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SECURITY WHEN EXPORTING

Letter of Credit, Surety, Guarantee, Commercial Credit Insurance, Bill of Lading, etc.

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DOING THE RIGHT THING

INTRODUCTION

How do you secure your export business? With a soft or hard letter of comfort, suretyship, (bank) guarantee, commercial credit insurance, Hermes cover, documentary collection, export factoring, advance payment or perhaps with a letter of credit? Organisations such as the International Chamber of Commerce (ICC) offer numerous templates for such instruments, which are supposed to allow an optimal security for the respective individual case (e.g. URDG 758, UCP 600, URC 522). Particularly in light of current uncertainties (e.g. pandemic, Brexit or embargoes), securing exports is of great importance. You can find more details on the possible effects of such radical events on supply chains in our [guideline – "Closer to shorter supply chains!?"](#).

When you have decided to use a letter of credit, the next questions arise: **How does it work? What do you need in the event of default in order to obtain the service?** The security agreements often specify a large number of different documents: bills of lading, waybills, etc. Depending on the type of transport route, the designations vary. This leads to an almost unmanageable number of so-called traditional documents. In international matters, the situation becomes even more complicated. The term bill of lading alone, which is commonplace in the export business, has numerous variations in international traffic: order or bearer bill of lading - shipped or received for shipment – without remarks (clean) or not (claused)?

To help you keep track of the security options for your export business, this guideline gives you insights into the **nine most important security methods**, especially the recently popular **letter of credit**. Followed by explanations of the most common transport documents and their terminology. Finally, we address classic stumbling blocks in export agreements so that you **do the right thing** in your export business right from the start.

Of course, clauses must also be understood in the same way by the parties. **Incoterms** (internationally standardised terms of delivery) are intended to ensure uniform interpretation of contracts. From 1 January 2020, the Incoterms will apply in their eighth version. Details on Incoterms and what will change from 2020 can be found in our [Newsflash – Incoterms® 2020](#).

PAYMENT SECURITY FOR INTERNATIONAL TRANSACTIONS

Internationally, security methods that are absolutely common in Germany, such as the reservation of title, often do not provide any or the desired security. It is certainly possible to choose the law applicable to the contract. However, the question of when and how ownership is transferred is always determined by the law of the country in which the goods are currently located. Depending on the country, the retention of title may therefore be partly inadmissible or subject to further conditions: Registration in Switzerland (Art. 715 SCC); notarised date in Poland, Italy ("*data certa*") and Spain ("*fecha cierta*"). Details on retention of title can be found in our [briefing "International retention of title - is it really of no use?"](#).

However, the contracting parties have a number of other security options at their disposal. You should have the following in mind:

Letter of comfort

In the case of a letter of comfort, a third party (usually the importer's parent company) is the guarantor for the importer's liability. Such a declaration is not standardised by law in Germany. Notarial certification is not necessary.

Depending on the individual case, different obligations may arise, such as financial funding of the importer or the use of possibilities of influence so that the patron can work towards a timely payment (**soft letter of comfort**). If specific payment or performance obligations are provided for, these can also be enforced (**hard letter of comfort**). They arise either between the importer and the guarantor so that the latter can fulfil its payment obligation towards the exporter (normal case) or between the guarantor and the exporter directly; the guarantor and the importer are then jointly and severally liable ("side by side").

Suretyship

Things are different in the case of a suretyship: the surety is only liable

on a subsidiary ("successive") basis. Suretyships are promises by third parties (e.g. a bank or again the parent company) to guarantee the fulfilment of the importer's liability. For example in the case of a directly enforceable suretyship, the surety is then liable in the same way as the principal debtor. Particularly advantageous, however, is the so-called suretyship on first demand, in which the guarantor is unconditionally liable for the payment obligations.

However, these security methods are not always available, especially in international transport. Legal differences are often to blame here (e.g. accessoriness of the surety, exclusion of banks).

Bank guarantee

In the case of a bank guarantee, the bank guarantees by means of a guarantee contract that it is responsible for a certain success or assumes the risk of loss. Here, too, exists the guarantee on first demand. Often it is a **payment guarantee by the importer's bank**. The importer's bank then arises an independent payment obligation towards the exporter as soon as the importer fails to meet its own payment obligation. No further documents need to be submitted in order to enforce the guarantee. However, a possible **inability or unwillingness to pay** on the part of the foreign bank must still be taken into account.

This is circumvented by using a so-called **indirect guarantee**. In this case, the importer is obliged to instruct its bank to issue the guarantee in such a way that it engages a second bank - preferably in Germany - to issue the guarantee. Because the risk is shifted to the importer, this type of guarantee is sometimes called a "suicide guarantee". This is reinforced by the effect that in the event of a legal dispute (e.g. interim injunction proceedings regarding payment) the bank will place itself in the exporter's team with its legal expertise from numerous similar proceedings.

Internationally, bank guarantees are typically concluded on the basis of

the **URDG 758** (Uniform Rules for Demand Guarantees) issued by the International Chamber of Commerce (ICC). The URDG clearly focus on legally secure formulations. According to the practice of German courts, they are subject to the strict general terms and conditions control. In addition to the inclusion requirements, there is another problem: a guarantee on first demand stipulated could be an ineffective clause according to Section 307 of the German Civil Code (*Bürgerliches Gesetzbuch*; ("BGB")) in individual cases. The parameters of the URDG should therefore be agreed individually or at least be part of a separate guarantee agreement. Furthermore, in international trade, legal regulations may prevent a bank guarantee, which was partly the reason for the development of other types of security (see above all US trade: 12 USC Sec. 24 (1988) did not allow banks to issue guarantees, which led to the further development of the so-called standby letter of credit or letters of credit).

Commercial credit insurance

The exporter regularly makes **advance performance** by shipping his goods and therefore grants the importer a kind of "trade credit". The exporter can insure himself against this at banks. The bank first checks the importer's agreement and creditworthiness. If the bank accepts the trade credit insurance at the applicable fees, the exporter can first transfer the claim to the bank in the event of late payment (debt collection) and finally demand a share of his outstanding claim from the bank via the so-called "**protracted default**" (advanced insurance case).

In some cases, however, insurers also offer a kind of claims management and **legal protection** as an additional service, whereby the costs of possibly enforcing the claim in court are covered. In individual cases, this can be a sensible but comparatively slow alternative to a solution via protracted default.

Apart from the costs and discounts of this security method, there is a **security gap** for deliveries to markets with high political and economic risk.

"Hermes cover"

Export credit guarantees issued by the **Federal Government** partially close this gap and are insurance policies that cover not only certain political risks but also commercial risks, including default of payment. The Federal Government uses the Euler Hermes AG and the Pricewaterhouse-Coopers GmbH to issue these guarantees, with the Euler Hermes AG having always been the leader in this cooperation. This is why the term "Hermes cover" is used, although all revenues from this business (from fees, charges) are transferred to the federal budget. The requirements for the acceptance are, among other things

- eligibility (no conflict with fundamental decisions of the Federal Republic of Germany and no violation of legal provisions);
- justifiability in terms of risk;
- special state interest in the implementation of this export transaction;
- no "high probability" of the Federal Government being utilized;
- contract design with conditions customary in foreign trade.

Both, the financing bank (financial credit) and the exporter itself (supplier credit), can apply for such support.

Hermes cover is, however, not for everyone: it is primarily aimed at small and medium-sized enterprises and the deductible can be between 5 and 15%. For more information on the product portfolio and details, as well as an initial assessment of your financing options, go the website: AGAPORTAL.DE.

Letter of credit

Many of the problems of the security methods discussed can be avoided with the letter of credit. The letter of credit is generally the obligation of a bank to pay out to the exporter upon

presentation of certain documents. The process is as follows (see the overview of the confirmed letter of credit, p. 4):

First, a basic transaction (e.g. a purchase contract) is concluded between the exporter and the importer, which contains an agreement on payment processing via a letter of credit. On the basis of this contractual agreement, the importer instructs its bank (letter of credit bank) to open an irrevocable letter of credit in favour of the exporter. The letter of credit bank contacts the exporter's bank (advice bank), which informs (advises) the beneficiary, the exporter. Upon presentation of the agreed documents (such as bills of lading or waybills, more on these documents, see below on p. 5), the exporter receives payment from the usually foreign letter of credit bank. Thus, payment depends only on the **submission of the correct documents**. However, the exporter is still subject to the foreign bank's ability and willingness to pay.

This is different with a **confirmed letter of credit**. Compared to the unconfirmed letter of credit and the payment guarantee of the importer's bank, it offers the advantage that the exporter's domestic bank, the advising bank, "confirms" the promise of payment, thus secures it. The confirmed letter of credit is therefore a relatively secure payment method. All that remains for the exporter is the risk of presenting the delivery documents exactly according to the conditions agreed in the contract.

The letter of credit can also be **revocable**, although this obviously reduces the security function, as the letter of credit bank can unilaterally withdraw from the letter of credit agreement or change the conditions until the documents are submitted.

Documentary collection

The exporter delivers the goods to the country of destination, but not yet to the importer, but to an intermediate point (e.g. a customs warehouse). The exporter's bank then receives the relevant documents to obtain power of disposal over the

goods. The exporter's bank thereupon contacts the importer's bank, which receives the documents and guarantees that the delivery documents will only be handed over to the importer if he pays the amount owed. Until payment is made, the goods can therefore be reclaimed from the exporter if the documents are returned. However, if the importer does not pay, there is no possibility to take action against it. Also, the acceptance of the contract documents by the importer's bank is not guaranteed.

Export factoring

It is also possible to assign the payment claims from the purchase contract in advance to a third party. The enforceability of the claims is then the responsibility of this third party. In some cases, however, high fees may be incurred or collateral may have to be provided to the third party.

Payment in advance

The advance payment offers the **highest security** for the exporter without additional fees. In case of any defaults, the importer bears the risk of enforcing his claims against the contracting party.

Down payment or partial payment is also possible. From the importer's point of view, it makes sense to conclude an advance payment guarantee, which in turn is linked to certain conditions, so that here as well, a certain distribution of risk often takes place.

IN PARTICULAR: THE LETTER OF CREDIT/DOCUMENTARY CREDIT

The letter of credit meets the most important interests of both sides in connection with **payment security**. The exporter gets the security that he will actually be paid after delivery according to the contract. This is because with a letter of credit he no longer has to make **advance performance** by shipping his goods. Instead, he has an independent promise of payment from a bank. The im-

porter, on the other hand, has the security of knowing that its bank will not release payment to the exporter until it submits the correct and complete delivery documents. With these documents, the importer, on the one hand, gains possession of the goods (cf. Sec. 524 p. 1 German Commercial Code (*Handelsgesetzbuch*; "HGB")) and, on the other hand, recognises at an early stage that the delivered goods comply with the agreements in the delivery contract. Accordingly, the letter of credit has enjoyed growing popularity, especially since the financial crisis.

Legal framework: ICC, UCP 600 und eI.UCP 2.0

Legally, a letter of credit is to be classified as a directly enforceable, abstract, conditional promise of payment by the importer's bank, since it exists separately from the underlying transaction. Today, letter of credits are drawn up and processed worldwide almost without exception on the basis of the "Uniform Customs and Practice for Documentary Credits" (UCP) recommended for use by the

International Chamber of Commerce (ICC). This set of rules, which aims at an internationally uniform handling of letter of credits, dates back to 1933 and has been updated several times and most recently in 2007 (as **UCP 600**). If German law is applicable, the conditions must be included in accordance with the provisions on general terms and conditions.

The majority of letter of credit transactions are still conducted in paper. For some time now, the economic players have been striving to modernise the processes and to digitalise them in the process. For example, the annex to UCP 600 (documentary credit) and to URC 522 (documentary collection) provide rules for processing with electronic documents: **eI.UCP** and eI.URC. The eI.UCP were renewed in April 2019 and have been in force since 1 July 2019 in the current version 2.0.

However, digitalisation reaches its limits where the individual legal system does not accept such digital documents. In Germany, Sec. 516 (2)

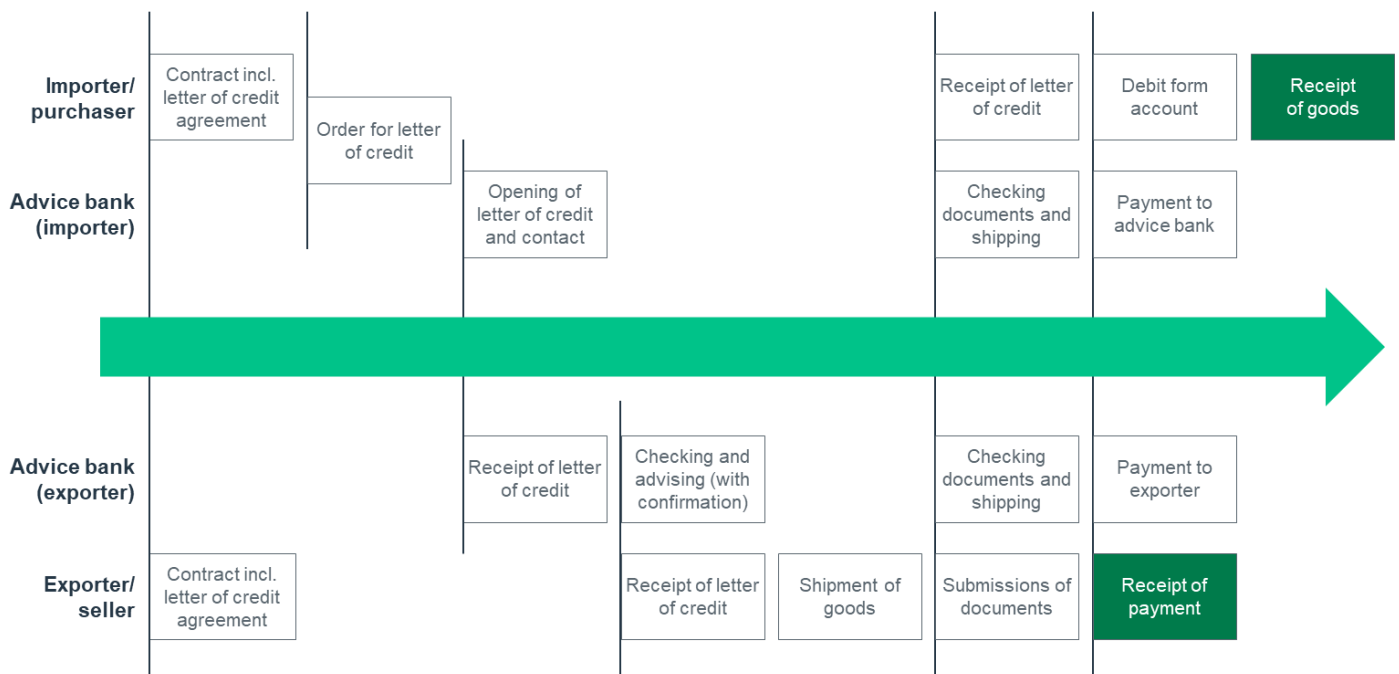
HGB stipulates that electronic records whose authenticity and integrity are ensured are equivalent to paper bills of lading (**electronic bill of lading**; comparable regulations in the USA, for example). In international traffic (e.g. Russia) and even in EU goods traffic (e.g. United Kingdom), however, surprises may well occur.

Deviations and defects of the letter of credit

Upon receipt of the letter of credit, it is essential for the exporter to immediately check the listed conditions to ensure that they correspond with the agreement from the underlying transaction. The following applies: **Clear regulations** in the letter of credit agreement ensure simple handling in the letter of credit process. If deviations or even real deficiencies are not noticed, they can cause the letter of credit to become worthless (you will find a checklist for confirmed irrevocable letters of credit in the info box on p. 5).

OVERVIEW

Confirmed letter of credit



Other functions of a letter of credit

In addition to the security function described above, the letter of credit can also ensure cashless settlement (**payment function**) and the exporter can use the letter of credit for refinancing (**credit function**). Accordingly, this form of security should be on your radar in international trade of goods.

TRANSPORT DOCUMENTS – BILL OF LADING, CONSIGNMENT NOTE AND WAY-BILLS

The disbursement in case of a letter of credit depends on whether the correct documents are submitted in time. It is important that the necessary documents are described as precisely as possible in the basic transaction, i.e. the purchase contract. For this purpose, it is essential that you are aware about the different terminology.

Bill of lading (B/L)

Bill of lading is a term from maritime trade and refers to a traditional document, which is regulated in Germany in Secs. 513-525 HGB. However, the international terminology

may differ from the classic understanding. Internationally the following terms are commonly used for bills of lading, which are often used in combination with each other:

1. Order bill of lading

The bill of lading regularly certifies the claim for delivery of the goods at the port of destination (including claims for damages). In the case of an order bill of lading, the authorised person (cf. Sec. 519 HGB) is the person named as therein or appointed by the authorised person (this can be the importer or exporter).

2. Bearer bill of lading

Entitled here is the mere holder of the bill of lading, without a person being named.

3. Shipped bill of lading

Normally, the bill of lading is an acknowledgement by the carrier to the exporter that the goods to be transported have been taken on board (shipped).

4. Received for shipment bill of lading

The received for shipment bill of lading is to be distinguished from the classic shipped bill of lading, as the latter does not confirm that the goods are already on board,

but only documents receipt at the port.

5. Owner bill of lading

This is a bill of lading issued by the shipowner.

6. Charter party bill of lading

In addition, the bill of lading can also be issued by a "charterer" in addition to the shipowner.

7. Liner bill of lading

This bill of lading is issued for a specific ship route (line) by standard and regularly only by the charterer.

8. Claused/Clean bill of lading

A bill of lading may contain a note about a defect or other remarks (clause). If it does not contain any such entries about any deviations from the delivery note, it is a clean bill of lading.

9. Combined bill of lading

Internationally, it is also possible to issue a uniform combined bill of lading for combined transport methods. The issuer is usually a single entrepreneur/charterer who manages the entire transport.

All these details have to be taken into account in the basic transaction so that the letter of credit can be de

Info box – Checklist for the confirmed irrevocable letter of credit

- ✓ Was the letter of credit opened as agreed (correct schedule, correct parties involved, etc.)?
- ✓ Are all markings, prices, the letter of credit amount, goods descriptions, delivery terms and conditions consistent with the agreement of the underlying transaction?
- ✓ Was the letter of credit issued irrevocably or revocably?
- ✓ Is it possible to obtain all the documents required in the letter of credit timely and to present them in due time (any postal delivery times must also be taken into account)?
- ✓ Are the required transport document and the agreed type of shipment compatible (e.g. bill of lading for sea freight and consignment note/waybill for rail/air freight, taking into account the terminological particularities of international transport)?
- ✓ Has your bank confirmed the letter of credit?
- ✓ Are partial shipments possible (if agreed in the underlying transaction)? What is the procedure to be followed in each case?

signed in a feasible way. The bill of lading required in the contract can therefore be described as a "bearer, shipped, owner" and "clean bill of lading".

Digitisation – el.UCP 2.0 and Blockchain

The el.UCP supplements the UCP so that the letter of credit can be processed in whole or in part by means of electronic documents. However, these regulations only apply if they are explicitly agreed (included) (Art. e1 lit. b el.UCP). The term electronic document ("electronic record") is intentionally defined broadly, but requires - similar to Sec. 516 para. 2 HGB - the authenticity and verifiability of the integrity of the document. If a bank is involved in the transaction and the el.UCP has been agreed, the bank must accept the el.UCP-compliant electronic form (Art. e7 lit. c el.UCP).

The regulations are not tied to the practical implementation. This is mostly done via specialised platforms, whereby the use of these platforms is currently possible mainly for large companies that are already creditworthy.

It would be conceivable to use new technologies such as blockchain instead of platforms. However, this also requires that the individual parties all have access to the digitised documents and that these digitised documents are recognised by the relevant legal systems. Practical implementation therefore remains a long way off. However, our **TW-Plugin** will keep you up to date with news in the field of digitisation and IOT.

Road, rail and air freight transport

German law does not refer to a bill of lading for road, rail and air freight transport, but it does provide for a similar institution in the consignment note according to Sec. 443 ff. HGB, for example. In addition, waybills (Sec. 408 ff. HGB) are used here. The CIM waybill (*Convention Internationale Concernant le Transport des Marchandises par Chemins de*

Fer) is recognised in rail transport, the CMR waybill (*Convention relative au contrat de transport international de marchandises par route*) is recognised in road transport and the AWB waybill is recognised in air transport. However, it only confirms that the forwarder has received the goods and that the forwarder undertakes to deliver the goods to the recipient named in the waybill. The goods are not embodied in the document, as is the case with the bill of lading, so that the claim for delivery does not normally arise solely on presentation of the waybill.

Other important documents

In some cases, a number of other documents and accompanying papers may also be necessary. For example, a packing list for customs, with the goods listed individually according to number of pieces, type and weight, a certificate of origin, health certificate, etc. In case of doubt, the requirements should be checked by experts in each individual case.

DOING THE RIGHT THING

Export contracts should be clearly formulated. In particular, the **due date of the purchase price claims** must be specified with exact dates ("At the latest..."), as some security instruments are accessory to the principal claim to be secured.

The **security method** should already be included in the contract for the underlying transaction. It is important to ensure that the security case is clearly defined in the contract. The prerequisites and necessary documents must actually be provable/collectable for the exporter (for common problems with bills of lading see info box).

You should also be aware that **export insurance is expensive**. Insofar as the risk is to be passed onto others, usually a fee for taking over the risk is charged. The fees or discounts associated with any security should therefore be priced into the export transaction from the start.

Info box – Common traps when dealing with bills of lading

- **Incorrect information:** You should particularly check the following details for accuracy:
 - sender, recipient, forwarder, carrier;
 - goods, amounts;
 - transportation means used;
 - order, invoice or purchase order numbers.
- **Incorrect issuer:** The bill of lading can be issued by the carrier directly or by the appointed forwarder.
- **Missing documents:**
 - to receive the bill of lading (e.g. packing list, certificates of origin, evidence for customs)
 - to receive the letter of credit (e.g. insurance certificates, documents of the forwarder)
- **Ignoring of printed clauses:** On the bill of lading, there are often clauses concerning
 - carrier's liability,
 - carrier's remuneration and
 - payment method.

Especially if special conditions have been negotiated with the forwarder, unexpectedly high costs can arise due to the carrier's general terms and conditions.

In order to avoid future difficulties or even years of court proceedings in enforcing your claims, it is wise to consult the expert already at the time of conclusion of the contract. If necessary, he will advise you on the **applicable law** and the **competent court/arbitration tribunal**.

Here, too, there are many differences in international trade. Therefore....

PLEASE DO NOT HESITATE TO CONTACT US!

Taylor Wessing

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