



## Analytical review of financial contracts and laws

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### Abstract

The financial contract is normally contained in a letter of credit. A letter of credit is a promise by the buyer's bank to pay the purchase price to the seller in exchange for certain documents. The bank will not agree to the transaction unless it has the buyer's promise to pay for that credit. In some situations, the finance contract may be more specific.

**Keywords:** contract, financial, credit, law

### Introduction

In terms of Securities law, financial contract is an arrangement that appears as a separately arranged contract, agreement, or alternative to purchase, offer, loan, swap, or repurchase, or other comparable independently arranged exchange usually went into by members in the money related markets. A money related contract includes securities, wares, monetary forms, premium or different rates, or some other budgetary or financial premium comparative in work. This agreement is gone into in light of a demand from counterparty for a citation, or to oblige the targets of the counterparty to such a game plan.

The gatherings to a worldwide exchange may utilize an unalterable affirmed letter of credit. Under an unavoidable affirmed letter of credit, both the purchaser's bank and the dealer's bank guarantee to pay the vender in return for specific records. On the off chance that the dealer's bank really pays, it looks for repayment from the purchaser's bank, which thusly looks for repayment from the purchaser.

That sort of arrangement is very useful if the seller lacks confidence in both the buyer and the buyer's bank. The seller wants an assurance of payment from someone it trusts – its own banker <sup>[1]</sup>.

Letters of credit are based on two principles:

1. **Autonomy Principle:** First, the autonomy principle states that payment is based on the seller's ability to satisfy the terms of credit (for instance, by handing over certain documents). Normally, payment is not made conditional on the state of the goods that are the subject of the sales contract. Thus, the seller may be entitled to payment even if the goods are defective. Payment is therefore "autonomous" from the condition of the goods <sup>[2]</sup>.
2. **Strict Compliance Doctrine:** Second, the principle of strict compliance states that the seller is entitled to payment on if it completely satisfies the terms of the letter of credit. Often the contractual terms will provide for more than simply a specific quantity of goods. They will include timing and delivery dates, shipping arrangements and other related details. The seller cannot demand payment under

the letter of credit until all conditions set out in the letter of credit have been strictly complied with <sup>[3]</sup>.

Such principles make good business sense for a number of reasons:

- a) Payment normally takes place while the goods are en route to their destination. It is therefore impossible for bankers to check the goods. The autonomy principle is based on the belief that the documents are a substitute for the goods themselves. A banker can, after all, verify trade documents even if it cannot examine the goods.
- b) The principle of strict compliance is also based on the need for certainty and efficiency in the business world. The parties and their bankers need a bright line rule. They do not want to be caught up in interpretive debates about whether or not certain conditions have, or have not, been met when deciding to make payment. Consequently, the seller is entitled to be paid only if it provides documents that properly evidence its compliance with all of the contractual terms, including timely dispatch of the goods.

An international set of rules known as the Uniform Customs and Practice for Documentary Credits (UCP), which we originally encountered last day, adopts the autonomy principle and the strict compliance principle. The UCP is both followed by banks as a common practice worldwide and recognized by courts.

### Supporting Documents of Financial Contracts

Although compliance with the sale of goods contract is usually a necessary condition for the seller's receipt of payment, it is not normally sufficient. As mentioned, the bank typically requires the seller to produce a number of other documents, possibly including:

- a) Bill of lading,
- b) Inspection certificate,
- c) Certificate of origin,
- d) Commercial invoice describing the goods,
- e) Insurance certificate, and

f) Draft (also known as a bill of exchange).

These supporting documents provide additional forms of risk management. A bill of lading provides the bank with evidence that the goods were actually shipped. Shipped goods are useless, however, if they are defective or do not otherwise meet contractual specifications. Consequently, the parties may have agreed that the seller would not receive payment until it provides an inspection certificate. That document is completed by a neutral third party, who verifies the quality of the goods before they are shipped. A commercial invoice, which is completed by the seller, may also provide some evidence about the quantity and condition of the goods. In many situations, the parties will also agree to the need for a certificate of origin. That document, which is normally completed by the producer of goods, verifies the product. It is often used by customs officials in the importing country to assign tariff classification. An insurance certificate assures the buyer that if the goods are lost or damaged, compensation will be provided under an insurance policy. The final document is the draft, or bill of exchange. A draft, or bill of exchange, is created when one person orders another person to pay a specific amount of money to a third person. This is a negotiable instrument, which the seller can transfer, or negotiate, to another person.

It is possible that seller's bank will experience difficulties in receiving payment from the buyer's bank, but that seldom happens<sup>[4]</sup>. The international banking system operates quite well, largely because each bank values its reputation. And if problems do arise, a bank is most certainly large and sophisticated enough to take action against the buyer's bank.

### Financial Contract Case Laws

The case of *Distribulite Ltd. v. Toronto Board of Education Staff Credit Union*<sup>[5]</sup> dealt with letters of guarantee issued by a credit union. In that case, the court correctly noted that, although the letters in that case utilized the word "guarantee" numerous times, "[t]he documents differ, however, from ordinary guarantees because the obligation imposed on the Credit Union did not depend on the liability of the [applicant] to any of the plaintiffs [the beneficiaries]". The court then stated:

"These differences from an ordinary guarantee bring the documents into a hybrid category variously known as performance guarantees or stand-by credits: The standby credit is thus something of a hybrid. It partakes of the nature of a guarantee in that the payment obligation is in form secondary, rather than primary; but it shares the characteristics of the traditional documentary credit that payment is required to be made on presentation of a specified document, without reference to the actual facts. Prima facie this is sufficient to prevent it from being legally characterized as a guarantee."

In *Harris Radio Corp. v. National Iranian Radio and Television*<sup>[6]</sup> an American manufacturer brought suit against Iranian defendants, seeking to enjoin payment and receipt of payment on guarantee and receipt of payment on letter of credit. It also sought a judgment declaring the contract underlying guarantee and letter of credit to have been terminated by force majeure as a result of the Iranian revolution and the subsequent crisis precipitated by the seizure

of hostages at the United States Embassy by Iranian militants. The court allowed the preliminary injunctive relief, enjoining payment and receipt of payment on guarantee and receipt of payment on letter of credit, since there was a substantial likelihood of plaintiff prevailing on the merits and since there was a substantial threat that plaintiff would suffer irreparable injury if the injunction was not granted, since the balance of harm weighed heavily in plaintiff's favor.

### Conclusion

This sort of contracts give the gatherings the capacity to grow their business through the coordinated effort or/and to balance out their current system. Makers and providers of merchandise as often as possible delegate operators to follow up for their sake in advancing deals, both in the nation of origin of the producer and in addition abroad. The most fundamental kind of monetary contract is the business organization agreement. In this sort of agreement the business operator is a self-utilized (autonomous) business mediator. He/She attempts the proceeding with commitment to arrange the deal or the buy of merchandise in the name and for the benefit of the provider, in return for a commission. In that way, the provider extends his system of business and expands the item/administrations deals. The operator is profited by the commissions and by his/her connection to the system and the notoriety of the provider.

### References

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3. Johan Schelin, Letters of Credit and Doctrine of Strict Compliance, available at <http://www.juridicum.su.se/transport/Forskning/Uppsatser/EssayKarl.pdf>.
4. There are exceptions. The collapse of a single bank, or, more seriously, the insolvency of part of a country's banking system, as happened in Thailand, Indonesia, and Korea in can have profound implications worldwide. One infamous example involved the Bank of Credit and Commerce International, a Luxembourg-based financial conglomerate. BCCI was involved in questionable financial dealings around the world. It collapsed in July 1991 amid allegations of fraud following an investigation by the Bank of England. Its failure had a significant impact on the 1.4 million depositors that it had in 73 countries, 1997.
5. 45 D.L.R. (4th) 161 Ont. H.C, 1987.
6. 691 F.2d 1344, 1982.