

LETTER OF CREDIT

Clause for inclusion in the contract of sale between buyer and seller providing for payment by way of letter of credit.

General note

Under a letter of credit a bank agrees to pay a seller, in connection with the export of specific goods, against the presentation of specified documents relating to those goods. The letter of credit is issued in favour of the seller, who is the beneficiary of the letter of credit. A letter of credit is thus the 'means of payment' for the sale of specific goods. This clause is therefore drafted for inclusion in the underlying contract of sale between the buyer and seller.

LETTER OF CREDIT – THE CLAUSE

Unless otherwise agreed between the parties, the price of any Goods sold pursuant to this agreement shall be secured by an irrevocable letter of credit satisfactory to the Seller, established by the Buyer in favour of the Seller [immediately upon receipt of the Seller's acceptance of the Buyer's order **OR** within [NUMBER] days of the date of the conclusion of the contract] and confirmed by a [United Kingdom] bank acceptable to the Seller. The letter of credit shall be for the price payable for the Goods (together with any tax or duty payable) to the Seller and shall be valid for [six months]. The Seller shall be entitled to [immediate cash payment] on presentation to such [United Kingdom] bank of the documents set out in Schedule [NUMBER] to this agreement.

Details of the clause: sentence 1

Payment by letter of credit

This express provision creates the legally binding obligation on the buyer to open a letter of credit in favour of the seller. In the absence of such an express provision, the seller is unable to insist on a letter of credit as the payment method of the underlying contract.

Type of letter of credit

In this case an irrevocable, straight, confirmed and sight credit. It is imperative that the seller specifies exactly the nature of the letter of credit required. The buyer is only obliged to provide the type of letter of credit that has been agreed by the parties and set out by them in the underlying agreement. Revocable letters of credit are rarely used today.

Confirmation by UK bank

Under a confirmed letter of credit, the confirming bank (a UK bank acceptable to the seller) will be required to add its own undertaking to pay the price of the goods to the seller if the seller produces the requisite documents. This requirement increases the seller's security, as the seller now has a right of action against a second bank (whose name and jurisdiction may be more familiar).

Time of opening of the letter of credit

The clause clearly states when the letter of credit is to be opened: "immediately upon receipt of the Seller's acceptance of the Buyer's order", or within a defined period after the contract is concluded. If the parties fail to specify such a time, the general legal view is that the courts will imply that the letter of credit should be provided to the seller within a reasonable time before the earliest shipping date under the contract. However, the parties should not rely on this rather uncertain common law view.

Details of the clause: sentence 2 (expiry of the letter of credit)

The second sentence of the clause specifies how long the letter of credit is to be open for, so that the seller can claim the contractual price of the goods in exchange for the specified documents any time within the six month period. This provides an element of certainty for the buyer and the seller.

An unnecessarily long lifetime will increase the charges levied by the banks, while too short a period will necessitate applying for extensions.

Details of the clause: sentence 3 (documents and payment)

The last sentence of the clause specifies that the seller will be entitled to immediate cash payment on presentation of the documents (a sight credit). This is a simple method of payment which does not allow the buyer any period of credit. Such a period of credit could have been achieved by providing for payment by way of a bill of exchange (aka a time bill) drawn on and accepted by the confirming bank.

The documents that the seller will be required to produce will be set out in the underlying contract and the letter of credit. The documents (for example invoice, transport documents, insurance documents) will vary from case to case, and may depend primarily on the nature of the underlying contract, for example 'FOB' (i.e. free on board). FOB is a typical term providing for the buyer to procure a ship leaving the seller's country and the seller to ship them on board free of charges and costs prior to loading. The risk passes at the point when the carrier takes possession.