

## **LETTER OF CREDIT (L/C): JURIDICAL REVIEW IN EXPORT-IMPORT TRADE PAYMENT TRANSACTION IN INDONESIA**

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### **Abstract**

*The purpose of this study is to analyze: 1) What is the meaning of Letter of Credit? 2) What is the legal basis for using Letter of Credit in export-import trade payment transactions? The research method used is normative juridical with a statutory approach, concept approach, and case studies. The results showed that: 1) The term Letter of Credit is also called documentary of credit in English, and in Indonesian it is used with the term documented credit. In general, Letters of Credit are used to finance long-distance sales contracts between buyers and sellers who do not know each other well. 2) Letter of Credit regulation in Indonesia is regulated based on Government Regulation No. 1 of 1982, and Bank Indonesia Regulation No. 26/34/external debt dated December 17, 1993 concerning Letter of Credit. A letter of credit is a conditional guarantee and is a letter issued by the issuing bank at the request of the importer submitted to another bank in the exporting country for the benefit of the exporter in which the exporter is given the right to withdraw money orders on the importer concerned in the amount of money stated in the guarantee letter.*

**Keywords:** Letter of Credit (L/C), Review, Juridical, Transaction, Payment, Trade Export, Import, Indonesia.

## **INTRODUCTION**

### **Background**

International business transactions are the study of private law, where in private law, the law provides wider opportunities for each party to make, agree and implement the clauses they make.<sup>1</sup> However, it cannot be denied that in order to be able to carry out these business activities, the parties must carefully understand and understand the legal rules that exist in the opposing State<sup>2</sup>. This will greatly affect the implementation of the agreement

One of the important issues associated with the success of international trade transactions is the use of payment methods that in practice are usually specified in contracts. In international trade between buyers (importers) and sellers (exporters) are in different places, separated by long distances so that each other may not meet each other directly in transactions. In such circumstances, it certainly makes it difficult for the parties to make payments and receive payments. It could even be that each party has different preferences in making payments or receiving payments.<sup>3</sup>

In international trade, the interests of the parties, both as sellers and as buyers, must be different and want to prioritize their own interests. As a seller it is in his interest to control and control his goods

until he accepts the price agreed in the contract. In addition, the seller is interested so that payment can be received immediately without having to wait long even though the goods are still on the way. On the other hand, it is in the buyer's interest not to immediately pay the amount of money he promised according to the contract as long as he has not checked the goods whether they comply with the specifications stated in the contract or at least there is written evidence that the goods have been shipped.<sup>4</sup>

Foreign trade transactions better known as export-import are essentially simple transactions and are nothing more than buying and selling goods between entrepreneurs located in different countries. Related to this phenomenon, there are interesting things that can be studied, namely about the way of selling and paying for products which are often the source of problems. For example, in international trade, sellers and buyers have different environmental backgrounds in terms of politics, economy, social, culture, and so on. Therefore, each party has concerns that its counterparty does not carry out its obligations as agreed and of course any such possibility is a risk for each party. The risk is related to the delivery of goods by the seller to the buyer and the payment of the price of goods by the buyer to the seller, when and how the delivery of goods and payment should be made, so that each party feels safe, depending on the relationship and trust of both parties. Therefore, in international trade there are several payment methods.

In order to bridge the two interests between sellers and buyers, the role of banks in international trade is needed in terms of payment. One of the payment systems known in international trade is the *documentary credits system* which is also known as a *letter of credit (L/C<sup>5</sup>)*. The legal basis for the enactment of L/C is regulated in the *Uniform Customs & Practice for Documentary Credits (UCPDC)* Publication of the *International Chamber of Commerce (ICC)* No.600 which took effect on July 1, 2007. While in Indonesia the legal basis of L/C is regulated in Government Regulation No.1 of 1982.

Understanding the mechanism of a Letter of Credit is important, especially in terms of import-export trade transactions, so that various issues can be resolved that may arise in the future. For this reason, it is necessary to understand how the process of opening a Letter of Credit as a guarantee in international trade. The process begins with a sale and purchase contract between the seller and buyer which requires the opening of a Letter of Credit as a method of payment. The buyer then submits a Letter of Credit application to the foreign exchange bank in his country for the benefit of the seller. The issuing bank will send a Letter of Credit to the user's beneficiary through its correspondent bank in the seller's country. The advising bank then notifies the user that he has opened a Letter of Credit.<sup>6</sup>

### **Problem Statement**

- 1) What is the meaning of a *Letter of Credit*?
- 2) What is the legal basis for using a *Letter of Credit* in export-import trade payment transactions?

### **THEORETICAL FRAMEWORK**

#### **1) Theory of Legal Certainty**

Legal certainty is judicial protection against arbitrary actions, which means that a person will be able to obtain something expected under certain circumstances. The community expects legal certainty, because with legal certainty the community will be more orderly. The law is tasked with creating legal certainty because it aims at public order.<sup>7</sup> Adherents of positive legal theory assert "legal certainty" as the goal of law. According to their assumption of order or order, it is impossible to exist without definite lines of life behavior. Order will only exist if there is certainty and for legal certainty to be made in a definite form (written).<sup>8</sup>

According to Utrecht, legal certainty contains two understandings, namely first, the existence of general rules that make individuals know what actions can or cannot be done, and second, in the form of legal security for individuals from government security because with the existence of general rules individuals can know what can be imposed or done by the state on individuals.<sup>9</sup>

## 2) Basic Theory of International Trade Law

The fundamental principles known in international trade law were introduced by international trade law scholar Professor Aleksander Goldštajn. He introduced these three basic principles, namely (1) the principle of *freedom of the parties to contract*; (2) the principle of *pacta sunt servanda*; and (3) the principle of use of arbitration.<sup>10</sup>

**Freedom of contract**, in fact, is a universal principle in international trade law. Every legal system in the field of commercial law recognizes the freedom of these parties to make (international) trade contracts.<sup>11</sup> Such freedom covers a fairly wide area of law. It includes the freedom to perform the types of contracts that the parties agree on. It also includes the freedom to choose its trade dispute resolution forum. It also includes the freedom to choose which laws will apply to the contract, etc. This freedom must certainly not contradict the law, public interest, decency, decency, and other requirements set by each legal system.<sup>12</sup>

**Pacta sunt servanda**, is a principle that requires that an agreement or contract that has been signed must be executed properly (in good faith). This principle is also universal. Every legal system in the world respects this principle. Then, the use of the principle of **arbitration** seems to sound a bit odd. Nevertheless, Goldštajn's confession calls this principle not without good reason. Arbitration in international trade is an increasingly commonly used dispute resolution forum. Arbitration clauses have been increasingly included in trade contracts. Therefore, this third principle is indeed relevant.

## RESEARCH METHODOLOGY

This type of research is normative law research *using* normative case studies in the form of legal behavior products. The subject of study is the law which is conceptualized as a norm or rule that applies in society and becomes a reference for everyone's behavior. So that normative legal research focuses on the inventory of positive law, legal principles and doctrines, legal findings in cases *in concreto*, legal systematics, levels of synchronization, comparative law and legal history.<sup>13</sup>

There are several approaches to legal research, with this approach researchers will get information from various aspects about the issues they are trying to find answers to. The approach method in this study is the approach to laws and regulations (*statue aproach*).<sup>14</sup> A normative research must certainly use a statutory approach, because what will be examined are various legal rules that are the focus as well as the central theme of a study.

In accordance with Soerjono Soekanto's opinion<sup>15</sup>, normative legal research is research that includes research on legal principles, research on legal systematics, research on legal synchronization, legal history research, and comparative legal research, in order to answer legal problems or issues to be studied. Normative legal research examines legal rules or regulations as a system building related to a legal event. This research was conducted with the intention of providing legal argumentation as a basis for determining whether an event has been true or false according to law.<sup>16</sup>

The data collection method in this study is carried out by literature study, which is a way of collecting data by searching and reviewing library materials (literature, research results, scientific magazines, scientific bulletins, scientific journals etc.). Legal materials are collected through inventory procedures and identification of laws and regulations, as well as classification and systematization of legal materials according to research problems.<sup>17</sup>

## RESEARCH RESULTS

### Definition of Letter Of Credit

The term *Letter of Credit* is also called *documentary of credit* in English, and in Indonesian it is used with the term *documented credit*. In general, *Letters of Credit* are used to finance long-distance sales contracts between buyers and sellers who do not know each other well. In principle, *Letters of Credit* are used to finance international trade transactions. In terminology, *a Letter of Credit is a letter issued by a foreign exchange bank at the request of the importer, a customer of the foreign exchange bank concerned, addressed to exporters outside the country who are relatives of the import, where the contents of the letter state that the exporter receives a Letter of Credit is given the right by the importer to withdraw a warrant to settle the debt on the opening bank for the amount of money referred to in the letter. Agoes Moerjono, defines a Letter of Credit as an engagement between a bank that issues a Letter of Credit and an exporter who enjoys the benefits of a Letter of Credit.*<sup>18</sup>

Another definition mentioned by experts, namely Amir, M.S. in his book *Letter of Credit in the Export-Import Business*, states that *a Letter of Credit* or commonly called *L/C* is a letter issued by a foreign exchange bank at the request of the import of the foreign exchange bank customer concerned and addressed to exporters abroad who are relations of the importer. The contents of the letter state that the *L/C* receiving exporter is entitled by the importer to withdraw a money order (an order to settle debts) on the importer concerned for the amount of money referred to in the letter. The bank concerned guarantees to accept or honor the withdrawn money order as long as it meets and meets all the conditions stated in the letter.<sup>19</sup>

Bank Indonesia defines a *Letter of Credit* as *a promise from the issuing bank to pay a sum of money to the exporter as long as the exporter can meet the terms and conditions of the Letter of Credit*. Apart from the two definitions above, *a Letter of Credit can also be defined as a contract in which a bank (issuing bank) acts on the request and order of a customer (applicant for a Letter of Credit) who is domiciled as an importer to make payments to the exporting party (exporter) or third party (beneficiary).*<sup>20</sup>

From the definitions presented by each *Letter of Credit*, the principle has the same meaning even though different formulations and editors. So it can be concluded that *a Letter of Credit* is a conditional payment guarantee which is a letter issued by a *bank (issuing bank) at the request of the importer addressed to other banks in the exporting country (advising/negotiating bank) for the benefit of the exporter (beneficiary)* where the exporter is entitled to withdraw the money order at the expense of the importer concerned in the amount of money stated in the letter.<sup>21</sup>

The parties generally involved in opening an *L/C* are:

- 1) *Opener or applicant* is an importer who asks for help from his foreign exchange bank to open *L/C* for the needs of sellers or exporters.
- 2) *Opening bank or issuing bank* is a bank that is required by the importer to open an *L/C* for the needs of the exporter.
- 3) *Advising* is a correspondent bank that is obliged to convey the mandate contained in the *L/C* to the exporter.
- 4) *Beneficiary* is an exporter who receives an opening *L/C* and is given the right to withdraw money from available *L/C* funds or is referred to as an *L/C* recipient.

- 5) *Negotiating* bank where in the issuance of L/C it is usually stated that the beneficiary may cash (negotiate shipping documents) through any bank he likes as long as he meets the L/C requirements.<sup>22</sup>

#### Legal Basis for the Use of *Letters of Credit* in Export-Import Trade Payment Transactions

Settings *Letter of Credit* in Indonesia is regulated based on Government Regulation No. 1 of 1982, and Bank Indonesia Regulation No. 26/34/external debt dated December 17, 1993 concerning *Letter of Credit*. *Letter of Credit* is a conditional guarantee and is a letter issued by the issuing bank at the request of the importer submitted to another bank in the exporting country for the benefit of the exporter in which the exporter is given the right to withdraw money orders on the importer concerned in the amount of money stated in the guarantee letter.<sup>23</sup> Purpose *Letter of Credit* to provide assurance and security for each party. For exporters, it is guaranteed to get payment for the goods sold with the provisions of the terms and conditions in *Letter of Credit* has been fulfilled, while the importer will get a guarantee that the money will not be paid to the exporter before all the terms and conditions *Letter of Credit* fulfilled by exporters. It should be understood that embassy *Letter of Credit* It is a separate transaction with Sales Kontrak which is the basis for publishing *Letter of Credit*, and is in no way related to contracts made by exporters and importers.<sup>24</sup>

Then, the explanation of the Letter of Credit (L/C) contained in the provisions of BI Regulation No. 5 / PBI / 2003 concerning Payment of Import Transactions in article 1 point 3 states that "*Letter of Credit hereinafter referred to as Letter of Credit is a promise to pay from the issuing bank to the recipient if the recipient submits to the issuing bank documents in accordance with the requirements of the letter of Credit*". And contained in the Regulation of the Minister of Trade of the Republic of Indonesia Number 94 of 2018 concerning Provisions for the Use of *Letters of Credit* for the Export of Certain Goods.<sup>25</sup>

As mentioned in the previous discussion point, when issuing *Lettr of Credit*, there are several parties who have their respective roles and functions, namely: (a). *Applicant (buyer, importer, accountee, consignee)*, namely the party who asks the bank to open a *Letter of Credit* on its behalf, and the applicant's position in international trade transactions as a buyer. (b). *Beneficiary (seller, exporter, consignor, vendor)* i.e.: to whom the *letter of credit* is issued or the party receiving the *Letter of Credit*. *Beneficiary* position in international trade transactions as a seller.<sup>26</sup> (c). *Opening Bank (issuing bank)* means a bank that opens or issues a *Letter of Credit* at the request of the *applicant*. *The letter of credit* opened by the opening bank based on the application for opening the *Lettr of Credit* submitted by the *appliance* must be a foreign exchange bank. This foreign exchange bank provides guarantees to exporters, therefore the value of the Letter of Credit *depends on the good name and reputation of the foreign exchange bank that opens the Letter of Credit*. (d). *Advising bank (comfirming bank)* means a bank that forwards the *Letter of Credit* received from the opening bank to the beneficiary (seller).<sup>27</sup>

Payment methods by applying a *Letter of Credit* (L/C) are first made on the sales contract. The definition of a sales contract is a document or letter of agreement between the seller and the buyer which is part of the *follow-up* of the *purchase order* billed by the buyer or importer. Where the contents consist of a prerequisite, fulfillment of a payment for goods to be sold, such as price, quality, quantity of goods, procedures for taking goods, insurance payments and others. By applying the clause of the procedure for fulfilling a payment using a Letter of Credit *in a contract, after that the buyer (importer) offers a Letter of Credit application to the foreign exchange bank in his country (opening bank)*.<sup>28</sup>

In practice, opening a bank opens a *Letter of Credit* for exporters through other banks in the exporting country that are correspondents of the opening bank. The correspondence bank is obliged to convey the mandate contained in the *Letter of Credit* to the rightful exporter. Therefore, the correspondent

bank is called Advising Bank, or trustee bank. (e). Negotiating bank, namely the bank that will make purchases or negotiate on drafts or money orders and shipping documents belonging to the seller (usually advising banks are also negotiating banks). The purpose of the negotiation conducted by the negotiating bank is to make payments to the beneficiary and thus become the bona fide holder of the documents that have been taken over. (f). Reimbursing bank, i.e. the bank that makes repayments to the negotiating bank on the *Letter of Credit* redeemed.<sup>29</sup>

Legal relations are relationships that occur between one legal subject and another legal subject and or between legal subjects and legal objects that occur in a society where the relationship is governed by law and therefore there are rights and obligations between parties in legal relations. General provisions of the agreement using a *Letter of Credit* in Import Export. The fulfillment of the achievements of the engagement must be carried out by both parties. Based on Article 1233 of the Civil Code, states that an engagement is "*tiap-every engagement is born either by consent, either by law*". The export-import agreement is connected with the provisions of the Civil Code, can be seen in the provisions of the third (three) book on Engagement that adheres to an open system. Article 1313 of the Civil Code states that an agreement is "*an act by which one or more persons bind themselves against one or more other persons*". An agreement made by the parties is inseparable from the principle of freedom of contract. Based on Article 1338 Paragraph (1) of the Civil Code, states that "*All agreements made validly apply as law to those who make them*".

The parties, both customers and issuing banks, have their own obligations that must be fulfilled. The Bank is obliged to issue a letter of credit in accordance with what has been agreed with the customer, namely the importer and the customer is obliged to make payments for a number of costs incurred for the issuance of the *letter of credit* and other costs incurred due to issuance. The parties already have a bond in the form of a legal relationship born from the L/C issuance agreement. All provisions in the agreement must be fulfilled, namely the fulfillment of the rights and obligations of each party. This is because there is an agreement made by the customer and the issuing bank which is marked by the signing of the agreement, so that the agreement is valid and has legal force to be executed.<sup>30</sup>

In conducting international trade, there are general provisions for how to pay a *Letter of Credit*, namely UCP. UCP is one form of the International Chamber of Commerce (ICC). The ICC was stationed in Paris in 1919 to serve the world in providing trade, oil investment, capital flows, and opening markets for goods and services.<sup>31</sup>

In the 1970s Indonesian banking activities have used this UCP as a standard in terms of trade. It is stated in SEBI No. 26/34/external debt 17/12/1993 that the L/C issued by the Bank can be said to be exempt to the Bank in Indonesia to be subject or not subject to this UCP. If the L/C is subject to the UCP, therefore in order for this UCP to have a binding legal effect on this L/C, the issuing bank needs an action to write a clause in this L/C which has the intention based on Article 1 of UCP No. 600/2007, namely:

*"Uniform Customs and Practice for Documentary Credit (UCP) Revision of July 1, 2007 No.600, shall apply to all "documentary credits" (including Standby Letters of Credit to the extent to which these UCPS may be applied) where in the text of such credits expressly states that such credits are subject to Uniform Customs and Practice for Documentary Credit, 2007 Revision, International Chamber of Commerce (ICC) Publication No. 600. UCP is binding on all parties concerned, unless expressly provided otherwise in such credit"*<sup>32</sup>

As for weaknesses in transactions using Letters of Credit, in this case the bank is only responsible for documents and the bank is not responsible for an item, or other applications. The following is based on Article 5 and Article 14a of uniform duties and practices for credit documentation of 600, if where

a foundation is based on the principle of commitment in the document on a Letter of Credit transaction.

In *Uniform Customs & Practice for Documentary Credits* 600 Article 5 UCP 600 which reads "*Banks deal with documents and not with goods, services or performance to which the documents may relate.*"

Thus the above article fully states that the bank is not responsible for a good, service or performance from the implementation of the master agreement rather than *Documentary Credit*. If in the future a dispute grows in line with the implementation of the master agreement, the bank cannot be aligned regarding the dispute because the bank is only responsible for the documents on the *Documentary Credit* only. In addition, based on an understanding of absolute suitability, documents that are a requirement in *Documentary Credit must be completed properly. Material or non-material disputes between the Documentary Credit and the documents presented by the recipient may not be made.* In the event of a dispute, neither the issuing bank nor its proxy is obliged to fulfill a *Documentary Credit* payment to the beneficiary. Thus, increasing international trade will increase the intensity of export-import payment traffic between countries in the world. The most secure payment system and viewed from the point of view of the size of the risk faced in export transactions is the use of *Letters of Credit (L/C)*. *Letter of Credit* as one of the documents, occupies a very strategic position as a means of collecting other shipping documents.<sup>33</sup> Another weakness in the Letter of Credit is about Embezzlement which is contained in the provisions of Article 372 of the Criminal Code. Embezzlement is the act of stealing objects owned by others, either partially or completely, because the management of the goods is in the hands of the perpetrator and the ownership is legal.<sup>34</sup>

Legal protection in the form of prevention can be provided to the parties to prevent losses that can be experienced by the parties involved in the agreement, while repressive legal protection is provided if losses have occurred. In the issuance of a *letter of credit*, the parties, both customers and issuing banks, may suffer losses if one party violates or does not implement the provisions contained in the agreement. This can bring losses in large amounts. The Civil Code has stipulated in article 1338 that all agreements made validly have the same force as law for both parties. Therefore, in the laws and regulations, it is clearly stipulated that the agreement that has been agreed by the parties must be implemented as appropriate. If there are parties who feel aggrieved because the other party in the agreement does not carry out their performance, they can process the problem through litigation channels to get legal protection. In filing a lawsuit in court, strong evidence is needed to support the legal process that will run.<sup>35</sup>

## **CONCLUSION**

The results showed that;

- a) The term *Letter of Credit* is also called *documentary of credit* in English, and in Indonesian it is used with the term *documented credit*. In general, *Letters of Credit* are used to finance long-distance sales contracts between buyers and sellers who do not know each other well.
- b) *Letter of Credit regulation in Indonesia is regulated based on Government Regulation No. 1 of 1982, and Bank Indonesia Regulation No. 26/34/external debt dated December 17, 1993 concerning Letter of Credit. A letter of credit is a conditional guarantee and is a letter issued by the issuing bank at the request of the importer submitted to another bank in the exporting country for the benefit of the exporter in which the exporter is given the right to withdraw money orders on the importer concerned in the amount of money stated in the guarantee letter.*

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