy of, or the receiver for any of the property of, the party in whose name the Credit provides that any drafts or other documents should be drawn or issued.

**7.** To procure promptly any essential import, export or other licenses for the import, export or shipping of any and all property shipped under or pursuant to or in connection with the Credit and to comply with any and all foreign and domestic governmental regulations in regard to the shipment of any and all such property or the financing thereof, and to furnish such certificates in that respect as you may at any time (s) require, and to keep the property covered by insurance satisfactory to you, issued by insurers acceptable to you, and to assign the policies or certificates of insurance to you, or to make the loss or adjustment, if any, payable to you, at your option, and to furnish you, if demanded, with evidence of acceptance by the insurers of such assignment.

**8.** That, as security for any and all obligations and/or liabilities of the undersigned hereunder, and also for any and all other obligation and/or liabilities, absolute or contingent, due or to become due, which are now, or may at any time (s) hereafter be owing by the undersigned to you, the undersigned hereby recognize (s) and admit (s) your ownership in and unqualified right to the possession and disposal of any and all shipping documents, warehouse receipts, policies or certificates of insurance and other documents accompanying or relative to drafts drawn under the Credit and in and to any and all property shipped under or pursuant to or in connection with the Credit, or in any way relative thereto or to any of the drafts drawn thereunder (whether or not such documents, goods or other property be released to or upon the order of the undersigned on trustor baileereceipt), and in and to the proceeds of each and all of the foregoing, until such time as all the obligations and/or liabilities of the undersigned to you at any time existing under or pursuant to this Agreement, or the Credit herein referred to, or any other obligations or liabilities of the undersigned to you, now existing or hereafter arising, have been fully paid and discharged. That all or any of such property and/or documents, and the proceeds thereof, coming into your possession, or that of any of your correspondents, may be held and disposed of by you as hereinafter provided, it being understood that the receipt by you, or by any of your correspondents, at any time of other security of whatsoever nature, including cash, shall not be deemed a waiver of any of your rights or powers hereunder. Insofar as any property and/or documents, which may be held by you, or for your account, as collateral hereunder, may be released by you to or upon the order of the undersigned in trust, the undersigned will sign and deliver to you on demand such form (s) of trust receipt and/or Statement (s) of Trust Receipt Financing as may be satisfactory to you, and will pay any relative filing fees, it being understood that your rights as specified herein or therein shall be in furtherance of and/or in addition to, but not in limitation of, your rights under any applicable law. Upon any transfer, sale, delivery, surrender or endorsement of any bill of lading, warehouse receipt or other document at any time (s) held by you, or held for your account by any of your correspondents, relative to any draft (s) accepted by you in reliance hereon, the undersigned will indemnify and hold you harmless from and against each and every claim, demand, action or suit which may arise against you, or any such correspondent (s), by reason thereof.

**9.** To pledge, and do (es) hereby pledge, to you as security for any and all of the obligations and/or liabilities of the undersigned herein before or hereinafter referred to, now or hereafter existing, any and all property of the undersigned now or at any time (s) hereafter in your possession or control, or that of any third party acting in your behalf, whether for the express purpose of being used by you as collateral security or for safekeeping or for any other or different purpose, including such property as may be in transit by mail or carrier to or from you, a lien being hereby given you upon any and all such property for the aggregate amount of any and all such obligations and/or liabilities; and the undersigned hereby authorize (s) you, at your option, at any time (s), whether or not the property then held by you as security hereunder is deemed by you to be adequate, to appropriate and apply upon any and all of the said obligations and/or liabilities, whether or not then due, any and all moneys now or hereafter with you on deposit or otherwise to the credit of or belonging to the undersigned and/or, in your discretion, to hold any such moneys as security for any such obligations or liabilities until the exact amount thereof, if any, shall have been definitely ascertained by you. Your rights and liens hereunder shall continue unimpaired, and the undersigned shall be and remain obligated in accordance with the terms and provisions hereof notwithstanding the release or substitution of any property which may be held as collateral hereunder at any time (s) or of any rights or interests therein, or any delay, extension of time, renewal compromise or other indulgence granted by you in reference to any of the aforesaid obligations and/or liabilities, or any promissory note, draft, bill of exchange or other instrument given you in connection with any of the aforesaid obligations and/or liabilities, the undersigned hereby waiving notice of any such delay, extension, release, substitution, renewal, compromise or other indulgence, and hereby consenting to be bound thereby as fully and effectually as if the undersigned had expressly agreed thereto in advance.

**10.** At any time and from time to time, on demand, to deliver, convey, transfer, or assign to you, as security for any and all of the obligations and/or liabilities of the undersigned hereunder, and also for any and all other obligations and/or liabilities, absolute or contingent, due or to become due, which are now, or may at any time hereafter be owing by the undersigned to you, additional security of a value and character satisfactory to you, or to make such cash payment (s) as you may require.

**11.** You are hereby authorized at your option and without any obligation to do so, to transfer to and/or register in the name (s) of your nominee (s) all or any part of the property which may be held by you as security at any time (s) hereunder, and to do so before or after the maturity of any of the said obligations and/or liabilities and with or without notice to the undersigned.

**12.** Upon the non-performance of any of the promises to pay hereinabove set forth, or upon the non-payment of any of the other obligations or liabilities abovementioned, or upon the failure of the undersigned forthwith, with or without notice, to furnish satisfactory additional collateral or to make payments on account as hereinbefore agreed, or to perform or comply with any of the other terms or provisions of this agreement, or in the event of the death, failure in business, dissolution or termination of existence of the undersigned, or in case any petition in bankruptcy should be filed by or against the undersigned, or any proceedings in bankruptcy, or under any laws in force relating to the relief of debtors, should be commenced for the relief or readjustment of any indebtedness of the undersigned, either through reorganization, composition, extension or otherwise, or if the undersigned should make an assignment for the benefit of creditors or take advantage of any insolvency law, or if a receiver of any property of the undersigned should be appointed at any time, or if any funds or other property of the undersigned which may be in, or come into, your possession or control, or that of any third party acting in your behalf as aforesaid, should be attached or distrained or should be or become subject to any mandatory order of court or other legal process, then, or at any time after the happening of any such event, any or all of the aforesaid obligations and/or liabilities of the undersigned shall, at your option, become due and payable immediately, without demand or notice; and full power and authority are hereby given you to sell, assign, and deliver all or any of the property hereinbefore referred to, at any broker's board or at public or private sale, at your option, either for cash or on credit or for future delivery, without assumption of any credit risk, and without either demand, advertisement or notice of any kind, all of which are hereby expressly waived. At any sale hereunder, you may, in your discretion, purchase the whole or any part of the property sold, free from any right of redemption on the part of the undersigned, all such rights being also hereby waived and released. In event of any sale or other disposition of any of the property aforesaid, after deducting all costs or expenses of every kind for care, safekeeping, collection, sale, delivery or otherwise, you may apply the residue of the proceeds of the sale (s) or other disposition thereof, to the payment or reduction, either in whole or in part, of all or any of the aforesaid obligations and/or liabilities, whether or not then due, making proper allowance for interest on obligations or liabilities not then due, and return the overplus, if any, to the undersigned (or the one (s) of us whose property may have yielded the overplus; all without prejudice to your rights as against the undersigned with respect to any and all amounts which may be or remain unpaid on any of the aforesaid obligations and/or liabilities at any time (s).

**13.** That neither you nor any of your correspondents shall be responsible for: (a) the use which may be made of the Credit or for any acts or omissions of the beneficiary (ies) in connection therewith; (b) the existence, character, quality, quantity, condition, packing, value or delivery of the property purporting to be represented by documents; (c) any difference in character, quality, quantity, condition, or value of the property from that expressed in documents; (d) the validity, sufficiency or genuineness of documents, or of any endorsement (s) thereon, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged; (e) the time, place, manner or order in which shipment is made; (f) partial or incomplete shipment, or failure or omission to ship any or all of the property referred to in the Credit; (g) the character, adequacy, validity or genuineness of any insurance; (h) the solvency or responsibility of any insurer, or for any other risk connected with insurance; (i) any deviation from instructions, delay, default or fraud by the shipper and/or any other (s) in connection with the property or the shipping thereof; (j) the solvency, responsibility or relationship to the property of any party issuing any documents in connection with the property; (k) delay in arrival, or failure to arrive, of either the property or any of the documents relating thereto; (l) delay in giving, or failure to give, notice of arrival or any other notice; (m) any breach of contract between the shipper (s) or vendor (s) and the consignee (s) or buyer (s); (n) failure of any draft to bear any reference or adequate reference to the Credit, or failure of documents to accompany any draft at negotiation, or failure of any person to surrender or to take up the Credit or to send forward documents apart from drafts as required by the terms of the Credit, each of which provisions, if contained in the Credit itself, it is agreed may be waived by you, or (o) errors, omissions, interruptions or delays in transmissions or delivery of any messages, by mail, cable, telegraph, wireless or otherwise whether or not they may be in cipher. That you shall not be responsible for any act, error, neglect or default, omission, insolvency or failure in business of any of your correspondents, and that the happening of any one or more of the contingencies referred to in the preceding sentences shall not affect, impair or prevent the vesting of any of your rights or powers hereunder. In furtherance and extension and not in limitation of the specific provision hereinbefore set forth it is hereby further agreed that any action, inaction or omission taken or suffered by you, or by any of your correspondents, under or in connection with the Credit or the relative drafts, documents or property, if in good faith, and in conformity with such foreign or domestic laws, customs or regulations as you or any of your correspondents may deem to be applicable thereto, shall be binding upon the undersigned and shall not place you or any of your correspondents under any resulting liability to the undersigned.

**14.** The word "property" as used herein includes goods and merchandise, as well as any and all documents relative thereto; also, securities, funds, choses in action, and any all other forms of property, whether real, personal or mixed and any right or interest of the undersigned therein or thereto.

**15.** That in the event of any change or modification with respect to: (a) the amount or duration of the Credit; (b) the time or place of shipment of any relative property; (c) the drawing, negotiation, presentation, acceptance, or maturity of any drafts, acceptances or other documents, or (d) any of the other terms or provisions of the Credit, such being done at the request of the undersigned, this Agreement shall be binding upon the undersigned in all respects with regard to the Credit so changed or modified, inclusive of any action taken by you or any of your correspondents relative thereto.

**16.** That you may assign or transfer the Agreement, or any instrument (s) evidencing all or any of the aforesaid obligations and/or liabilities, and may deliver all or any of the property then held as security therefor, to the transferee (s), who shall thereupon become vested with all the powers and rights in respect thereto given you herein or in the instrument (s) transferred, and you shall thereafter be forever relieved and fully discharged from any liability or responsibility with respect thereto, but you shall retain all rights and powers hereby given with respect to any and all instrument (s), rights or property not so transferred.

**17.** No delay on your part in exercising any power of sale or any other rights or options hereunder, and no notice or demand, which may be given to or made upon the undersigned by you with respect to any power of sale or other rights or option hereunder, shall constitute a waiver thereof, or limit or impair your right to take any action or to exercise any power of sale, or any other rights or options hereunder, without notice or demand, or prejudice your rights as against the undersigned in any respect.

**18.** If for any reason or cause, you are required to effect payment of any amount in foreign currencies under the credits issued for our account, and if for whatever reason or cause such currencies are or become subject to any form of control or restrictions, we assume full responsibility for any and all consequences arising by reason of such restrictions or controls and we undertake to pay such price as may be necessary, and/or to use all possible means to purchase ourselves, or to enable you to purchase at your option and from such market of your choice, the foreign currency required in adequate amounts and in such conditions of transferability as to enable you to settle our debt to you in full for the principal amount and additional charges and expenses.

**19.** The word "draft" as used in this contract shall mean and include all drafts, receipts and/or other documents required and/or negotiated under any credit.

**20.** This Agreement shall be binding upon the undersigned, the heirs, executors, administrators, successors and assigns of the undersigned, and shall inure to the benefit of, and be enforceable by, you, your successors, transferees and assigns. If this Agreement should be terminated or revoked by operation of law as to the undersigned, the undersigned will indemnify and save you harmless from any loss which may be suffered or incurred by you in acting hereunder prior to the receipt by you, or your successors, transferees or assigns, of notice in writing of such termination or revocation. If this Agreement is executed by two or more parties, they shall be severally liable hereunder, and the word "undersigned" wherever used herein shall be construed to refer to each of such parties separately, all in the same manner and with the same effect as if each of them had signed separate instruments; and in any such case, this Agreement shall not be revoked or impaired as to any one or more of such parties by the death of any of the others or by the revocation or release of any obligations hereunder of any one or more of such other parties.

**21.** Except as far as otherwise expressly stated, this documentary credit is subject to the "Uniform Customs and Practice for Documentary Credits" (1974 Revision), International Chamber of Commerce (Brochure No. 290).

Very truly yours,

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Signature of Applicant

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Date

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Address



**Universal Bank sal**

Heliopolis Bldg., Verdun Street  
P.O.Box 113-5024 Beirut, Lebanon  
Telex: 21798 LE  
Telephone: 315691,315697  
Capital: L.L. 15,000,000 fully paid  
R.C. Beirut 38861 - L.B. 42

**NOTIFICATION OF  
IRREVOCABLE  
DOCUMENTARY CREDIT**

Number

Ref. No. of Advising Bank  
Place and date of notification

Issuing Bank	Beneficiary
Ref. No. of Issuing Bank	Amount

*Handwritten: MEN*

We have been informed by our aforementioned correspondent that the abovementioned documentary credit has been issued in your favour. Please find enclosed the advice intended for you.

Please check the credit terms carefully. In the event that you do not agree with the terms and conditions or if you feel unable to comply with any of the terms and conditions, please arrange an amendment of the credit through your contracting party (the applicant for the credit).

- This notification and the enclosed advice are sent to you without engagement on our part.
- As requested by our correspondent, we hereby confirm the abovementioned Credit.

*Handwritten signature*



## Universal Bank sal

Heliopolis Bldg., Verdun Street • P.O.Box 113-5024 Beirut, Lebanon  
R.C. Beirut 38861 • L.B. 42 • Tel. 315691, 315697

### TRUST RECEIPT

SPECIMEN

Beirut, \_\_\_\_\_

The undersigned (hereinafter called the "Trustee") hereby acknowledges receipt from the UNIVERSAL BANK Beirut, (hereinafter called the "Entruster") of the documents listed below representing the goods therein specified, a security interest in both said documents and said goods remaining in or hereby passing to the Entruster.

In consideration of such receipt and other valuable consideration, the Trustee agrees to hold said documents and goods in trust for the Entruster and subject to its security interests, to be used promptly by the Trustee without expense to the Entruster for the purpose of selling said goods or manufacturing and selling said goods, but for no other purpose and without liberty to pledge the same.

The Trustee agrees to account by delivering to the Entruster, immediately upon the receipt thereof by the Trustee, the proceeds of the sale of such goods in whatever form received, to be applied by the Entruster under the terms of its Letter of Credit No. \_\_\_\_\_ issued for the Trustee's account and/or to the payment of any obligations for which said goods and documents are security or were security before this transaction and of any obligations arising as part of this transaction and of any renewals of any such obligations. If such proceeds be notes, bills receivable, acceptances, or in any form other than cash, they shall not be so applied by the Entruster until paid; the Entruster, however, to have the option at any time to sell or discount such items and so apply, conditionally upon final payment of such items, the net proceeds thereof.

The Trustee agrees to pay all charges in connection with said goods, documents and any proceeds thereof, and will at all times hold said goods, documents, and proceeds thereof, and will at all times hold said goods, documents, and proceeds separate and apart from the property of the Trustee and will definitely show such separation in all its records and entries.

The Trustee undertakes to keep the said goods fully insured at the Trustee's expense under his blanket insurance policy, and to remit to the Entruster proceeds of claims under such insurance in respect of damage to the said goods.

The Entruster may at any time cancel this trust and bailment and take possession of said goods, manufactured or unmanufactured, and any documents representing the same (until delivery of said goods and documents to the purchaser (s) pursuant to a sale hereby authorized and the receipt by the Trustee of the proceeds of such sale) and the proceeds of any sale, wherever said goods, manufactured or unmanufactured, documents, or proceeds may then be found. As to articles manufactured by style or model, the Trustee's interest therein may be forfeited, at the election of the Entruster, in the event of any default on the part of the Trustee, against cancellation to the extent and as provided by law of the Trustee's then remaining indebtedness with respect to such articles.

The Trustee agrees that the Entruster assumes no responsibility for the correctness, validity, or genuineness of the documents released to the Trustee hereunder or for the existence, character, quantity, quality, condition, value, or delivery of any goods purported to be represented by any of such documents.

No waiver of any rights or powers of the Entruster or consent by it shall be valid unless in writing signed by it. The rights and powers herein given the Entruster are in addition to those otherwise created.

EXHIBIT 4

SPECIMEN

This form is to be completed and returned to Universal Bank if transfer with no substitution of invoices is desired.

June 22, 19..

Universal Bank,  
Verdun Street,  
Beirut,  
Lebanon.

Gentlemen:

With reference to your Letter of Credit No. 0004/222 we hereby transfer all rights therein to the extent of \$10,000.00 to Standard Machine Co., Anytown, N.J. against shipment of merchandise as specified in the credit subject to the terms and conditions of said credit.

Please notify the transferee of this transfer and of the terms and conditions thereof.

Enclosed is the original Letter of Credit so that you may endorse the transfer thereon.

To cover your commission for making this transfer, please debit our account.

Yours very truly  
General Trading Co.

.....  
\_\_\_\_\_  
Vice-President

## Reprint of

## UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS

(1962 REVISION)

## THE INTERNATIONAL CHAMBER OF COMMERCE BROCHURE NO. 222

## GENERAL PROVISIONS AND DEFINITIONS

a. These provisions and definitions and the following articles apply to all documentary credits and are binding upon all parties hereto unless otherwise expressly agreed.

b. For the purposes of such provisions, definitions and articles the expressions "documentary credit(s)" and "credit(s)" used herein mean any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and in accordance with the instructions of a customer (the applicant for the credit), is to make payment to or to the order of a third party (the beneficiary) is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or authorizes such payments to be made or such drafts be paid, accepted or negotiated by another bank, against stipulated documents and compliance with stipulated terms and conditions.

c. Credits, by their nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts.

d. Credit instructions and the credits themselves must be complete and precise and, in order to guard against confusion and misunderstanding, issuing banks should discourage any attempt by the applicant for the credit to include excessive detail.

e. When the bank first entitled to avail itself of an option it enjoys under the following articles does so, its decision shall be binding upon all the parties concerned.

f. A beneficiary can in no case avail himself of the contractual relationships existing between banks or between the applicant and the issuing bank.

## A.—FORM AND NOTIFICATION OF CREDITS

Article 1.—Credits may be either

- a) revocable, or
- b) irrevocable.

All credits, therefore, should clearly indicate whether they are revocable or irrevocable.

In the absence of such indication the credit shall be deemed to be revocable, even though an expiry date is stipulated.

Article 2.—A revocable credit does not constitute a legally binding undertaking between the bank or banks concerned and the beneficiary because such a credit may be modified or cancelled at any moment without notice to the beneficiary.

When, however, a revocable credit has been transmitted to and made available at a branch or other bank, its modification or cancellation shall become effective only upon receipt of notice thereof by such branch or other bank and shall not affect the right of that branch or other bank to be reimbursed for any payment, acceptance or negotiation made by it prior to receipt of such notice.

Article 3.—An irrevocable credit is a definite undertaking on the part of an issuing bank and constitutes the engagement of that bank to the beneficiary or, as the case may be, to the beneficiary and bona fide holders of drafts drawn and/or documents presented in accordance with the provisions for payment, acceptance or negotiation contained in the credit will be duly fulfilled, provided that all the terms and conditions of the credit are complied with.

An irrevocable credit may be advised to a beneficiary through another bank without engagement on the part of that other bank (the advising bank), but when an issuing bank authorizes another bank to confirm its irrevocable credit and the latter does so, such confirmation constitutes a definite undertaking on the part of the confirming bank either that the provisions for payment or acceptance will be duly fulfilled or, in the case of a credit available by negotiation of drafts, that the confirming bank will negotiate drafts without recourse to the issuing bank.

Such undertakings can neither be modified nor cancelled without the agreement of all concerned.

Article 4.—When an issuing bank instructs a bank by cable, telegram or telex to notify a credit and the original letter of credit is to be the operative credit instrument, the issuing bank must send the original letter of credit, and any subsequent amendments thereto to the beneficiary through the notifying bank.

The issuing bank will be responsible for any consequences arising from its failure to follow this procedure.

Article 5.—When a bank is instructed by cable, telegram or telex to issue, confirm or advise a credit similar in terms to one previously established and which has been the subject of amendments, it shall be understood that the details of the credit being issued, confirmed or advised will be transmitted to the beneficiary excluding the amendments, unless the instructions specify clearly any amendments which are to apply.

Article 6.—If incomplete or unclear instructions are received to issue, confirm or advise a credit, the bank requested to act on such instructions may give preliminary notification of the credit to the beneficiary for information only and without responsibility; and in that event the credit will be issued, confirmed or advised only when the necessary information has been received.

## B.—LIABILITIES AND RESPONSIBILITIES

Article 7.—Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit.

Article 8.—In documentary credit operations all parties concerned deal in documents and not in goods.

Payment, acceptance or negotiation against documents which appear on their face to be in accordance with the terms and conditions of a credit by a bank authorized to do so, binds the party giving the authorization to take up the documents and reimburse the bank which has effected the payment, acceptance or negotiation.

If upon receipt of the documents, the issuing bank considers that they appear on their face not to be in accordance with the terms and conditions of the credit, that bank must determine, on the basis of the documents alone, whether to claim that payment, acceptance or negotiation was not effected in accordance with the terms and conditions of the credit.

If such claim is to be made, notice to that effect, stating the reasons therefor, must be given by cable or other expeditious means to the bank from which the documents have been received and such notice must state that the documents are being held at the disposal of such bank or are being returned thereto. The issuing bank shall have a reasonable time to examine the documents.

**Article 9.**—Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented thereby, or for the good faith or acts and/or omissions, solvency, performance or standing of the consignor, the carriers or the insurers of the goods or any other person whomsoever.

**Article 10.**—Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any messages, letters or documents, or for delay, mutilation or other errors arising in the transmission of cables, telegrams or telex, or for errors in translation or interpretation of technical terms, and banks reserve the right to transmit credit terms without translating them.

**Article 11.**—Banks assume no liability or responsibility for consequences arising out of the interruption of their business by strikes, lock-outs, riots, civil commotions, insurrections, wars, Acts of God or any other causes beyond their control. Unless specifically authorized, banks will not effect payment, acceptance or negotiation after expiration under credits expiring during such interruption of business.

**Article 12.**—Banks utilizing the services of another bank for the purpose of giving effect to the instructions of the applicant for the credit do so for the account and at the risk of the latter.

They assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank.

The applicant for the credit shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages.

### C.—DOCUMENTS

**Article 13.**—All instructions to issue, confirm or advise a credit must state precisely the documents against which payment, acceptance or negotiation is to be made.

Terms such as "first class", "well known", "qualified" and the like shall not be used to describe the issuers of any documents called for under credits and if they are incorporated in the credit terms banks will accept documents as presented without further responsibility on their part.

#### Documents evidencing Shipment or Despatch (Shipping Documents)

**Article 14.**—Except as stated in Article 18, the date of the Bill of Lading, or date indicated in the reception stamp or by notation on any other document evidencing shipment or despatch, will be taken in each case to be the date of shipment or despatch of the goods.

**Article 15.**—If the words "freight paid" or "freight prepaid" appear by stamp or otherwise on documents evidencing shipment or despatch they will be accepted as constituting evidence of the payment of freight.

If the words "freight prepayable" or "freight to be prepaid" or words of similar effect appear by stamp or otherwise on such documents they will not be accepted as constituting evidence of the payment of freight.

Unless otherwise specified in the credit or inconsistent with any of the documents presented under the credit, banks may honour documents stating that freight or transportation charges are payable on delivery.

**Article 16.**—A clean shipping document is one which bears no superimposed clause or notation which expressly declares a defect of condition of the goods and/or the packaging.

Banks will refuse shipping documents bearing such clauses or notations unless the credit expressly states clauses or notations which may be accepted.

#### Marine Bills of Lading

**Article 17.**—Unless specifically authorized in the credit, Bills of Lading of the following nature will be rejected:

- a) Bills of Lading issued by forwarding agents.
- b) Bills of Lading which are issued under and are subject to the conditions of a Charter-Party.
- c) Bills of Lading covering shipment by sailing vessels.

However, unless otherwise specified in the credit, Bills of Lading of the following nature will be accepted:

- a) "Port" or "Custody" Bills of Lading for shipments of cotton from the United States of America.
- b) "Through" Bills of Lading issued by steamship companies or their agents even though they cover several modes of transport.

**Article 18.**—Unless otherwise specified in the credit, Bills of Lading must show that the goods are loaded on board.

Loading on board may be evidenced by an on board Bill of Lading or by means of a notation to that effect dated and signed or initialled by the carrier or his agent, and the date of this notation shall be regarded as the date of loading on board and shipment.

**Article 19.**—Unless transhipment is prohibited by the terms of the credit, Bills of Lading will be accepted which indicate that the goods will be transhipped enroute, provided the entire voyage is covered by one and the same Bill of Lading.

Bills of Lading incorporating printed clauses stating that the carriers have the right to tranship will be accepted notwithstanding the fact that the credit prohibits transhipment.

**Article 20.**—Banks will refuse a Bill of Lading showing the stowage of goods on deck, unless specifically authorized in the credit.

**Article 21.**—Banks may require the name of the beneficiary to appear on the Bill of Lading as shipper or endorser, unless the terms of the credit provide otherwise.

### Other Shipping Documents, etc.

*Article 22.*—Banks will consider a Railway or Inland Waterway Bill of Lading or Consignment Note, Counterfoil Waybill, Post Receipt, Certificate of Mailing, Air Mail Receipt, Air Transportation Waybill, Air Consignment Note or Air Receipt, Trucking Company Bill of Lading or any other similar document as regular when such document bears the reception stamp of the carrier or issuer, or when it bears a signature.

*Article 23.*—When a credit calls for an attestation or certification of weight in the case of transport other than by sea, banks will accept a weight stamp or any other official indication of weight on the shipping documents unless the credit calls for a separate or independent certificate of weight.

### Insurance Documents

*Article 24.*—Insurance documents must be as specifically described in the credit, and must be issued and/or signed by insurance companies or their agents or by underwriters.

Cover notes issued by brokers will not be accepted, unless specifically authorized in the credit.

*Article 25.*—Unless otherwise specified in the credit, banks may refuse any insurance documents presented if they bear a date later than the date of shipment as evidenced by the shipping documents.

*Article 26.*—Unless otherwise specified in the credit, the insurance document must be expressed in the same currency as the credit.

The minimum amount for which insurance must be effected is the CIF value of the goods concerned. However, when the CIF value of the goods cannot be determined from the documents on their face, banks will accept as such minimum amount the amount of drawing under the credit or the amount of the relative commercial invoice, whichever is the greater.

*Article 27.*—Credits must expressly state the type of insurance required and, if any, the additional risks which are to be covered. Imprecise terms such as "usual risks" or "customary risks" shall not be used.

Failing specific instructions, banks will accept insurance cover as tendered.

*Article 28.*—When a credit stipulates "insurance against all risks", banks will accept an insurance document which contains a "all risks" notation or clause, and will assume no responsibility if any particular risk is not covered.

*Article 29.*—Banks may accept an insurance document which indicates that the cover is subject to a franchise, unless it is specifically stated in the credit that the insurance must be issued irrespective of percentage.

### Commercial Invoices

*Article 30.*—Unless otherwise specified in the credit, commercial invoices must be made out in the name of the applicant for credit.

Unless otherwise specified in the credit, banks may refuse invoices issued for amounts in excess of the amount permitted by credit.

The description of the goods in the commercial invoice must correspond with the description in the credit. In the remaining documents the goods may be described in general terms.

### Other Documents

*Article 31.*—When other documents are required, such as Warehouse Receipts, Delivery Orders, Consular Invoices, Certificates of Origin, of Weight, of Quality or of Analysis, etc., without further definition, banks may accept such documents as tendered, without responsibility on their part.

## D.—MISCELLANEOUS PROVISIONS

### Quantity and Amount

*Article 32.*—The words "about", "circa" or similar expressions are to be construed as allowing a difference not to exceed 10% more or 10% less, applicable, according to their place in the instructions, to the amount of the credit or to the quantity or unit price of the goods.

Unless a credit stipulates that the quantity of the goods specified must not be exceeded or reduced, a tolerance of 3% more or less will be permissible, always provided that the total amount of the drawings does not exceed the amount of the credit. This tolerance does not apply when the credit specifies quantity in terms of packing units or containers or individual items.

### Partial Shipments

*Article 33.*—Partial shipments are allowed, unless the credit specifically states otherwise.

Shipments made on the same ship and for the same voyage, even if the Bills of Lading evidencing shipment "on board" bear different dates, will not be regarded as partial shipments.

*Article 34.*—If shipment by instalments within given periods is stipulated and any instalment is not shipped within the period allowed for that instalment, the credit ceases to be available for that or any subsequent instalment, unless otherwise specified in the credit.

### Validity and Expiry Date

*Article 35.*—All irrevocable credits must stipulate an expiry date for presentation of documents for payment, acceptance or negotiation, notwithstanding the indication of a latest date for shipment.

*Article 36.*—The words "until" and words of similar import applying to the expiry date for presentation of documents for payment, acceptance or negotiation, the stipulated latest date for shipment, will be understood to include the date mentioned.

*Article 37.*—When the stipulated expiry date falls on a day on which banks are closed for reasons other than those mentioned in Article 11, the period of validity will be extended until the first following business day.

This does not apply to the date for shipment which, if stipulated, must be respected.

Banks paying, accepting or negotiating on such extended expiry date must add to the documents their certification in the following wording:

"Presented for payment (or acceptance or negotiation as the case may be) within the expiry date extended in accordance with Article 37 of the Uniform Customs."

**Article 38.**—The validity of a revocable credit, if no date is stipulated, will be considered to have expired six months from the date of the notification sent to the beneficiary by the bank with which the credit is available.

**Article 39.**—Unless otherwise expressly stated, any extension of the stipulated latest date for shipment shall extend for an equal period the validity of the credit.

Where a credit stipulates a latest date for shipment, an extension of the period of validity shall not extend the period permitted for shipment unless otherwise expressly stated.

#### Shipment, Loading or Despatch

**Article 40.**—Unless the terms of the credit indicate otherwise, the words "departure", "despatch", "loading" or "sailing" used in stipulating the latest date for shipment of the goods will be understood to be synonymous with "shipment".

Expressions such as "prompt", "immediately", "as soon as possible" and the like should not be used. If they are used, banks will interpret them as a request for shipment within thirty days from the date on the advice of the credit to the beneficiary by the issuing bank or by an advising bank, as the case may be.

#### Presentation

**Article 41.**—Documents must be presented within a reasonable time after issuance. Paying, accepting or negotiating banks may refuse documents if, in their judgment, they are presented to them with undue delay.

**Article 42.**—Banks are under no obligation to accept presentation of documents outside their banking hours.

#### Date Terms

**Article 43.**—The terms "first half", "second half" of a month shall be construed respectively as from the 1st to the 15th, and the 16th to the last day of each month, inclusive.

**Article 44.**—The terms "beginning", "middle" or "end" of a month shall be construed respectively as from the 1st to the 10th, the 11th to the 20th, and the 21st to the last day of each month, inclusive.

**Article 45.**—When a bank issuing a credit instructs that the credit be confirmed or advised as available "for one month", "for six months" or the like, but does not specify the date from which the time is to run, the confirming or advising bank will confirm or advise the credit as expiring at the end of such indicated period from the date of its confirmation or advice.

### E.—TRANSFER

**Article 46.**—A transferable credit is a credit under which the beneficiary has the right to give instructions to the bank called upon to effect payment or acceptance or to any bank entitled to effect negotiation to make the credit available in whole or in part to one or more third parties (second beneficiaries).

A credit can be transferred only if it is expressly designated as "transferable" by the issuing bank. Terms such as "divisible", "fractionable", "assignable" and "transmissible" add nothing to the meaning of the term "transferable" and shall not be used.

A transferable credit can be transferred once only. Fractions of a transferable credit (not exceeding in the aggregate the amount of the credit) can be transferred separately, provided partial shipments are not prohibited, and the aggregate of such transfers will be considered as constituting only one transfer of the credit. The credit can be transferred only on the terms and conditions specified in the original credit, with the exception of the amount of the credit, of any unit price stated therein, and of the period of validity or period for shipment, any or all of which may be reduced or curtailed. Additionally, the name of the first beneficiary can be substituted for that of the applicant for the credit, but if the name of the applicant for the credit is specifically required by the original credit to appear in any document other than the invoice, such requirement must be fulfilled.

The first beneficiary has the right to substitute his own invoices for those of the second beneficiary, for amounts not in excess of the original amount stipulated in the credit and for the original unit prices stipulated in the credit, and upon such substitution of invoices the first beneficiary can draw under the credit for the difference, if any, between his invoices and the second beneficiary's invoices. When a credit has been transferred and the first beneficiary is to supply his own invoices in exchange for the second beneficiary's invoices but fails to do so on demand, the paying, accepting or negotiating bank has the right to deliver to the issuing bank the documents received under the credit, including the second beneficiary's invoices, without further responsibility to the first beneficiary.

The first beneficiary of a transferable credit can transfer the credit to a second beneficiary in the same country, but if he is to be permitted to transfer the credit to a second beneficiary in another country this must be expressly stated in the credit. The first beneficiary shall have the right to request that payment or negotiation be effected to the second beneficiary at the place to which the credit has been transferred, up to and including the expiry date of the original credit, and without prejudice to the first beneficiary's right subsequently to substitute his own invoices for those of the second beneficiary and to claim any difference due to him.

The bank requested to effect the transfer, whether it has confirmed the credit or not, shall be under no obligation to make such transfer except to the extent and in the manner expressly consented to by such bank, and until such bank's charges for transfer are paid.

Bank charges entailed by transfers are payable by the first beneficiary unless otherwise specified.

**NOTE:** In the U.S.A. the Definitions of Export Quotations, which are now in wide use, are known as the "Revised American Foreign Trade Definitions—1941" adopted July 30, 1941.

The adherence of the United States banks, which have subscribed to these regulations, is effective July 1, 1963.

## EXHIBIT 6

## REVISED AMERICAN FOREIGN TRADE DEFINITIONS — 1941

Adopted July 30, 1941, by a Joint Committee representing the Chamber of Commerce of the United States of America, the National Council of American Importers, Inc., and the National Foreign Trade Council, Inc.

## FOREWORD

Since the issuance of *American Foreign Trade Definitions* in 1919, many changes in practice have occurred. The 1919 Definitions did much to clarify and simplify foreign trade practice, and received wide recognition and use by buyers and sellers throughout the world. At the Twenty-Seventh National Foreign Trade Convention, 1940, further revision and clarification of these Definitions was urged as necessary to assist the foreign trader in the handling of his transactions.

The following *Revised American Foreign Trade Definitions - 1941* are recommended for general use by both exporters and importers. These revised definitions have no status at law unless there is specific legislation providing for them, or unless they are confirmed by court decisions. Hence, it is suggested that sellers and buyers agree to their acceptance as part of the contract of sale. These revised definitions will then become legally binding upon all parties.

In view of changes in practice and procedure since 1919, certain new responsibilities for sellers and buyers are included in these revised definitions. Also, in many instances, the old responsibilities are more clearly defined than in the 1919 Definitions, and the changes should be beneficial both to sellers and buyers. Widespread acceptance will lead to a greater standardization of foreign trade procedure, and to the avoidance of much misunderstanding.

Adoption by exporters and importers of these revised terms will impress on all parties concerned their respective responsibilities and rights.

## GENERAL NOTES OF CAUTION

1. As foreign trade definitions have been issued by organizations in various parts of the world, and as the courts of countries have interpreted these definitions in different ways, it is important that sellers and buyers agree that their contracts are subject to the *Revised American Foreign Trade Definitions - 1941* and that the various points listed are accepted by both parties.
2. In addition to the foreign trade terms listed herein, there are terms that are at times used, such as Free Harbor, C.I.F. & C. (Cost, Insurance, Freight, and Commission), C.I.F.C. & I. (Cost Insurance, Freight, Commission, and Interest), C.I.F. Landed (Cost, Insurance, Freight, Landed), and others. None of these should be used unless there has first been a definite understanding as to the exact meaning thereof. It is unwise to attempt to interpret other terms in the light of the terms given herein. Hence, whenever possible, one of the terms defined herein should be used.
3. It is unwise to use abbreviations in quotations or in contracts which might be subject to misunderstanding.
4. When making quotations, the familiar terms "hundredweight" or "ton" should be avoided. A hundredweight can be 100 pounds of the short ton, or 112 pounds of the long ton. A ton can be a short ton of 2,000 pounds, or a metric ton of 2,204.6 pounds, or a long ton of 2,240 pounds. Hence the type of hundredweight or ton should be clearly stated in quotations and in sales confirmations. Also, all terms referring to quantity, weight, volume, length, or surface should be clearly defined and agreed upon.
5. If inspection, or certificate of inspection, is required, it should be agreed, in advance, whether the cost thereof is for account of seller or buyer.
6. Unless otherwise agreed upon, all expenses are for the account of seller up to the point at which the buyer must handle the subsequent movement of goods.
7. There are a number of elements in a contract that do not fall within the scope of these foreign trade definitions. Hence, no mention of these is made herein. Seller and buyer should agree to these separately when negotiating contracts. This particularly applies to so-called "customary" practices.

## DEFINITIONS OF QUOTATIONS

## (I) EX (Point of Origin)

"Ex Factory", "Ex Mill", "Ex Mine", "Ex Plantation", "Ex Warehouse", etc. (named point of origin)

Under this term, the price quoted applies only at the point of origin, and the seller agrees to place the goods at the disposal of the buyer at the agreed place on the date or within the period fixed.

Under this quotation:

Seller must

- (1) bear all costs and risks of the goods until such time as the buyer is obliged to take delivery thereof;
- (2) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) take delivery of the goods as soon as they have been placed at his disposal at the agreed place on the date or within the period fixed;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) bear all costs and risks of the goods from the time when he is obligated to take delivery thereof;
- (4) pay all costs and charges incurred in obtaining the documents issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.



## (II) F.O.B. (Free on Board)

*Note: Seller and buyer should consider not only the definitions but also the "Comments on All F.O.B. Terms" given at end of this section (page 73), in order to understand fully their respective responsibilities and rights under the several classes of "F.O.B." terms.*

**(II-A) "F.O.B. (named inland carrier at named inland point of departure)"\***

Under this term, the price quoted applies only at inland shipping point, and the seller arranges for loading of the goods on, or in railway cars, trucks, lighters, barges, aircraft, or other conveyance furnished for transportation.

Under this quotation:

Seller must

- (1) place goods on, or in, conveyance, or deliver to inland carrier for loading;
- (2) provide clean bill of lading or other transportation receipt, freight collect;
- (3) be responsible for any loss or damage, or both, until goods have been placed in, or on, conveyance at loading point, and clean bill of lading or other transportation receipt has been furnished by the carrier;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) be responsible for all movement of the goods from inland point of loading, and pay all transportation costs;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) be responsible for any loss or damage, or both, incurred after loading at named inland point of departure;
- (4) pay all costs and charges incurred in obtaining the documents issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

**(II-B) "F.O.B. (named inland carrier at named inland point of departure) Freight Prepaid To (named point of exportation)"\***

Under this term, the seller quotes a price including transportation charges to the named point of exportation and prepays freight to named point of exportation, without assuming responsibility for the goods after obtaining a clean bill of lading or other transportation receipt at named inland point of departure.

Under this quotation:

Seller must

- (1) assume the seller's obligations as under II-A, except that under (2) he must provide clean bill of lading or other transportation receipt, freight prepaid to named point of exportation.

Buyer must

- (1) assume the same buyer's obligations as under II-A, except that he does not pay freight from loading point to named point of exportation.

**(II-C) "F.O.B. (named inland carrier at named inland point of departure) Freight Allowed To (named point)"\***

Under this term, the seller quotes a price including the transportation charges to the named point, shipping freight collect and deducting the cost of transportation, without assuming responsibility for the goods after obtaining a clean bill of lading or other transportation receipt at named inland point of departure.

Under this quotation:

Seller must

- (1) assume the same seller's obligations as under II-A, but deducts from his invoice the transportation cost to named point.

Buyer must

- (1) assume the same buyer's obligations as under II-A, including payment of freight from inland loading point to named point, for which seller has made deduction.

**(II-D) "F.O.B. (named inland carrier at named point of exportation)"\***

Under this term, the seller quotes a price including the costs of transportation of the goods to named point of exportation, bearing any loss or damage, or both, incurred up to that point.

Under this quotation:

Seller must

- (1) place goods on, or in, conveyance, or deliver to inland carrier for loading;
- (2) provide clean bill of lading or other transportation receipt, paying all transportation costs from loading point to named point of exportation;
- (3) be responsible for any loss or damage, or both, until goods have arrived in, or on, inland conveyance at the named point of exportation;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

\* See Note above and Comments on all F.O.B. Terms (page 73).

**Buyer must**

- (1) be responsible for all movement of the goods from inland conveyance at named point of exportation;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) be responsible for any loss or damage, or both, incurred after goods have arrived in, or on, inland conveyance at the named point of exportation;
- (4) pay all costs and charges incurred in obtaining the documents issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

**II-E) "F.O.B. Vessel (named port of shipment)"\*\***

Under this term, the seller quotes a price covering all expenses up to, and including, delivery of the goods upon the overseas vessel provided by, or for, the buyer at the named port of shipment.

**Under this quotation:****Seller must**

- (1) pay all charge incurred in placing goods actually on board the vessel designated and provided by, or for, the buyer on the date or within the period fixed;
- (2) provide clean ship's receipt or on-board bill of lading;
- (3) be responsible for any loss or damage, or both, until goods have been placed on board the vessel on the date or within the period fixed;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

**Buyer must**

- (1) give seller adequate notice of name, sailing date, loading berth of, and delivery time to, the vessel;
- (2) bear the additional costs incurred and all risk, of the goods from the time when the seller has placed them at his disposal if the vessel named by him fails to arrive or to load within the designated time;
- (3) handle all subsequent movement of the goods to destination:
  - (a) provide and pay for insurance;
  - (b) provide and pay for ocean and other transportation;
- (4) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (5) be responsible for any loss or damage, or both, after goods have been loaded on board the vessel;
- (6) pay all costs and charges incurred in obtaining the documents, other than clean ship's receipt or bill of lading, issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

**II-F) "F.O.B. (named inland point in country of importation)"\*\***

Under this term, the seller quotes a price including the cost of the merchandise and all costs of transportation to the named inland point in the country of importation.

**Under this quotation:****Seller must**

- (1) provide and pay for all transportation to the named inland point in the country of importation;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) provide and pay for marine insurance;
- (4) provide and pay for war risk insurance, unless otherwise agreed upon between the seller and buyer;
- (5) be responsible for any loss or damage, or both, until arrival of goods on conveyance at the named inland point in the country of importation;
- (6) pay the costs of certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or of both, which the buyer may require for the importation of goods into the country of destination and, where necessary, for their passage in transit through another country;
- (7) pay all costs of landing, including wharfage, landing charges, and taxes, if any;
- (8) pay all costs of customs entry in the country of importation;
- (9) pay customs duties and all taxes applicable to imports, if any, in the country of importation.

*The seller under this quotation must realize that he is accepting important responsibilities, costs, and risks, and should therefore be certain to obtain adequate insurance. On the other hand, the importer or buyer may desire such quotations to relieve him of the risks of the voyage and to assure him of his landed costs at inland point in country of importation. When competition is keen, or the buyer is accustomed to such quotations from other sellers, seller may quote such terms, being careful to protect himself in an appropriate manner.*

**Buyer must**

- (1) take prompt delivery of goods from conveyance upon arrival at destination;
- (2) bear any costs and be responsible for all loss or damage, or both, after arrival at destination.

### Comments On All F.O.B. Terms

In connection with F.O.B. terms, the following points of caution are recommended:

1. The method of inland transportation, such as trucks, railroad cars, lighters, barges, or aircraft should be specified.
2. If any switching charges are involved during the inland transportation, it should be agreed, in advance, whether these charges are for account of the seller or the buyer.
3. The term "F.O.B. (named port)", without designating the exact point at which the liability of the seller terminates and the liability of the buyer begins, should be avoided. The use of this term gives rise to disputes as to the liability of the seller or the buyer in the event of loss or damage arising while the goods are in port, and before delivery to or on board the ocean carrier. Misunderstandings may be avoided by naming the specific point of delivery.
4. If lighterage or trucking is required in the transfer of goods from the inland conveyance to ship's side, and there is a cost therefor, it should be understood, in advance, whether this cost is for account of the seller or the buyer.
5. The seller should be certain to notify the buyer of the minimum quantity required to obtain a carload, a truckload, or a barge-load freight rate.
6. Under F.O.B. terms, excepting "F.O.B. (named inland point in country of importation)", the obligation to obtain ocean freight space, and marine and war risk insurance, rests with the buyer. Despite this obligation on the part of the buyer, in many trades the seller obtains the ocean freight space, and marine and war risk insurance, and provides for shipment on behalf of the buyer. Hence, seller and buyer must have an understanding as to whether the buyer will obtain the ocean freight space, and marine and war risk insurance as is his obligation, or whether the seller agrees to do this for the buyer.
7. For the seller's protection, he should provide in his contract of sale that marine insurance obtained by the buyer include standard warehouse to warehouse coverage.

### (III) F.A.S. (Free Along Side)

Note: Seller and buyer should consider not only the definitions but also the "Comments" given at the end of this section, in order to understand fully their respective responsibilities and rights under "F.A.S." terms.

#### "F.A.S. Vessel (named port of shipment)"

Under this term, the seller quotes a price including delivery of the goods along side overseas vessel and within reach of its loading tackle.

Under this quotation:

Seller must

- (1) place goods along side vessel or on dock designated and provided by or for buyer on the date or within the period fixed; pay any heavy lift charges, where necessary, up to this point;
- (2) provide clean dock or ship's receipt;
- (3) be responsible for any loss or damage, or both, until goods have been delivered along side the vessel or on the dock;
- (4) render the buyer, at the buyer's request and expense, assistance in obtaining the documents issued in the country of origin, or of shipment, or of both, which the buyer may require either for purposes of exportation, or of importation at destination.

Buyer must

- (1) give seller adequate notice of name, sailing date, loading berth of, and delivery time to, the vessel;
- (2) handle all subsequent movement of the goods from along side the vessel:
  - (a) arrange and pay for demurrage or storage charges, or both, in warehouse or on wharf, where necessary;
  - (b) provide and pay for insurance;
  - (c) provide and pay for ocean and other transportation;
- (3) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (4) be responsible for any loss or damage, or both, while the goods are on a lighter or other conveyance along side vessel within reach of its loading tackle, or on the dock awaiting loading, or until actually loaded on board the vessel, and subsequent thereto;
- (5) pay all costs and charges incurred in obtaining the documents, other than clean dock or ship's receipt, issued in the country of origin, or of shipment, or of both, which may be required either for purposes of exportation, or of importation at destination.

### F.A.S. Comments

1. Under F.A.S. terms, the obligation to obtain ocean freight space, and marine and war risk insurance, rests with the buyer. Despite this obligation on the part of the buyer, in many trades the seller obtains ocean freight space, and marine and war risk insurance, and provides for shipment on behalf of the buyer. In others, the buyer notifies the seller to make delivery along side a vessel designated by the buyer and the buyer provides his own marine and war risk insurance. Hence, seller and buyer must have an understanding as to whether the buyer will obtain the ocean freight space, and marine and war risk insurance, as is his obligation, or whether the seller agrees to do this for the buyer.

2. For the seller's protection, he should provide in his contract of sale that marine insurance obtained by the buyer include standard warehouse to warehouse coverage.

### (IV) C. & F. (Cost and Freight)

Note: Seller and buyer should consider not only the definitions but also the "C. & F. Comments" and the "C. & F. and C.I.F. Comments" in order to understand fully their respective responsibilities and rights under "C. & F." terms.

**"C. & F. (named point of destination)"**

Under this term, the seller quotes a price including the cost of transportation to the named point of destination.

Under this quotation:

**Seller must**

- (1) provide and pay for transportation to named point of destination;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) obtain and dispatch promptly to buyer, or his agent, clean bill of lading to named point of destination;
- (4) where received-for-shipment ocean bill of lading may be tendered, be responsible for any loss or damage, or both, until goods have been delivered into the custody of the ocean carrier;
- (5) where on-board ocean bill of lading is required, be responsible for any loss or damage, or both, until the goods have been delivered on board the vessel;
- (6) provide, at the buyer's request and expense, certificates of origin, consular invoices, or any other documents issued in country of origin, or of shipment, or of both, which the buyer may require for importation of goods into country of destination and where necessary, for their passage in transit through another country.

**Buyer must**

- (1) accept the documents when presented;
- (2) receive goods upon arrival, handle and pay for all subsequent movement of the goods, including taking delivery from vessel in accordance with bill of lading clauses and terms; pay all costs of landing, including any duties, taxes, and other expenses at named point of destination;
- (3) provide and pay for insurance;
- (4) be responsible for loss of or damage to goods, or both, from time and place at which seller's obligations under (4) or above have ceased;
- (5) pay the costs of certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or of both, which may be required for the importation of goods into the country of destination and, where necessary, their passage in transit through another country.

**C. & F. Comments**

1. For the seller's protection, he should provide in his contract of sale that marine insurance obtained by the buyer include storage warehouse to warehouse coverage.

2. The comments listed under the following C.I.F. terms in many cases apply to C. & F. terms as well, and should be read and understood by the C. & F. seller and buyer.

**(V) C.I.F. (Cost, Insurance, Freight)**

*Note: Seller and buyer should consider not only the definitions but also the "Comments" at the end of this section, in order to understand fully their respective responsibilities and rights under "C.I.F." terms.*

**"C.I.F. (named point of destination)"**

Under this term, the seller quotes a price including the cost of the goods, the marine insurance, and all transportation charges to the named point of destination.

Under this quotation:

**Seller must**

- (1) provide and pay for transportation to named point of destination;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) provide and pay for marine insurance;
- (4) provide war risk insurance as obtainable in seller's market at time of shipment at buyer's expense, unless seller has agreed to provide for war risk coverage [See Comment 10 (c)];
- (5) obtain and dispatch promptly to buyer, or his agent, clean bill of lading to named point of destination, and also insurance policy or negotiable insurance certificate;
- (6) where received-for-shipment ocean bill of lading may be tendered, be responsible for any loss or damage, or both, until goods have been delivered into the custody of the ocean carrier;
- (7) where on-board ocean bill of lading is required, be responsible for any loss or damage, or both, until the goods have been delivered on board the vessel;
- (8) provide, at the buyer's request and expense, certificates of origin, consular invoices, or any other documents issued in country of origin, or of shipment, or of both, which the buyer may require for importation of goods into country of destination and, where necessary, for their passage in transit through another country.

**Buyer must**

- (1) accept the documents when presented;

- (2) receive the goods upon arrival, handle and pay for all subsequent movement of the goods, including taking delivery from vessel in accordance with bill of lading clauses and terms; pay all costs of landing, including any duties, taxes, and other expenses at named point of destination;
- (3) pay for war risk insurance provided by seller;
- (4) be responsible for loss of or damage to goods, or both, from time and place at which seller's obligations under (6) or (7) above have ceased;
- (5) pay the cost of certificates of origin, consular invoices, or any other documents issued in the country of origin, or of shipment, or both, which may be required for importation of the goods into the country of destination and, where necessary, for their passage in transit through another country.

### C. & F. and C.I.F. Comments

Under C. & F. and C.I.F. contracts there are the following points on which the seller and the buyer should be in complete agreement at the time that the contract is concluded:

1. It should be agreed upon, in advance, who is to pay for miscellaneous expenses, such as weighing or inspection charges.
2. The quantity to be shipped on any one vessel should be agreed upon, in advance, with a view to the buyer's capacity to take delivery upon arrival and discharge of the vessel within the free time allowed at the port of importation.
3. Although the terms C. & F. and C.I.F. are generally interpreted to provide that charges for consular invoices and certificates of origin are for the account of the buyer, and are charged separately, in many trades these charges are included by the seller in his price. Hence, seller and buyer should agree, in advance, whether these charges are part of the selling price, or will be invoiced separately.
4. The point of final destination should be definitely known in the event the vessel discharges at a port other than the actual destination of the goods.
5. When ocean freight space is difficult to obtain, or forward freight contracts cannot be made at firm rates, it is advisable that sales contracts, as an exception to regular C. & F. or C.I.F. terms, should provide that shipment within the contract period be subject to ocean freight space being available to the seller, and should also provide that changes in the cost of ocean transportation between the time of sale and the time of shipment be for account of the buyer.
6. Normally, the seller is obligated to prepay the ocean freight. In some instances, shipments are made freight collect and the amount of the freight is deducted from the invoice rendered by the seller. It is necessary to be in agreement on this, in advance, in order to avoid misunderstanding which arises from foreign exchange fluctuations which might affect the actual cost of transportation, and from interest charges which might accrue under letter of credit financing. Hence, the seller should always prepay the ocean freight unless he has a specific agreement with the buyer, in advance, that goods can be shipped freight collect.
7. The buyer should recognize that he does not have the right to insist on inspection of goods prior to accepting the documents. The buyer should not refuse to take delivery of goods on account of delay in the receipt of documents, provided the seller has used due diligence in their dispatch through the regular channels.
8. Sellers and buyers are advised against including in a C.I.F. contract any indefinite clause at variance with the obligations of a C.I.F. contract as specified in these Definitions. There have been numerous court decisions in the United States and other countries invalidating C.I.F. contracts because of the inclusion of indefinite clauses.
9. Interest charges should be included in cost computations and should not be charged as a separate item in C.I.F. contracts, unless otherwise agreed upon, in advance, between the seller and buyer; in which case, however, the term C.I.F. and I. (Cost, Insurance, Freight, Interest) should be used.
10. In connection with insurance under C.I.F. sales, it is necessary that seller and buyer be definitely in accord upon the following points:
  - (a) The character of the marine insurance should be agreed upon in so far as being W.A. (With Average) or F.P.A. (Free of Particular Average), as well as any other special risks that are covered in specific trades, or against which the buyer may wish individual protection. Among the special risks that should be considered and agreed upon between seller and buyer are theft, pilferage, leakage, breakage, sweat, contact with other cargoes, and others peculiar to any particular trade. It is important that contingent or collect freight and customs duty should be insured to cover Particular Average losses, as well as total loss after arrival and entry but before delivery.
  - (b) The seller is obligated to exercise ordinary care and diligence in selecting an underwriter that is in good financial standing. However, the risk of obtaining settlement of insurance claims rests with the buyer.
  - (c) War risk insurance under this term is to be obtained by the seller at the expense and risk of the buyer. It is important that the seller be in definite accord with the buyer on this point, particularly as to the cost. It is desirable that the goods be insured against both marine and war risk with the same underwriter, so that there can be no difficulty arising from the determination of the cause of the loss.
  - (d) Seller should make certain that in his marine or war risk insurance, there be included the standard protection against strikes, riots and civil commotions.
  - (e) Seller and buyer should be in accord as to the insured valuation, bearing in mind that merchandise contributes in General Average on certain bases of valuation which differ in various trades. It is desirable that a competent insurance broker be consulted, in order that full value be covered and trouble avoided.

### (VI) Ex Dock

#### (VI) "Ex Dock (named port of importation)"

**NOTE:** Seller and buyer should consider not only the definitions but also the "Ex Dock Comments" at the end of this section (page 76), in order to understand fully their respective responsibilities and rights under "Ex Dock" terms.

Under this term, seller quotes a price including the cost of the goods and all additional costs necessary to place the goods on the dock at the named port of importation, duty paid, if any.

Under this quotation:

**Seller must**

- (1) provide and pay for transportation to named port of importation;
- (2) pay export taxes, or other fees or charges, if any, levied because of exportation;
- (3) provide and pay for marine insurance;
- (4) provide and pay for war risk insurance, unless otherwise agreed upon between the buyer and seller;
- (5) be responsible for any loss or damage, or both, until the expiration of the free time allowed on the dock at the named port of importation;
- (6) pay the costs of certificates of origin, consular invoices, legalization of bill of lading, or any other documents issued in the country of origin, or of shipment, or of both, which the buyer may require for the importation of goods into the country of destination and, where necessary, for their passage in transit through another country;
- (7) pay all costs of landing, including wharfage, landing charges, and taxes, if any;
- (8) pay all costs of customs entry in the country of importation;
- (9) pay customs duties and all taxes applicable to imports, if any, in the country of importation, unless otherwise agreed.

**Buyer must**

- (1) take delivery of the goods on the dock at the named port of importation within the free time allowed;
- (2) bear the cost and risk of the goods if delivery is not taken within the free time allowed.

**Ex Dock Comments**

This term is used principally in United States import trade. It has various modifications, such as "Ex Quay", "Ex Pier", etc. It is seldom, if ever, used in American export practice. Its use in quotations for export is not recommended.

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