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GRADUATE PROGRAM IN COMMERCIAL AND
INVESTMENT LAW

**Import Letter of Credits in Ethiopia: Special Emphasis to Import Letter of Credits in
Public Contracts**

A Thesis Submitted in Partial Fulfillment of the Requirements of LLM Degree in Commercial
and Investment Law

By:

Getachew Negash

Advisors:

Yosef Alemu (Ass. Prof.)

Tadele Geremew(LLB, LLM)

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Declaration

I, Getachew Negash, “Import Letter of Credits in Ethiopia: Special Emphasis to Import Letter of Credits in Public Contracts” is my own original work. To this end, no work identical to this has been submitted for any degree or examination in any other University. Whenever the works of others are quoted, it’s with due acknowledgement.

Student: Getachew Negash.....

ID No. RM1071/09

This LL.M Study has been submitted for examination with my approval as an advisor.

Principal Advisor’s Name: Yosef Alemu (Asst. Professor of Law)

Signature:

Date:

Co-advisor’s Name: Mr. Tadele Geremew(LLB,LLM)

Signature.....

Date.....

Place: Jimma University

Approval by Board of Examiners

.....
Advisor	Signature	Date
.....
Examiner	Signature	Date
.....
Examiner	Signature	Date
.....
Examiner	Signature	Date

Table of Contents

List of abbreviations.....	VI
Acknowledgement.....	VIII
<i>ABSTRACT</i>	IX
Chapter One.....	1
1. Introduction.....	1
1.1 Background of the Study.....	1
1.2 Statement of the Problem.....	5
1.3 Research Questions.....	7
1.4 Literature Review.....	7
1.5 Objectives of the Study.....	8
<i>1.5.1 General Objectives</i>	8
<i>1.5.2 Specific Objectives</i>	8
1.6 Significance of the Study.....	8
1.7 Research Methodology.....	9
<i>1.7.1 Sources of Data Collection</i>	9
<i>1.7.2 Data Collection Techniques</i>	9
<i>1.7.3 Sampling Techniques</i>	9
1.8 Scope of the Study.....	10
1.9 Organization of the Paper.....	10
Chapter Two.....	11
Nature of Public Contracts.....	11
2.1 Public Contracts Defined.....	11
2.2 Special Laws Governing Public Contracts in Ethiopia.....	13
2.3 Public Procurement Procedures in Ethiopia.....	14
2.3.1 Public Procurement Procedures in National Competitive Bidding.....	17
2.3.2 Public Procurement Procedures in International Competitive Bidding (ICB).....	18
2.4 Public Contracts Implementation.....	18
2.4.1 Rights and Duties of Public Body in Public Contracts.....	21
2.4.1.1 Rights of the Public Body.....	21
2.4.1.2 Duties of the Public Body.....	21
2.4.2 Rights and Duties of the Seller (Supplier).....	22

2.4.2.1. Rights of the Seller (Supplier).....	22
2.4.2.2. Duties of the Supplier.....	22
Chapter Three.....	24
Nature, History, Type and Legal Framework of Letter of Credit.....	24
3.1 Nature of Letter of Credit.....	24
3.2 Process of the operation in Documentary Credits.....	25
3.3 Main Parties to Letter Of Credit and Their Contractual Relationship.....	27
3.3.1 <i>The Relationship between Public Body and the Seller</i>	28
3.3.2 <i>The Relationship between the Public Body and the Issuing Bank</i>	29
3.3.3 <i>The Relationship between the Issuing Bank and the Beneficiary</i>	31
3.4 Basic Principles of Letter of Credit.....	32
3.4.1 <i>Principle of Autonomy “Pay First, Argue Later”</i>	32
3.4.2 <i>Principle of Strict Compliance</i>	33
3.5 Historical Development of Letter Of Credit.....	34
3.6 Types of Letter Of Credit.....	35
3.6.1 <i>Unconfirmed or Confirmed</i>	35
3.6.2 <i>Revocable or Irrevocable</i>	35
3.6.3 <i>Sight or Time LC</i>	36
3.6.4 <i>Red Clause Letter Of Credit</i>	36
3.6.5 <i>Transferable Letter Of Credit</i>	36
3.6.6 <i>Back-To-Back Letter Of Credit</i>	38
3.7 Accompanying Documents of Letter of Credit.....	39
3.7.1 <i>Commercial Invoice</i>	39
3.7.2 <i>Bill of Lading</i>	39
3.7.3 <i>Insurance Policy or Certificate</i>	41
3.7.4 <i>Certificate of Origin</i>	41
3.8 Legal Framework of Letter Of Credit.....	41
Chapter Four.....	45
Analysis of the Practice and Problems Associated With Import LC in Public Contracts.....	45
4.1 Application for Opening of LC.....	45
4.1.1 <i>Procedures of Application</i>	45
4.1.2 <i>Problems Associated With Application for LC</i>	46

4.2 Terms and Conditions of the Current CBE Letter Of Credit Application Form.....	47
4.2.1 Analyses of Problems Associated With CBE Letter Of Credit Application Form and Directives of LC.....	49
4.3. Ways of Transferring LC Payments from Public Body to CBE.....	53
4.3.1 Legal Procedures of Transferring Payments.....	53
4.3.2 Problems Associated With Transfer of Payment.....	53
4.4. Controlling Mechanisms of the Pool Account (LC Common Account).....	54
4.5. Closure of the Transaction of Import LC.....	55
4.5.1 Procedures of Closure.....	55
4.5.2. Examination of Problems Relating With Closure of LC.....	56
Chapter Five.....	57
Conclusions and Recommendation.....	57
5.1 conclusions.....	57
5.2 Recommendations.....	59
Bibliography.....	60
ANNEX - I.....	1
Annex II.....	2

List of abbreviations

LC - letter of credit

ICC - International Chamber Of Commerce

UCP - Uniform Customs and Practice for Documentary Credits

eUCP - electronic Uniform Customs and Practice for Documentary Credits

UNCITRAL - United Nations Conference for International Trade Law

UCC- Uniform Commercial Code of United State

ISP98- International Standby Practices for Independent Guarantees and Standby Documentary Credits

CIF- Cost Insurance and Freight

FOB- Free On Board

PPA- Public Procurement Agency

SBD- Standard Bidding Document

ICB- International Competitive Bidding

OECD- Organization for Economic Cooperation and Development

MOFEC- Ministry of Finance and Economic Cooperation

CBE- Commercial Bank of Ethiopia

NBE- National Bank of Ethiopia

MOFED- Ministry of Finance and Economic Development

USD- United States Dollar

LDC- Least Developed countries

GCC- General Conditions of Contract

SCC- Special Condition of Contract

AAU- Addis Ababa University

JU- Jimma University

HPR- House of Peoples Representatives (Ethiopia)

LIST OF FIGURES

Figure 1 Basic import letter of credit transaction flow chart..... 27

Figure 2 a chart which shows various contracts in a single LC transaction.....32

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ABSTRACT

Letter of credit is an undertaking by a bank to make a payment either directly to a named beneficiary or through a confirming or advisory bank within a specified time against the presentation of documents. Import of public goods by public body constitutes the major share of import of the country. All of the payment to such import by public bodies is to be made through LC. The process of LC involves the participation of at least four contracting parties and it relies on documents. As it purely relies on documents, it is not free from problems. The problem exacerbates when we come to LDCs like Ethiopia where the law on LC is outdated and where there is no modern mechanisms of controlling such problems.

Exposing those problems by examining the current Ethiopian laws on the matter and the practice in the selected institutions is the main objective of the study. To achieve the objectives the researcher has employed both doctrinal and non doctrinal legal research methods. The thesis, however, only emphasizes on import LC in public contracts. The result of the study shows that, among others, lack of up to date law on the matter and the enactment of MOFEC directive which dictates public bodies to open LC only in CBE are the main problems in the area.

The researcher would like to recommend the replacement of the current Ethiopian laws on LC with laws that contains provisions about rights and duties parties, accompanying documents of LC and all types of LCs. The researcher also recommends the repeal of MOFEC directive no. 4/2003 in a way of enabling public bodies to open LC in any efficient bank which can extend more favorable terms and conditions to the public bodies

Chapter One

1. Introduction

1.1 Background of the Study

Products cannot be produced where ever you want to produce them due various reasons. It is impossible to make all your products in your home country due to labor and other production costs. It is sometimes cheaper to produce and assemble products in foreign countries because of availability of technologies, skilled human resource or raw materials. When this happens, the only way to fulfill the need of such product is by importing from other countries with such product.

While importing goods there is a risk regarding nonpayment in international trade. In order to eliminate or at least minimize the risk of non-delivery and non-payment, merchants have created different methods and various instruments to finance international trade.¹Letter of credit, which some named as the life blood of international commerce, is one of such method.

Letter of credit is any arrangement, however named or described, that constitutes a definite undertaking of the issuing bank to honor a complying presentation.² It is also an undertaking by a bank to make a payment, either directly to a named beneficiary or through a confirming or advisory bank, within a specified time against the presentation of documents which is strictly incompliance with the terms of the letter of credit.³

Letters of credit are mainly used to finance foreign trade and solve the problems which arise when a prospective buyer in one country wishes to buy goods from a prospective seller in another country. Letters of credit, among others, avoids difficulties which happen because of the distance between the seller's and the buyer's country. It also avoids difficulties due to the different mercantile and legal conditions existing in these two countries.⁴ In such occasion LC will reduce the risk of trade by shifting payment obligation from buyer as

¹ZsuzsannaTóth, documentary credits in international commercial transactions with special focus on the fraud rule, (unpublished, Doctoral Degree Program Of the Faculty Of Law- And Political Sciences, Pázmány Péter Catholic University, 2006.) at 1.

² International Chamber of Commerce, Uniform Customs and Practice for Documentary Credits, ICC Publication No. 600 ("UCP")(2007.), art.2 .

³ZsuzsannaTóth,*Supra note* 1 at 17.

⁴EleniMoschouri-Tokmakidou, Commercial Letters of Credit in England and in Greece,(unpublished, masters of jurisprudence thesis , The University of Birmingham ,1995.), at 1.

an individual to a payment guarantee of a bank as a legal entity in return for presentation of complying documents with terms of credit by seller.⁵That is why most importers and exporters arrange their payment through letters of credit.

When we come to the operation of letter of credit, it starts to operate when the buyer who desires to pay for goods by means of a credit requests his bank to extend its credit to him in the form of a letter sent to his seller.⁶ Then the issuing bank informs, usually through the confirming bank, the seller that the bank undertakes to honor drafts drawn by the seller upon the seller's compliance with the letter's terms. Unlike a clean credit⁷, a documentary credit conditions honor upon the presentation of documents with the draft.⁸

Regarding the documents that need to be included, as we can infer from different laws and different forms of letter of credit prepared by banks, documents ordinarily required are a bill of lading or air waybill, a commercial invoice, an insurance policy, an inspection certificate and, often, a certificate of origin. If the buyer's bank finds that these documents comply on their face with the credit terms, and if the other terms have been met, it will honor the seller's draft.⁹ Then it surrenders these documents to the buyer to allow his receipt of the goods and charges his account.¹⁰ The bank usually demands the applicant to deposit in advance the amount in an account with the bank.¹¹This will enable the bank to withdraw the amount paid under the credit adding the commission fee and additional charges directly from the applicant's account after honoring the credit.¹²

Concerning types of LC, based on different measurements one can mention different types of letter of credit. Revocable and irrevocable type of letter of credit is one type. A revocable letter of credit is a credit which can be amended, revoked or cancelled without the beneficiary's consent and even without prior notice to the beneficiary.¹³A revocable letters of credit gives the

⁵*Id.*

⁶Hamed Alavi, Tallinn Law School Tallinn University of Technology, documentary letters of credit, legal nature and sources of law, *Journal of legal studies* Volume 17 Issue 31(2016.), at 108.

⁷ Clean credits, such as travelers' credits, are not conditioned.

⁸Roger J. Gewolb, *the Law Applicable to International Letters of Credit*, 11 Vol. L. Rev. (1966.), at 743

⁹*Id.*, at 742.

¹⁰*Id.*

¹¹ZsuzsannaTóth,*Supra note 1*, at 47.

¹²*Id.*

¹³ZsuzsannaTóth, *Supra note 1*, at 22.

applicant maximum flexibility, whereas it gives less security to the beneficiary.¹⁴ An irrevocable letter of credit, on the other hand, constitutes a definite undertaking of the issuing bank to pay and accept drafts and/or documents, provided that the stipulated documents are presented and that the terms and conditions are complied with.¹⁵ Based on the undertaking of another bank invited into the transaction by the issuing bank, letters of credit can be classified as confirmed and unconfirmed credits. Confirmed credit is a credit which constitutes a definite undertaking of the confirming bank, in addition to that of the issuing bank, towards the beneficiary to pay, accept draft or to negotiate.¹⁶ A letter of credit is unconfirmed, if the bank merely acts as an agent of the issuing bank without assuming any responsibility towards the beneficiary, thus acting as an advising bank.¹⁷

As to the contracts that LC constitute, all letters of credit involve at least three, and sometimes four or more, separate contracts that function independently of one another.¹⁸ The first contract is the underlying contract for the sale of goods to which only the buyer and seller are parties. The second is a contract between the buyer and the issuing bank. Here the bank agrees to issue the credit and to notify the seller of the credit. The bank has to make payments on presentation of stipulated documents by the seller. The third contract is a contract between the issuing bank and a confirming bank authorizing the latter to make payments on presentation of documents by the seller. The confirming bank remits the documents to the issuing bank on reimbursement for amounts paid out by the confirming bank. The fourth contract is between the issuing bank (the confirming bank) and the seller, under which the relevant bank undertakes to pay the seller on presentation of the stipulated documents.¹⁹

Payment through letter of credit has its own advantage both for the seller and public bodies. For example for the seller it has advantage of reducing the production risk, if the public body cancels or changes his order. It creates the opportunity to get financing in the period between the shipment of the goods and receipt of payment (especially in case of differed payment).²⁰ Besides,

¹⁴*Id.*

¹⁵*Id.*

¹⁶*Id.*, at 23

¹⁷*Id.*, at 24

¹⁸Jacqueline D. Lipton, *Documentary Credit Law and Practice in the Global Information Age*, *Fordham International Law Journal*, vol.22, 1998, at 1973.

¹⁹ZsuzsannaTóth, *Supra note 1*, at 79.

²⁰*Id.*

the public body has the advantage that the whole transaction will be concluded by the issuing bank.²¹The public organ can be sure that in the case of a contract of sale the goods will be shipped and the bill of lading will be presented in accordance with the underlying contract.²²

We do have different legal framework both at the international level and national level. At international level International Chamber of commerce(ICC) has provided the major source of law for documentary letters of by assuming the responsibility for codification of relevant customs and usage under Unified Custom and Practices for Documentary Credits (UCP). Additional to UCP, International Chamber of Commerce has introduced other regulations including eUCP, Uniform Rules of Contract Guarantees, Uniform Rules for Demand Guarantees, ISP98, which is International Standby Practices for Independent Guarantees and Standby Documentary Credits. United Nations Conference for International Trade Law also took the initiative to prepare universal regulations for Independent Guarantees and Standby Letters of Credits which is known as UNCITRAL Convention.²³

At domestic level, among Civil Law countries only Colombia, El Salvador, Greece, Guatemala, Honduras, Lebanon, Mexico, and Syria have statutory rules on the letter of credit.²⁴ The only country in the common law system is the United States.²⁵In other Common Law Countries including England, Legal issues of documentary credits are subjected to case law.²⁶

For the purpose of comparing Ethiopian law on letter of credit let see major contents of UCP and uniform commercial code of united state (UCC). Both UCP and UCC starts by defining important terms like applicant, beneficiary, adviser, confirmer, dishonor, document, issuer and others. Both UCP and UCC have provisions about scope of applicability. The rights and duties to each party to the credit also dealt well under these two instruments. List of documents that should be fulfilled by parties and standard for examination of such documents are also part of the contents under UCP and UCC. There are also provisions about fraud and forgery in UCC.

²¹*Id.*

²²ZsuzsannaTóth ,*Supra* note 1 ,at 14.

²³ZsuzsannaTóth ,*Supra* note 1, at 56.

²⁴ZsuzsannaTóth ,*Supra* note 1 at 111.

²⁵ZsuzsannaTóth ,*Supra* note 1, at 89.

²⁶ZsuzsannaTóth ,*Supra* note 1, at 67.

When we come to Ethiopia, the 1960 commercial code of Ethiopia has incorporated provisions which deal with documentary credits from article 959-967 of the code. The code started by defining ‘documentary credit’ under article 959. Accordingly, documentary credit is a credit opened by a bank providing for payment against presentation of specified documents to the opening bank or to its agent. The code also recognized the fact that documentary credit contract is independent from the underlying sale contract (principle of autonomy).²⁷ The principle of strict compliance, which obliges the confirming bank to check the fulfillment of all documents as required by the credit, also included in Ethiopian commercial code.²⁸ The issuing bank is obliged to honor the conditions as to payment, acceptance, discount or negotiation of the credit.²⁹ The two types of documentary credits (revocable and irrevocable) have been recognized in Ethiopian law but, unlike the international legal framework revocable letters of credit are recognized as of a principle.³⁰ The law also allows issuance of transferable and divisible letters of credit under article 967 of the commercial code.

Public contract is a contract entered for public purpose and involves at least one public body as a party to the contract. The payments of most importation of goods for public purpose in Ethiopia effected through import letter of credit.

1.2 Statement of the Problem

Ethiopia imports enormous amount of goods every year in order to fulfill the needs for modern infrastructure, health care facilities and educational facilities. The need for public goods like medical equipments, medicines, construction materials, stationeries and books in every sector is very high. Due to lack of technology and skilled manpower such goods cannot be produced locally. As a result public bodies import such materials by arranging the payment through LC.

Having in mind these facts as they are, when we see Ethiopian public bodies’ payment arrangement through LC, we may come across to the following problems. To begin with, Letter of credit is limited by time (it has expiry date). Unless the payment is effected during this period the opened LC expires. On the other contrary shipment and/or delivery of the goods to be

²⁷COMMERCIAL CODE OF THE EMPIRE OF ETHIOPIA, Proclamation No. 166/1960, NEGARIT GAZETA, 5th May 1960, Addis Ababa, article 959(2).

²⁸*Id.* Article 965.

²⁹*Id.* Article 960.

³⁰*Id.* Article 961.

imported might not be made within the intended time due to different reasons. Non implementation of the main contract brings different risks to the LC. But, there is no clear law and practice in Ethiopia regarding the risk associated with the expiring of letter of credit due to the delaying of shipment or delivery.

The other problem relates to the quality and the quantity of the goods to be delivered. Sometimes the goods may not be delivered with the specified quality and quantity. In such case the issuing banks request public bodies to bear the risk associated with non conformity with the quality and quantity of the goods delivered. This in turn causes huge loss to public bodies.

Foreign currency valuation also causes an additional unexpected cost to public bodies. Due to the absence of clear legislations regarding the effect of expired letter of credit and change in relation to foreign currency in Ethiopia public bodies incur additional cost.

Ethiopian law on letter of credit recognizes both principle of autonomy and principle of strict compliance.³¹ But there is no fraud exception to the principle of autonomy in Ethiopia. Even if there exists a contractual relationship between the public bodies and the issuing bank when the bank accepts the application for opening of the letter of credit, the nature of such contract is not clear.

Another problem is that in case a credit is transferred to a third party by the beneficiary, it may result in another autonomous credit for the banker with second beneficiary. Hence, the bank has to pay the second beneficiary irrespective of the relationship with the first beneficiary. This will affect the primary letter of credit transaction and also negatively affect the interest of parties involved. There is no clear and detailed law and literature which show the respective rights and obligations of public bodies, sellers, banks and beneficiaries of letter of credit in Ethiopia.

In case where the issuing bank becomes insolvent after it has been put in funds by the buyer, there is no clear law and practice as to the effect of such credits on the respective parties.

According to most current public contracts for importation of goods, 80% of the total contract price is payable on submission of documents which show shipment of goods while the remaining 20% is retained until the delivery of goods, but there is no clear law and practice of the reason why such 20% is retained and how such payment is to be paid.

³¹*Id.* article 959(2) and 965.

Generally, since the transaction with letter of credit is complex and contain varies parties, it needs at least a clear literature in order to decrease potential risks associated with the credit.

1.3 Research Questions

The following are the main research questions that will be considered throughout the paper.

- What are the rights and obligation of the public body, the seller and banks in LC? Which party of the LC should bear risks associated with change in foreign currency valuation or change in price of goods happened due to the delaying of the implementation of the main contract?
- How the principle of autonomy, which is recognized in Ethiopian letter of credit law, can be implemented in the absence of the principle of fraud exception?
- What are the rights and obligations of the bank, the applicant (the public body in our case), and the transferee in a transferable LC?
- Which party (the seller or the public body) should bear the risk where the issuing bank becomes insolvent after it has been put in funds by the buyer?
- What is the role of retention in public contracts and how is going to be paid?

1.4 Literature Review

The concept, history, nature and type of letter of credit are discussed by different authors. Accordingly, Susanna Toth in her PhD thesis expressed letter of credit as transaction which involves four independent, but interdependent relationships: usually a sales contract between the seller and the buyer, a contract between the buyer and the issuing bank, the actual letter of credit relationship between the issuing bank and the seller and a separate contract between the issuing bank and the corresponding banks.³²Zsuzsanna stressed out that since the transaction with letter of credit is a complex we need to have standard to regulate the transaction both at the national and international level.

The theory behind the use of documentary credits, as expressed by Jacqueline D. Lipton, is often referred to as "pay now, litigate later," meaning that commerce continues to flow and payments continue to be made while disputes about conformity of goods to underlying contracts stipulations are relegated to the background.

³²Roger J. Gewolb , *Supra note 8*, at 1.

Osman Mohammed Seid, in his short blog, mentioned types of letters of credit and legal principles recognized under Ethiopia commercial code, but, he didn't discussed legal and practical issues of letters of credit.³³ So, the present paper is different from the existing literatures since it focuses on discussing legal and practical issues of letters of credit by giving special emphasis to import letters of credit on public contracts in Ethiopia.

1.5 Objectives of the Study

The research has been conducted in order to achieve the following general and specific objectives.

1.5.1 General Objectives

The general objective of the thesis is to critically examine the operation of LC by emphasizing on import letter of credits in public contracts.

1.5.2 Specific Objectives

Specifically the thesis will achieve the following objectives.

- To analyze the nature, type and history of LC by making Ethiopian import LC the center of the discussion
- To examine public contracts, laws governing public contracts and procedures to be followed by public bodies while transacting through LC.
- To explore in depth the nature of the existing Ethiopian laws on import LC.

1.6 Significance of the Study

In order to decrease cost of importing public goods through LC arrangements the concerned public officials and employees in Ethiopia need to have clear insight of LC and legal consequence of each action and inaction relating with LC. The thesis helps the stakeholder by familiarizing all them with the laws and practices relating with import LC in Ethiopia. Familiarity with legal nature and different legal frameworks which govern both the international and national operation of documentary letters of credit can facilitate the process of import LC for the importation of public goods. The paper also provides vital opportunity in opening the way for those who want to conduct further research on this area.

³³Osman Mohammed Seid, Letters of Credit in General, Abyssinian law may 6/2016, available at www.abysinnialaw.com , last visited on 2/1/2018.

1.7 Research Methodology

The thesis is a combination of both doctrinal and non-doctrinal. It is doctrinal because the researcher has systematically analyzed existing literatures, treaties, rules, principles, doctrines and legislations to get answers for the research questions. It is also non-doctrinal since the researcher assessed practical problems associated with import letters of credit in public contracts. It is also qualitative research type.

1.7.1 Sources of Data Collection

The researcher employed primary sources like proclamations, rules, regulation, directives and customary practices in order to answer the research questions. Secondary sources like books, journals, articles and other unpublished materials also have been used while conducting the research.

1.7.2 Data Collection Techniques

Data to assess practical problems associated with import LC in public contract have been gathered through interviewing selected public organs which controls LC, transact by LC and banks. Since the research is qualitative the type of interview applied is unstructured and key informant interview. Officials and employees of the institutions that have closer contact with LC cases have been interviewed. Accordingly, directors of procurement and property administration, directors of finance administration of the selected institutions have been interviewed. Additionally, one individual who has closer contact with LC cases from commercial bank of Ethiopia and two employees of ministry of finance and economic cooperation have been interviewed. Totally, seven individuals from the selected institutions have been interviewed.

1.7.3 Sampling Techniques

The sampling technique is Purposive sampling technique. Purposive sampling can be employed when the researcher deliberately or purposively selects certain units for study from the population. It is more useful especially when some of the units are very important. This technique is selected due to the researcher's intention to investigate the problems of LC within public bodies whose contract shall be prepared by PPA by interviewing key individuals mentioned above. Since, the initial point for this research is practical problems that we came across in Jimma University, before saying something about the problem we need to see the situation in other similar public bodies. Ethiopian public procurement agency prepares the

General conditions of public contracts. Except the slight disparity in special conditions of the contracts, all public contracts contain the same provisions. There are many federal institutions that use contract prepared by public procurement agency. Among such institutions the researcher purposely selected to see the problems in Jimma University and Addis Ababa University. Therefore, the situation in these two institutions can represent the situation in other institutions due to similarity of the contents of their contract prepared by PPA.

Regarding the selection of banks, according to federal government payment directive no.4/2003 arrangement of LC for public bodies can only be made with commercial bank of Ethiopia and construction and business bank. Since construction and business bank has merged with commercial bank of Ethiopia the researcher selected only commercial bank of Ethiopia. Therefore, the concerned officials and employees of each body have been asked about the problems through unstructured interviews.

1.8 Scope of the Study

The thesis is limited to import letter of credit in Ethiopia by specifically emphasizing on import letter of credit in public contracts. So import letter of credit in private contract is out of the scope of this thesis. Unless the situation in other countries used for comparative purpose the study is also limited to import LC in Ethiopia. The paper will not discuss issues about standby letters of credit, it rather discuss issues on documentary letters of credit.

1.9 Organization of the Paper

The paper has been organized into four chapters. The first chapter is all about the introductory matters like background of the study, statement of the problem, research questions, literature review, and objective of the study, significance of the study and research methodology. In the second chapter meaning of public contracts, special laws governing public contracts and the procedures to be followed by public bodies while implementing public contracts through import LC arrangements in Ethiopia have been discussed. The third chapter is about examining nature, type, history of LC, and sources of the laws of LC. Analysis of practical problems associated with import LC made at the fourth chapter. The paper ends up by concluding and recommending at the fifth chapter.

Chapter Two

Nature of Public Contracts

2.1 Public Contracts Defined

Contracts concluded by the administration with individuals in order to work together to meet a public or general interest, subject to the administrative system, are public contracts or administrative contracts.³⁴ The content of an administrative contract is determined by regulatory and conventional way. The regulatory provisions include binding clauses stipulated by laws and the conventional provisions include terms negotiated by the parties.³⁵ France public procurement code defined Public contracts as contracts for pecuniary interest concluded with public or private entities by the State, its public bodies other than those of an industrial and commercial nature, the local authorities and their public bodies to meet their requirements in terms of works, supplies or services.³⁶

There are certain features which are essential elements of an administrative contract. The first is that one of the contracting parties to the transaction must be the government or an agency of the government.³⁷ But, sometimes the government or its agencies may be engaged in activities of a purely private nature, as, for instance, in the operation of a bank, or in the production and distribution of different goods and service. Commercial bank of Ethiopia, Ethiopian Sugar Corporation, Ethiopian airline, Ethic-telecom and other can be instances of such government activity. Contracts entered into by the government while engaged in private transactions are regulated by the civil or commercial codes, as the case may be. The second requirement is that the promise to be performed must be in the nature of a public service.³⁸ Contracts called administrative contracts because of the parties who made them and the public interest surrounding the performance of the promises made by the parties. The sale of goods or supply of

³⁴ Liana-TeodoraPascariu, *The Distinction of The Administrative Contract from Other Types Of Contracts*, Vol. 10, Special Number, 2010.

³⁵ *Id.*

³⁶ French Public Procurement Code (CMP or Code des Marchés Publics) – decree Nr 2006- 975 of August 1st, 2006, article 1 and 2.

³⁷ Julio Cueto-Rua, *Administrative, Civil and Commercial Contracts in Latin-American Law*, 26 *Fordham L. Rev.* 15 (1957), at 21.

³⁸ *Id.*, at 21.

good to the government when these are necessary to carry on a public service is one instance of such contract.

Ethiopian civil code defined public contract (administrative contract) based on the characteristic of the contract. A contract is an administrative contract where: it is specifically qualified as administrative contract by the law or by the parties; or it is connected with an activity of the public service and implies a permanent participation of the party contracting with the administrative authorities in the execution of such service; or it contains one or more provisions which could only have been inspired by urgent considerations of general interest extraneous to relations between private individuals.³⁹ So, according to the civil code a contract can be called as administrative contract if one of the above mentioned characteristics happened to that contract. In other word the criterions listed in the law are not cumulative criterions rather it is optional criterions.

The first criterion for a certain contract to be considered as an administrative contract it should be expressly qualified as “administrative contract”. But, it is difficult to consider a contract qualified as administrative contract by the parties except one of the contacting parties is an administrative authority.⁴⁰

The second optional criteria mentioned in the civil code is where the contract is associated with an activity of the public service and entail a lasting partaking of the party contracting with the public bodies in the execution of such service. This criterion is about the aim of the contract. If the contract is formed to conduct activities which are related with public services and involves enduring participation of the contracting party for its performance we can name such contract an public contract.

The third characteristic that makes a contract a public contract, according to the civil code, is the existence of provisions, in the contract, which shows public interests. This criterion is almost the same to the second criteria.

³⁹ CIVIL CODE OF THE EMPIRE OF ETHIOPIA, Proclamation No 165/1960, NEGARIT GAZETA, 19th Year No. 2, 5th May 1960, Addis Ababa, article 3132.

⁴⁰Wondwossen Wakene, The Law of Administrative contract, Justice and Legal System Research Institute, 2009, at 5.

Even though private law entered the administrative action, administrations shall also apply specific public rules in bargaining public procurements, such as service, supply and work contracts, and in contracting out instrumental services in order to improve their efficiency.⁴¹This is to mean that even if contracts concluded by public bodies are essentially subject to the private law, in order to protect the public interests in the development of the public contractual action public laws may be applied.⁴²As a result, according to the phases of public contracting, a double standard system regulates “public contracts” the selection of competitors follows public rules, whereas private law applies in the performance of the contract.⁴³During the performance of a public contract, indeed, contractual parties have rights and obligations in an equal relationship, whereas in the tendering procedure, the contracting administration exerts some authoritative powers over the competitors, whose legal position matches the notion of legitimate interest. Administrative action by contract may be perfectly divided into two phases, the first one governed by administrative law, the second one by private law.⁴⁴

As a general principle, every public entity assigning benefits by contracts to private persons through the allocation of limited resources shall make a call for competition. The next section is devoted for examining the nature and types of such competition by specifically focusing on Ethiopian laws and policies.

2.2 Special Laws Governing Public Contracts in Ethiopia

Unlike civil contract public contracts are required to fulfill mandatory requirements of public procurement laws. In Ethiopia, there is Procurement and Property Administration Proclamation No. 649/2009. This proclamation was enacted with the aim of achieving better transparency, efficiency, fairness and impartiality in public procurement and to enable the utilization of the large sum of public money spent on procurement in a manner that ensures greater economy and efficiency by addressing problems encountered in the course of implementation of the proclamation determining the procedures of public procurement and establishing the Supervisory

⁴¹Prof. Alberto MASSERA –Dott.ssa Marta Simoncini, Basic Of Public Contracts In Italy annual report,2011, at 2 .

⁴²*Id.*

⁴³*Id.*

⁴⁴ *Id.*, at 3.

Agency (public procurement agency).⁴⁵ Five basic principles of Public procurement and property administration have been recognized in the proclamation. These are:-

- ensure value for money in the use of public fund for procurement,
- non discrimination among candidates,
- transparency and fairness of the criteria,
- accountability for decisions made and measures taken and
- careful handling and proper use of public property

Duties and responsibilities of each stakeholder should be towards achieving the above five basic principles. The Property Administration Agency (PPA), with its duties and responsibilities, also established by this proclamation.

In order to implement the proclamation Ministry of Finance & Economic Development has enacted Federal Public Procurement Directive in 2010. In addition to the proclamation and the directive, there is also Procurement and Property Administration Agency Public Procurement Manual which supports implementation of the proclamation and the directives by giving practical examples. There is also standard bidding document (SBD) for every type of public procurement prepared by PPA. The SBD shows what the contents of public contracts should look like.

So, unlike private contracts every public procurement and public contracts in Ethiopia should adhere to the above special laws. Moreover, as per article 1767(2) of Ethiopian civil code the provisions of the civil code from article 3191-3193 shall apply to contracts made with a public administration.

2.3 Public Procurement Procedures in Ethiopia

Public procurement is the process of the acquisition, usually by means of a contractual arrangement after public competition, of goods, services, works and other supplies by the public entity.⁴⁶ ‘Public body’ also defined as “ any public body, which is partly or wholly financed by the Federal Government budget, higher education institutions and public institutions of like

⁴⁵ The Ethiopian Federal Government Procurement and Property Administration Proclamation, Proclamation No. 849/2009, FED. NEGARIT GAZETA 15th Year No. 60, Addis Ababa, 9 September 2009.

⁴⁶ The Federal Democratic Republic of Ethiopia Ministry of Finance and Economic Development Public Procurement and Property Administration Agency, public procurement manual, Addis Ababa, December 2011, at 6.

nature.⁴⁷ From this it is possible to infer that at least two conditions make an entity an administrative body. The first is the source of income of the entity. If the entity partly or wholly derives its income from the government, there is a possibility to consider it a public body which can enter into administrative contracts. Secondly, the purpose of the organ makes it an administrative body.⁴⁸ If the organ established to serve the public it can be taken as public body.

Public procurement is an issue of key importance for a State's economic development due to the following reasons. Firstly, the goods and services involved in public procurement typically affect a large section of the population.⁴⁹ Second, public procurement often involves physical infrastructure or public health, which support other forms of economic activity.⁵⁰ Third, it also has impacts on international competitiveness and on investment climate.⁵¹ Fourth, distortion of public procurement typically has the heaviest detrimental impact on the most disadvantaged in society, who rely on public services and infrastructure to the greatest extent.⁵² Public procurement often concerns "public goods", and so government failures cannot be addressed by private market mechanisms.⁵³

A federal public body in Ethiopia needs to follow the following basic procurement procedures in order to procure work, goods or services.

The first procedure is to prepare an annual procurement plan showing their procurement for the concerned budget year.⁵⁴ Such procurement shall be supported by action plan enabling them to execute in due time.⁵⁵ Such annual plan should be publicized on the website of the public body. Publication of realistic annual procurement plans allows the private sector to respond more effectively to the requirements and specifications of Government, through investment in staff

⁴⁷*Supra* note 45, at 78.

⁴⁸ Julio Cueto-Rua, *Supra* note 37, at 23.

⁴⁹Organization for Economic Co-Operation and Development, Competition and Procurement OECD Key Findings, 2011, at 10.

⁵⁰*Id.*

⁵¹*Id.*

⁵²*Id.*

⁵³*Id.*

⁵⁴*supra* note 46, article 22.

⁵⁵ Ethiopian Ministry Of Finance & Economic Development , Federal Public Procurement, Directive, 2010 ,article 8.

and equipment, manufacture and importing of goods, and financial planning.⁵⁶ The plan also enables the PPA in order to monitor the public body procurement effectively.

The second procedure is selection and application of procurement method. There are six approved procurement method in Ethiopian law.⁵⁷ These are:-

- Open bidding
- Restricted bidding
- Request for quotations
- Single source/ direct procurement
- Request for proposal, and
- Two stage bidding

Public bodies need to select one of the above methods of procurement with the reason why they selected such method. The method selected depends on a number of factors including the type of goods or service being procured, the value of the good or service being procured, the potential interest of foreign bidders and even the cost of the procurement process itself.⁵⁸

The procurement may be made open to either national or international competitor based on different conditions set in the law. We will see each of them with their justification for choosing one of them in the next sub section.

As a third procedure, after choosing the procurement method the public body needs to invite bidders. Such invitation shall include at least the name and address of the public body, the type, quantity and place of delivery of the goods, the criteria to be satisfied by the candidates, the place where the bidding documents can be obtained, The amount of the bidding security, the price of the bid document and the means of payment, deadline of submission of bids, and a statement that the public body reserves the right to reject any or all bids.⁵⁹

⁵⁶ Manual, *supra* note 46 , at 133.

⁵⁷*supra* note 45 ,article 33.

⁵⁸Manual, *supra* note 46, at 41.

⁵⁹ Manual, *Supra* note 46, at 54.

Fourthly, the bids shall be delivered to the place(s) stated in the Bidding Document, prior to the deadline for the submission of bids stated in the Bidding Document or amendments thereof.⁶⁰

Fifthly, A public body shall open in public and only in one place all bids received on or before the deadline for the submission of bids.⁶¹

Finally, after examining and evaluation of the bids the public bodies shall announce the result of a bid evaluation to all bidders alike at the same time. Public body has to sign with a supplier, a contract containing the general conditions of contract forming an integral part of the bidding document and the special conditions of contract to be agreed upon by and between it and the supplier.⁶² The implementation of such contract, the rights and duties the contracting parties will be examined in the next section.

2.3.1 Public Procurement Procedures in National Competitive Bidding

National competitive bidding is a procurement proceeding wherein the government entity decides that only the domestic suppliers or contractors may participate in the tender.⁶³ It refers to the procurement procedure where Invitation to Bid is restricted to the Federal Democratic Republic of Ethiopia. Public bodies shall use the standard bidding documents prepared by the Agency while applying national competitive bidding. The invitation to bid has to be published at least once in a news paper that has nationwide circulation to ensure participation of as many bidders as possible.⁶⁴ Additionally, in order to attract a large number of bidders, the bid advertisement may also be posted on the website of the procuring public body and on the website of PPA.⁶⁵ In national competitive bidding the supplier of public goods is a domestic supplier. So, unlike the ICB the payment modality in national competitive bidding contract is simple (the public body can effect payment easily by transferring to account number of the supplier or in cash or in check.)

2.3.2 Public Procurement Procedures in International Competitive Bidding (ICB)

When, due to lack of capacity within Ethiopia, there is either no or only limited competition for the provision of specific goods and related services and works and physical services, a public

⁶⁰ Manual, *Supra* note 46, at 60.

⁶¹ Manual, *Supra* note 46, at 61.

⁶² Manual, *Supra* note 46, at 69.

⁶³*Id.*

⁶⁴ Manual, *Supra* note 46, at 50.

⁶⁵ Manual, *Supra* note 46, at 49.

body shall undertake special efforts to improve the level of competition by seeking bids from foreign bidders to accomplish their procurement requirements.⁶⁶ Ethiopian procurement law allows international competitive bidding if the value of the goods exceeds for works above Birr 50,000,000.00 for goods above Birr10, 000,000.00 for consultancy services above Birr 2,500,000.00 and for other services Birr 7,000,000.00.⁶⁷The procedure to be followed by public bodies is almost similar to open national competitive Bidding Method.

However, international competitive bidding differs from the national competitive bidding on the following points. First, the bid advertisement and the bidding documents shall be prepared in English.⁶⁸ Second, the bid advertisement shall be published in a news paper that has wide circulation and accessible to foreign bidders.⁶⁹ Third, the schedule of requirements to be prepared shall comply with national standard and be internationally acceptable.⁷⁰ Fourth, Bid prices offered by foreign bidders shall be quoted and bid securities required of such bidders shall be furnished in a freely convertible currency used for payment in international commercial transactions.⁷¹ Fifth, Contracts concluded for procurements to be made by means of international competitive bidding may incorporate standard terms and conditions applicable in international commercial transactions to the extent that such terms and conditions are not in conflict with the Proclamation, Directive and other documents governing public procurement.⁷²

2.4 Public Contracts Implementation

A post tendering stage of public procurement is implementation of the contract according to the terms and conditions of the contract. But, at times public contracts might not be performed with the desired quality and quantity. OECD Principles for Integrity in Public Procurement mentions the following possible reasons for non implementation of public contracts.

The primary reason is deficient supervision from public officials and/or collusion between contractors and supervising officials.⁷³The second reason is abuse of the contractor in performing

⁶⁶ Manual, *Supra* note 46, at 76.

⁶⁷*supra* note 55, article 17(2).

⁶⁸ Manual, *Supra* note 46, at 76.

⁶⁹*Id.*

⁷⁰*Id.*

⁷¹*Id.*

⁷²*Id.*

⁷³ Organization for Economic Co-Operation and Development (OECD) Principles for Integrity in Public Procurement, 2009, at 69.

the contract, in particular in relation to its quality, price and timing.⁷⁴ This reason is very much related with the first reason. If the public officials and suppliers collide they may compromise the quality of the good and time of delivery. The third is Deficient separation of financial duties and/or lack of supervision of public officials which leads to false accounting and cost misallocation or cost migration between contracts, late payments of invoices, and false or duplicate invoicing for goods and services not supplied and for interim payments in advance of entitlement.⁷⁵

In order to avert such non implementation problems, OECD material on Principles for Integrity in Public Procurement suggests the following Precautionary measures in post-tendering.⁷⁶

One of such measure is ensuring that the contracting agency and the supplier are aware of policies in order to prevent conflict of interest and corruption. Another similar measure is ensuring that contract and purchase orders provide sufficient information to enable the supplier to deliver the goods/services of the correct description and quantity within the specified time. Including models in the contract for appropriate risk sharing between the public body and the contractor, especially for complex procurements (e.g. performance bond, penalty for late delivery and/or payment) is also another recommended measure. Stating in the contract possible compensation in case of undue withholding of payment by contracting officials is a recommended way of proper performance of public contracts. Where possible, testing the product, system or other results in a real world environment prior to delivery of the work is also one possible measure for appropriate implementation of public contract. There should be a mechanism of ensuring that contract changes that alter the price and/or description of the work are supported by a robust and objective amendment approval process. Ensuring that contract changes beyond a cumulative threshold are monitored at a high level, preferably by the decision making body that awarded the contract is also another measure by which public contracts can be implemented. Contract changes allowed only up to a reasonable threshold, and changes that do not alter the quality of the good or service. Beyond this threshold, a review system could be set up to understand the reasons for these changes and consider the possibility to re-tender. Creating

⁷⁴*Id.*

⁷⁵*Id.*

⁷⁶*Id.*

a mechanism whereby stakeholders, civil society and the wider public scrutinize public procurement is also one measure recommended by OECD.

As to order and payment the above OECD material specifically recommends public bodies to consider the following points before granting payment.

To begin with the public body should inspect the goods against the purchase order and the delivery invoice before payment.⁷⁷ Secondly, public bodies need to ensure that the final accounting or audit of a project is not carried out by personnel involved in former phases to ensure the separation of duties and authorization.⁷⁸ Thirdly, public bodies ensure that the budgeting system provides for a timely release of funds to make payment against contractual conditions.⁷⁹ Using innovative methods such as purchase cards for small value procurements, provided that their use is limited to purchases of specified items and that expenditure is limited. The public body should prepare systematic completion of reports for certification of budget execution and for reconciliation of delivery with budget programming. The public body should review procurement process, draw lessons that can be learned for any future contracts and place this information on record.⁸⁰

As indicated elsewhere in this paper letter of credit has expiration date. According to MOFEC directive⁸¹ a one period LC works only for 90 days. The public body pays LC service charge only for one period. If the public body wants to extend the expiry date of LC it shall pay a new LC service charge. The supplier has to make effort to ship the goods before the expiry date of LC. However, if the supplier cannot ship the goods within the provided time he/she shall request the public body to allow amendment of LC. The public body handles acceptable requests of amendment of letter of credit provided that the supplier covers service charge for the amended (new) LC. So, if the underlying contract is not implemented within the agreed time it results in the amendment of the letter of credit. Amendment of the letter of credit in turn results in payment

⁷⁷*Id.*, at 72.

⁷⁸*Id.*

⁷⁹*Id.*

⁸⁰*Id.*

⁸¹ Ethiopian ministry of finance and economic development, federal government payment directive no. 4/2003 ,Article 17.

of new LC service charge which should be covered by the party who asked the amendment of the previous LC.

2.4.1 Rights and Duties of Public Body in Public Contracts

In a given contract the contracting parties have their own rights and obligations. Where the contract is a public contract the rights and duties of the contracting parties framed by taking into consideration the public interest.

2.4.1.1 Rights of the Public Body

The public body has the right to get goods delivered in the agreed quality and quantity, within the agreed time and at the agreed place. The public body also has the right to reject delivered goods if they are not in conformity with the agreed description, quality and quantity. The Public Body or its designated representative shall be entitled to attend the tests and/or inspections of the goods. In relation to this the public body has the right to get a reasonable time and opportunity to examine the goods for ascertaining whether they are in conformity with the contract. The public body can claim liquidated damages when the goods are not delivered within the agreed time.⁸² But, the failure of a Supplier to fulfill any of its obligations shall not be considered to be a breach of, or default under, the Contract insofar as such inability arises from an event of Force Majeure.⁸³ The public body has the right to terminate the contract if the supplier fails to deliver any or all of the goods within the specified period, if the supplier fails to provide any registration or other certificate in respect of the goods, if the goods do not meet the technical specifications, if the supplier engaged in corrupt or fraudulent practices, if the supplier becomes bankrupt or insolvent and if the supplier fails to perform any other obligation.⁸⁴

2.4.1.2 Duties of the Public Body

The first common duty imposed upon public bodies in most public contracts is the duty not to participate in corrupt practices. The public body needs to observe the highest standards of ethics during the procurement and the execution of contracts.⁸⁵ Public bodies or officials of public bodies are required to refrain from corrupt activities in the implementation of public contracts.

⁸² Standard Bidding Document (SBD) For Procurement Of Health Sector Goods For International Competitive Biddings (ICB), Addis Ababa, 2011, article 34.2 which reads “a delay by the Supplier in the performance of its Delivery and Completion obligations shall render the Supplier liable to the imposition of liquidated damages pursuant to GCC Clause 25, unless an extension of time is agreed upon”.

⁸³ *Id.*, article 32.

⁸⁴ *Id.*

⁸⁵ *Id.*, article 3.

The second duty is to give any notice as to the supplier in the mode mentioned in the contract. SBD of Ethiopia requires any notice given by one party to the other pursuant to the contract shall be in writing to the address specified in special condition of the contract.

The third duty of public body is to effect payment for the supplier promptly. The mode of payment also shall be as agreed in the contract. The mode of payment in most ICB contracts is by letter of credit. The public body is duty bound to Open letter of credit (LC) promptly in respect of a procurement requiring the issuance of letter of credit in favor of a supplier.

The fourth duty of the public body is to inform the supplier in case the public body refuses to accept or rejects the goods. The Public Body shall notify the Supplier of the discovery of any defect within a reasonable time of its discovery and shall give the Supplier all reasonable opportunities to investigate such defect.⁸⁶ The public body, in some public contracts, also required to co-operate with the supplier to facilitate registration of the supplied goods.

2.4.2 Rights and Duties of the Seller (Supplier)

2.4.2.1. Rights of the Seller (Supplier)

The seller has the right to claim payment if delivery is made before payment. Since the payment of most ICB contracts made through LC arrangements, the public body needs to open LC within the agreed time so that the payment might not be delayed. The unpaid seller of the goods has the right to retain the goods for the price while in possession of them. In the case of the insolvency of the buyer, a right of stopping the goods in transit after the seller has parted with the possession of them. The supplier has the right to demand an equitable price adjustment if change of order and contract amendment asked by the public body caused an increase in the price of the goods.⁸⁷

2.4.2.2. Duties of the Supplier

The supplier is duty bound to deliver the goods at the time and place agreed in the contract. Delivery shall be completed when the Goods have been unloaded at the location and such delivery has been accepted by a duly authorized agent, employee or location representative of the Public Body.⁸⁸The Supplier shall supply all the goods and related services included in the Scope of Supply. The Supplier shall carry out, at its own expense and at no cost to the Public Body, all

⁸⁶*Id.*

⁸⁷*Id.*

⁸⁸ *Id.*

tests and/or inspections of the goods and related services. The Supplier shall indemnify and hold harmless the Public Body and its employees and officers from and against any and all suits, actions or administrative proceedings, claims, demands, losses, damages, costs, and expenses of any nature, including attorney's fees and expenses, which the Public Body may suffer as a result of any infringement or alleged infringement of any patent, utility model, registered design, trademark, copyright, or other intellectual property right registered or otherwise existing at the date of the Contract by reason of The use and sale of the Goods.⁸⁹ Moreover, the Supplier shall, at all times, act loyally and impartially and as a faithful adviser to the Public Body in accordance with the rules and/or code of conduct of its profession as well as with appropriate discretion.

⁸⁹*Id.*, article 29.

Chapter Three

Nature, History, Type and Legal Framework of Letter of Credit

3.1 Nature of Letter of Credit

Payment in sales contract can be made in several different ways: by the buyer remitting cash with his order or by open account whereby the buyer remits payment at an agreed time after receiving the goods. Payments can also be effected by documentary collection through a bank in which case the buyer pays the collecting bank for account of the seller in exchange for shipping documents which would include, in most cases, the document of title to the goods.⁹⁰ In the aforementioned methods of payment, the seller relies entirely on the willingness and ability of the buyer to effect payment. When the seller has doubts about the credit-worthiness of the buyer and wishes to ensure prompt payment, the seller can insist that the sales contract provides for payment by letter of credit.⁹¹ Furthermore, if the bank issuing the letter of credit (issuing bank) is unknown to the seller or if the seller is shipping to a foreign country and is uncertain of the issuing bank's ability to honor its obligation, the seller can, with the approval of the issuing bank, request its own bank (confirming bank) to assume the risk of the issuing bank by confirming the letter of credit.⁹²

Thus, use of documentary credits keeps commercial activity flowing smoothly without the need for lengthy pauses between shipment of goods and payment, and the possible consequential need for interim finance for the seller.⁹³ Problems arising in relation to the quality or quantity of goods shipped may be litigated between the parties to the underlying sales transaction on eventual receipt of the goods by the buyer.⁹⁴ Prior to the litigation, the seller can use the payment moneys in furtherance of its business activities and the buyer can deal with the goods through the documents.⁹⁵

⁹⁰ International trade finance service, *Documentary Letters Of Credit A Practical Guide*, Scotia bank, 2011, at 3.

⁹¹*Id.*, at 5.

⁹²*Id.*, at 12.

⁹³*Id.*, at 15.

⁹⁴Jacqueline D. Lipton, *Documentary Credit Law and Practice in the Global Information Age*, *Fordham International Law Journal*, vol.22, 1998 at 1973.

⁹⁵*Id.*

In documentary credit transactions the obligations undertaken by the parties are mutually dependent. From the beneficiary's point of view the independence of documentary credit relieves him from the concern that the buyer applicant may be unwilling to perform his engagement to pay. Moreover, documentary credit provides considerable assurance that payment will not be withheld pending resolution of commercial disputes.

This independence rule of the documentary credit is based on two policy considerations.⁹⁶One is that the issuing bank does not assume any liability for the performance of the underlying contract between the buyer and the seller as the banker does not have control over making the underlying contract.⁹⁷ Another consideration is that if the issuing bank look beyond the terms of the credit to the underlying contractual controversy between its customer and the beneficiary the commercial utility of documentary credit will get eroded.⁹⁸ Many of its operative rules, regardless of geography or legal systems, have emerged from the customs of banks dealing with importers and exporters, and with shipping and insurance companies. Credits are by their nature transactions separate from their underlying transactions and that payment need to be based solely on a determination of the conformity of the documents presented with the terms and conditions of the credit without reference to the beneficiary's performance of the underlying contract.⁹⁹ Letter of credit has strictly documentary nature, and is independent from the underlying transaction.

3.2 Process of the operation in Documentary Credits

The whole operation of documentary credit is initiated by a stipulation in the underlying contract of sale between buyer (public body) and an exporter (seller) to the effect that payment of the price is to be made by documentary letter of credit. After signing of such contract the public body applies to its nearby bank in order to open LC in favor of the seller abroad. The public body's request will be made by completing and signing an application form supplied by his bank. The application form contains the terms which are to be set out in the letter of credit, e.g. its amount, the expiry date, its type and the documents that payment is to be made against,

⁹⁶Susmithap Mallaya, *Documentary Credit Law: An Indian Perspective*,(unpublished, PhD thesis Cochin University of Science and Technology 2007), at 62.

⁹⁷*Id.*

⁹⁸*Id.*, at 66.

⁹⁹*Id.*, at 56.

etc.¹⁰¹The bank's acceptance of the public body's request creates the contract between them, the terms of which are contained in the application form.¹⁰²

After accepting the application form the public bodies, bank will either instruct a bank in the exporter's country to issue the letter of credit in accordance with the terms of the application form or issue such a letter of credit itself.¹⁰³ It will then notify the exporter of its issuance by mailing it directly or by using the service of another bank.¹⁰⁴ The letter of credit is regarded as the basis of the contract between the issuing bank (and confirming bank) and the exporter.¹⁰⁶After receiving the documentary letter of credit the exporter will ship the goods and obtain documents (i.e., bill of lading, insurance policy, invoice, etc.) that conform to the terms and conditions of the letter of credit.¹⁰⁷ The exporter will then draw a draft for the price of the goods and himself present it together with the documents for payment, acceptance or negotiation as the case may be, before the expiry date of the credit to the issuing bank, confirming bank or another bank authorized by the issuing bank to make such payment, acceptance or negotiation.¹⁰⁸ The bank after receiving the documents will examine them and reject them if they are not in compliance with the terms of the credit or accept them if they are, and pay, accept or negotiate the exporter's draft.¹⁰⁹

The public body's bank after accepting the documents and paying the exporter or reimbursing the bank that made such payment will be in possession of the documents as a security for such payment. If the public body has put the bank in funds before issuing or requesting the issuance of the credit, the bank will reimburse itself from such funds.

Except the restriction to arrange LC process with commercial bank of Ethiopia public bodies in Ethiopia follow the same process while implementing public contracts which involve importation of goods.

The following chart summarizes the process of LC in public contracts.

¹⁰¹Ahmed A. Al-Ghadyan, *The Legal Relationships under Commercial Letter of Credit a Comparative Study*, (unpublished, PhD thesis University of Edinburgh, 1993) at 12.

¹⁰² See application forms of LC of different banks.

¹⁰³Ahmed A. Al-Ghadyan, *Supra* note 100, at 13.

¹⁰⁴*Id.*

¹⁰⁶*Id.*, at 24.

¹⁰⁷*Id.*, at 45.

¹⁰⁸*Id.*

¹⁰⁹*Id.*, at 29.

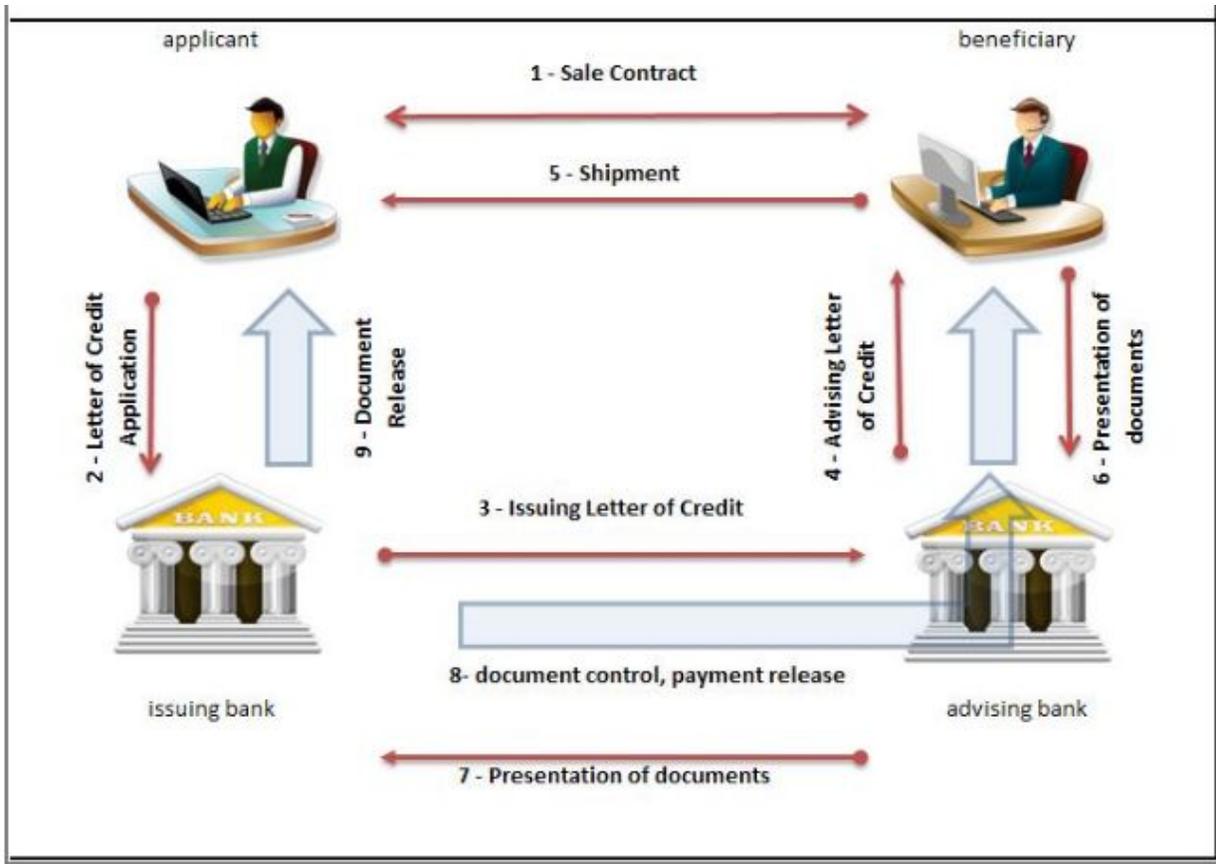


Figure 1 Basic import letter of credit transaction flow chart¹¹⁰

3.3 Main Parties to Letter Of Credit and Their Contractual Relationship

In a certain letter of credit at least there exist four parties and contractual relationships. The first party is the buyer in this particular instance the public body. While processing letter of credit the public body creates contractual relationship with the seller and with the issuing bank. The second party is the seller (the supplier). In the process of LC the seller creates contractual relationship with the buyer (public body), with issuing bank and advising or confirming bank. The third party is issuing bank and it creates contractual relationship with the buyer, advising or confirming bank and with the seller. The fourth party in letter of credit is advising or confirming bank. Advising or confirming bank enters into contractual relationship with the seller and with the issuing bank.

The following sub-titles are devoted for examining the contents of the three main contractual relationships.

¹¹⁰ Taken from <http://www.letterofcredit.biz/how-does-an-import-letter-of-credit-work.html> last visited on 5/2/18.

3.3.1 The Relationship between Public Body and the Seller

The letter of credit and all legal relationships involved in it come into existence because of a term in an underlying contract which provides that the payment should be effected through LC arrangement. Such underlying contract is a contract of sale, where the seller stipulates that payment is to be made by a documentary letter of credit, stating the type of the letter of credit, the time in which such LC is to be opened, expiry date of LC, the name and address of the beneficiary's bank, name and address of the beneficiary, SWIFTCODE, mode of shipment and list of accompanying documents. The fulfillment of such stipulation by the buyer is a condition precedent to the seller's duty to perform his obligation under the contract of sale.¹¹¹ So, if the letter of credit was not opened or opened but not on time, the seller can bring an action against the buyer under the sale contract. The seller also can bring an action against the public body if the opened LC doesn't conform to the terms and conditions set under the sales contract. But the seller cannot bring action against the issuing or confirming bank because their obligations under the letter of credit are independent of the underlying contract and are not affected by it.¹¹²

In case where the issuing bank becomes insolvent after it has been put in funds by the public body the LC amount remains unpaid. But it is controversial as to the effect of such opened LC. Some writers propose two possibilities to such controversy. The first possibility is that the fund was allocated to meet the seller's drafts; in this case the seller will be entitled to payment in preference over the general creditors of the insolvent issuing bank.¹¹³ The second possibility is that such funds were not appropriated to meet the seller's drafts; in this case the seller will be treated as a general creditor of the insolvent bank and will be entitled to payment from the public body for the unsatisfied part of the price of the goods.¹¹⁴ Such possibility obliges the public body

¹¹¹ Ahmed A. Al-Ghadyan, *Supra* note 100, at 18.

¹¹² *Id.*, at 19.

¹¹³ Uniform commercial code, (U.C.C.) USA, §5-117(1) which reads as follows "Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which the Article is made applicable by paragraphs (a) or (b) of Section 5-102(1) on scope, the receipt of allocation of funds or collateral to secure or meet obligations under the credit shall have the following results: (a) to the extent of any funds or collateral turned over after or before the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and (b) on expiration of the credit or surrender of the beneficiary's rights under it unused any person who have given such funds or collateral is similarly entitled to return thereof; and (c) a change to a general or current account with a bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instructions."

¹¹⁴ ZsuzsannaTóth, *Supra* note 1 at 21.

to pay the LC for the second time. Al-Ghadyan justifies the public body's obligation to pay for the second time as follows.

It is true that it is unjust to require the public body to pay almost twice the price of the goods, but the situation is that one of two innocent parties should bear the loss caused by the insolvency and it is fairer that it should be the buyer rather than the seller, because on the one hand the buyer is under an obligation to provide a solvent paymaster and he failed to fulfill this obligation, on the other hand the public body is in a better position to evaluate the financial status of the issuing bank than the seller.¹¹⁵

3.3.2 The Relationship between the Public Body and the Issuing Bank

After conclusion of the underlying contract the public body applies to its nearby bank (issuing bank)¹¹⁶ for the opening of LC in favor of the seller abroad. The public body's request is usually made by completing and signing a standard application form prepared by the issuing bank which contains the terms on which the bank undertakes to issue the credit. As we can infer from different bank's application form, the public body should clearly fill the following questions as required. The public body is expected to fill its name and address at the top of the application form for LC. The name and address of the beneficiary are also required to be filled by the public body. The public body is also expected to specify the name, address and SWIFT CODE of the advising or confirming bank if needed. The type of LC, amount of LC both in figure and in words, delivery terms, shipment date, expiry date, place of shipment and delivery, whether partial and transshipment is allowed or not, country of origin of the good, list of required documents, number of original documents, insurance policy and certificate of origin are some other of the required things that should be mentioned by public body while applying for LC. In the form the authorized person of the public body also conform by his signature that the bank can take the LC amount and any cost from the public body's account.

The bank, having accepted the public body's request in one of these ways, must adhere strictly to the public body's instructions set out in the application form in order to be entitled to indemnity.

¹¹⁵Ahmed A. Al-Ghadyan ,*supra* note 100,at 22.

¹¹⁶ In Ethiopia according to ministry of finance and economic cooperation directive no. 4/2003 public bodies can only open LC in commercial bank of Ethiopia and construction and business bank of Ethiopia. Since these two banks have been merged together currently public bodies can only arrange LC with commercial bank of Ethiopia.

Regarding coming into existence of such contract, In Common Law countries the public body's signed application form constitutes an offer which when accepted by the bank either expressly by notifying the buyer or by acting upon the application e.g. by issuing the requested credit, by accepting the commission or by accepting a fund for the opening of the credit etc., brings into existence a contract between the two parties.¹¹⁷

In Germany the buyer's application becomes a contract binding on both parties from the time it was received by the bank or after that time but by a reasonable period of time.¹¹⁸ In Italy the view is that the application constitutes a special contract which is binding on both parties, but at the same time its binding nature depends on the creditworthiness of the parties.¹¹⁹

The nature of such contract is controversial. In Germany the contract between the issuing bank and the buyer was considered to be a contract for employment.¹²⁰ This contract is regulated in German Law by para631 of the Buergerliches Gesetzbuch. Some scholars on the other hand say that the nature of issuing bank-public body relationship is agent- principal relationship. They justify it by mentioning the similarities between these two relationships. The first similarity is that the public body pays a commission to the bank for opening the credit.¹²¹ This is similar to a commission by principal to his agent. The second is that the instruction contained in the application form which the buyer gives to the bank is similar to the mandate which is given by the principal to his agent.¹²² These scholars argue that these similarities are sufficient to label the contract between the issuing bank and the public body as agent-principal contract. But the above conclusion is not free from criticism.

Some other scholars also argue that issuing bank –public body relationship is similar to creditor-debtor relationship. When the buyer puts the issuing bank in funds before issuing the credit, the money will not be held in trust for the seller by the issuing bank but the bank will be a mere debtor of the buyer for that fund.¹²³ If the issuing bank was not put initially in funds and it

¹¹⁷Ahmed A. Al-Ghadyan ,*Supra* note 100 , at 26.

¹¹⁸Kozolchyk, International Encyclopedia of Comparative Law Chapter 5 Letters of Credit, as cited in Ahmed A. Al-Ghadyan ,*Supra* note 100.

¹¹⁹ Ahmed A. Al-Ghadyan ,*Supra* note 100, at 27.

¹²⁰*Id.*

¹²¹*Id.*, at 29.

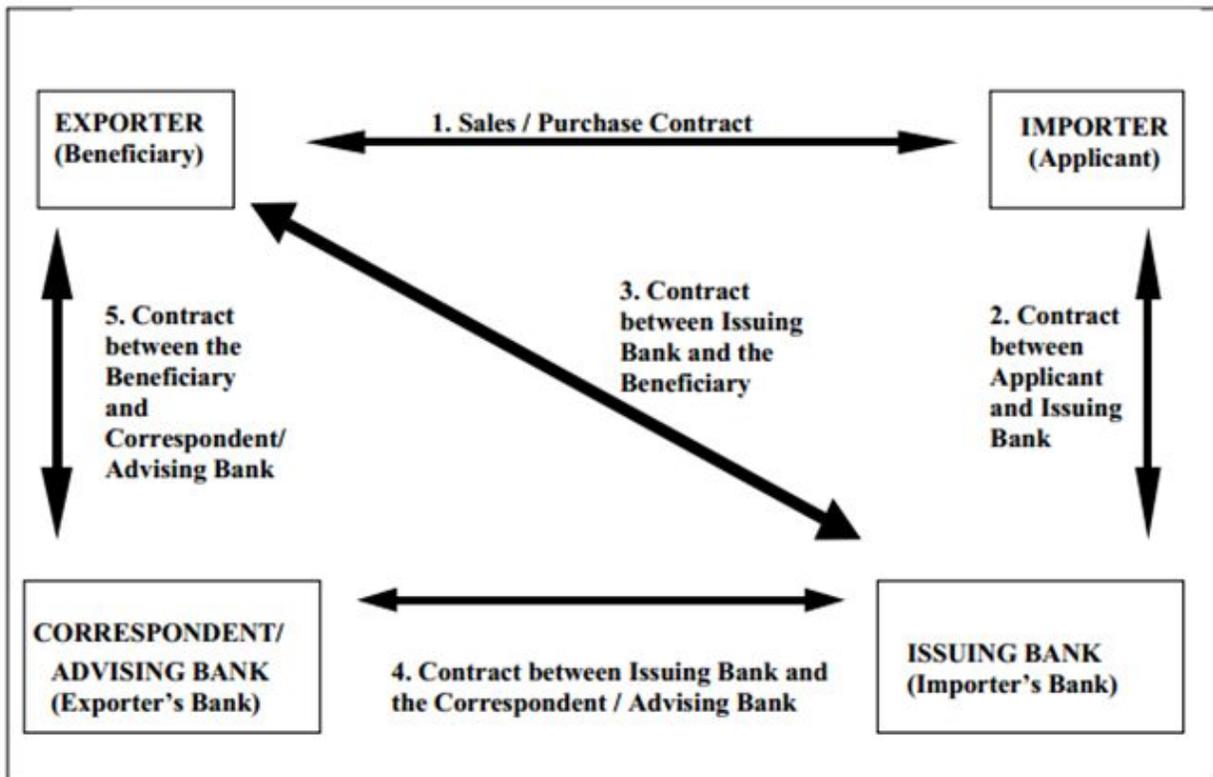
¹²²Ellinger, Documentary Letters of Credit, as cited in Ahmed A. Al-Ghadyan ,*Supra* note 100.

¹²³*Id.*, at 30.

accepted the documents from the seller and effected payment, the issuing bank, when reimbursement becomes due, will be the creditor of the buyer for such payment.¹²⁴

3.3.3 The Relationship between the Issuing Bank and the Beneficiary

The relationship between the issuing bank and the beneficiary becomes binding on the part of the issuing bank at the time when the letter of credit is communicated to the beneficiary. Like all the other contracts involved in the letter of credit transaction the issuing bank's undertaking towards the seller is independent of the contract between the seller and the public body and of the contract between the issuing bank and the public body.¹²⁵ Thus, neither the seller nor the public body can raise defense against the issuing bank defenses arising out of the underlying contract.¹²⁶ The issuing bank must honor the beneficiary's draft or demand for payment if accompanied by documents that are in compliance with the terms of the credit.¹²⁷



¹²⁴*Id.*

¹²⁵ Dolan J. The Correspondent Bank in the Letter of Credit Transaction, *Banking L.J.* Vol.109, No.5 ,1992, 396 at 404.

¹²⁶ Ahmed A. Al-Ghadyan ,*Supra* note 100, at 35 .

¹²⁷*Id.*

Figure 2 a chart which shows various contracts in a single LC transaction¹²⁸

3.4 Basic Principles of Letter of Credit

There are two basic principles governing letter of credit. These are the principle of autonomy and the principle of strict compliance.

3.4.1 Principle of Autonomy “Pay First, Argue Later”

The principle of autonomy refers to the understanding that the credit is independent of and separate from the underlying contract between the seller and the buyer, and also from the agreement between the applicant and the issuer.¹²⁹ According to this principle the issuer must honor its obligation to the beneficiary under the letter of credit, irrespective of any disputes or claims relating to either the underlying transaction or the application agreement, unless fraud is established in the transaction.¹³⁰ The principle of autonomy is supported by the rule that banks deal only with documents and not with the goods covered by them.¹³¹ The bank’s decision whether to accept or reject the documents presented by the seller depends only on a formal examination of the documents.¹³² This principle enables the beneficiary to prompt payment regardless of any dispute relating to the underlying contracts (“pay first, argue later” function).¹³³ The bank is in no way concerned with any dispute that the buyer may have with the seller.¹³⁴ The buyer may say that the goods are not up to the contract. Nevertheless the bank must honor its obligations. The buyer may say that he has a cross-claim in a large amount. Still the bank must honor its obligation.

The principle of autonomy has two exceptions. The first exception is in case where transaction has an illegal element. Such illegality happen for example if a buyer furnishes an irrevocable credit for an amount higher than the amount stated in the underlying sales contract for the purpose of obtaining extra funds overseas in breach of the exchange control legislation

¹²⁸ Taken from Roberto Bergami, School of Applied Economics, Institute for Community Engagement and Policy Alternatives, Victoria University.

¹²⁹ *Supra* note 1, at 85.

¹³⁰ J.E. Byrne, Critical Issues in the International and Domestic Harmonization of Letter of Credit Law and Practice In Commercial Law, as cited in ZsuzsannaTóth, *Supra* note 1, at 67.

¹³¹ UCP, *Supra* note 2, Article 5.

¹³² ZsuzsannaTóth, *Supra* note 1, at 86.

¹³³ Rodrigo, Thanuja, UCP 500 to 600: A forward movement, Murdoch University Law Review, 2011, at 5.

¹³⁴ *Id.*

prevailing in his country.¹³⁵ In such case the LC will not be enforceable. The second exception to the principle of autonomy is the fraud exception where the seller commits a fraudulent act (e.g.: tenders forged documents) in order to obtain payment.¹³⁶ The fraud in the documents involves a fraudulent misrepresentation.

Principle of autonomy has been recognized in Ethiopian commercial code.¹³⁷ But unlike the UCP¹³⁸ and USA Uniform Commercial Code¹³⁹, Ethiopian commercial code recognizes this principle with general statement without mentioning it specifically. Moreover unlike the UCP and USA uniform commercial code, Ethiopian commercial code has no provisions of fraud exception. As discussed above the whole process of letter of credit is document based or paper based. A document based process is susceptible for fraud. The susceptibility of letter of credit for fraud becomes high with the advancement of technology. Enacting and implementing laws on fraud in LC can be one means of tackling fraud on letter of credit.

3.4.2 Principle of Strict Compliance

According to this principle the bank is entitled to reject documents which do not comply strictly with the terms and conditions of the credit.¹⁴⁰ When a bank receives the documents for payment, the bank is under a duty to check the documents for discrepancies. The documents should comply strictly with the terms of LC. The principle of strict compliance gives protection to the public body. It guarantees that the public body will have to reimburse the issuing bank only against documents it has specified in the LC triggering the obligation.¹⁴¹ If the documents presented vary with the mentioned documents in the application form of the letter of credit, the issuing bank is justified in violating the autonomy principle and applying the principle of strict compliance.

¹³⁵ Ellinger, Letters of Credit In Norbert Horn, Clive M. Schmitthoff (ed.), The transnational law of international commercial transactions, as cited in ZsuzsannaTóth, *Supra note 1*, at 88.

¹³⁶ ZsuzsannaTóth, *Supra note 1*, at 88.

¹³⁷ See civil code, *supra note 27*, article 959(2) which read as “A documentary credit is independent of any contract of sale on which it may be based and to which a bank is not a party.

¹³⁸ UCC, *Supra note 111*, article 4(a) recognize this principle in detail. The provision reads as follows “A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate or to fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from its relationships with the issuing bank or the beneficiary”.

¹³⁹ UCC, *supra note 111*, article 5 section 5-103(d).

¹⁴⁰ ZsuzsannaTóth, *Supra note 1*, at 88.

¹⁴¹ Id

Just like the principle of independent, the principle of strict compliance has been also mentioned in Ethiopian commercial code.¹⁴²

3.5 Historical Development of Letter Of Credit

During the 12th and 13th centuries, the instrument most frequently mentioned as the forerunner of the modern commercial LC is an early Mediterranean form of the bill of exchange, referred to by some historians as the letter of payment.¹⁴³ Letter of payment involves four parties. These parties were the remitter, the maker or drawer, the payer to whom the instrument was addressed, and the payee to whom it was sent by the remitter.¹⁴⁴ But, it is doubtful whether the payee of the letter of payment could have forced the payer to pay the stated sum in the nonexistence of a formal recognition of the remitter's or payee's right.¹⁴⁵ Moreover it has not been clearly established whether the letter of payment was merely the result of a contract of exchanger of both a contract of exchange and an extension of credit.¹⁴⁶ Letter payment also contained only an order of payment and not an explicit promise to pay.

Latter on during the 17th century was common to find other instruments referred to as "letters of credit". They describe letter of credit as a merchant doth send his friend or servant to buy some commodities or take up money for some purpose.¹⁴⁷ As with the twelfth and thirteenth century letter of payment, this was a multiparty transaction; however, the letter of credit contained an express or implied promise to reimburse the payer.¹⁴⁸ But, in the 17th century letters of credit the nominee-payee acquired no right of action against the payer, and presumably would acquire a right of action in restitution against the issuer only upon proof of prepayment.¹⁴⁹

After the middle of the nineteenth century a new (modern) type of letter of credit, the "commercial letter of credit," issued by mercantile factors and banking houses, began to gain favor with Anglo-American and European trade.¹⁵⁰ This letter was used as a means finance and

¹⁴² Civil code, *supra* note 27, articles 965 and 966.

¹⁴³ Boris Kozolchik, *The Legal Nature of the Irrevocable Commercial Letter of Credit*, Oxford University Press, 1965, at 395.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*, at 396.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*, at 397.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*, at 398.

pay for international sales of the documentary variety.¹⁵¹ The purpose of such LC was to enable an exporter to draw his draft or bill of exchange, not on the buyer-importer, but on a bank or factor of known solvency.

There is no source which shows the starting point of documentary credits in Ethiopia. But, the law on documentary credit enacted in 1960.

3.6 Types of Letter Of Credit

Based on different measurements LCs can be categorized as follows.

3.6.1 *Unconfirmed or Confirmed*

In many transactions the issuing bank communicates the letter of credit through another bank that may act as an advising or a confirming bank. Under an unconfirmed credit this second bank simply transmits the credit to the beneficiary “advising” him of the availability of funds at the issuing bank.¹⁵² An advising bank assumes no obligation to honor drafts. An unconfirmed letter of credit carries the obligation of the issuing bank to honor all drawings, provided that the terms and conditions of the LC have been complied with.¹⁵³ On the other hand, the correspondent may confirm a credit instead of merely advising it. A confirmed letter of credit also carries the obligation of another bank which is normally located in the beneficiary’s country, thereby giving the beneficiary the comfort of dealing with a bank known to him.¹⁵⁴ Confirmed credits are particularly desirable where an issuing bank is in a politically or financially unstable country.

An irrevocable, confirmed letter of credit “gives the beneficiary a double assurance of payment, since it represents both the undertaking of the issuing bank and the undertaking of the confirming bank.”¹⁵⁵

3.6.2 *Revocable or Irrevocable*

If letter of credits are revocable they can be cancelled or amended at any time by the issuing bank without notice to the beneficiary. It is not possible to cancel irrevocable LC unless the beneficiary consented to cancel. In other words, every amendment at least requires beneficiary's

¹⁵¹*Id.*

¹⁵²Roger J. Gewolb, the Law Applicable to International Letters of Credit, 11 Vill. L. Rev. 742 (1966), at 743

¹⁵³ Ahmed A. Al-Ghadyan, *Supra* note 100, at 14.

¹⁵⁴*Id.*, at 2.

¹⁵⁵ZsuzsannaTóth,*Supra* note 1, at 87.

acceptance in order to be effective.¹⁵⁶ A revocable letter of credit gives the applicant (public body) maximum flexibility, whereas it gives less security to the beneficiary.¹⁵⁷ An irrevocable letter of credit gives greater assurance to the beneficiary as to the payment by the bank, since it cannot be modified or cancelled without the express consent of the beneficiary.

3.6.3 Sight or Time LC

Letters of credit can permit the beneficiary to be paid immediately upon presentation of specified documents (sight letter of credit), or at a future date as established in the sales contract (time letter of credit).¹⁵⁸ If the buyer is in a better bargaining position than the seller, he may try to acquire credit from the latter by insisting in his agreement with the seller that the letter of credit should call for a time draft. In this method the seller does not receive an immediate payment as in the case for sight draft, but he will receive payment at some time after tendering the required documents for instance, at 90 or 180 days after sight after the date of the bill of lading.¹⁵⁹

3.6.4 Red Clause Letter Of Credit

It incorporates a clause, traditionally written in red, which authorizes the bank performing as the negotiating or paying bank to pay the beneficiary in advance of shipment.¹⁶⁰ This enables the purchase and accumulation of goods from a number of different suppliers, and the arrangement of shipment in accordance with the letter of credit terms.¹⁶¹ Such advances will be deducted from the amount due to be paid when the documents called for are presented with the LC. If the beneficiary fails to ship the goods or cannot do so before the expiry of the LC, the issuing bank is required to reimburse the negotiating or paying bank, recovering its payment from the applicant.¹⁶²

3.6.5 Transferable Letter Of Credit

A transferable LC let the beneficiary to act as a middleman and transfer his rights in the LC to another party or parties who may be suppliers of the goods.¹⁶³ The letter of credit however, can be transferred only once: the secondary beneficiaries cannot transfer their rights to a third

¹⁵⁶Ahmed A. Al-Ghadyan ,*Supra* note 100, at 35.

¹⁵⁷ZsuzsannaTóth,*Supra* note 1,at 22.

¹⁵⁸ Ahmed A. Al-Ghadyan ,*Supra* note 100, at 65.

¹⁵⁹ Ahmed A. Al-Ghadyan ,*Supra* note 100, at 297.

¹⁶⁰Jacqueline D. Lipton ,*Supra* note 94, 1979.

¹⁶¹*Id.*

¹⁶²*Id.*, at 1998.

¹⁶³*Id.*

party.¹⁶⁴ To be transferable, a letter of credit must be marked as such by the issuing bank which can only do so on the applicant's specific instructions. By making a credit transferable the seller assigns his right to perform under the documentary credit to a third person. This third person steps into the credit and in advance is assured payment out of funds made available by the ultimate buyer, provided that the conditions of the original LC are complied with.¹⁶⁵

In the course of the operation of the transferable credit the supplier presents the required documents, including his invoice, to the bank and request payment.¹⁶⁶ The seller also presents his invoice and receives the difference in price between his invoice and what has already been paid to the supplier. Thus, the seller can obtain his profit on the transaction. The bank then sends the invoice presented by the seller to the buyer. This way the buyer will have no knowledge of who the supplier is unless it is revealed by other documents such as the transport documents that may indicate the supplier as the shipper.¹⁶⁷ The importance of the first beneficiary's Seller ability to conceal the name of the party selling to him lies in the fact that otherwise the buyer might cut him out on future transactions dealing directly and more cheaply with the third party seller.¹⁶⁸

UCP600 and USA Uniform Commercial Code have specific provisions about each controversial issue of transferable letter of credit. For instance, unless otherwise agreed at the time of transfer, all charges (such as commissions, fees, costs or expenses) incurred in respect of a transfer must be paid by the first beneficiary.¹⁶⁹ UCP also gives explanation regarding the payment to the first beneficiary and the second beneficiary. Accordingly, the first beneficiary has the right to substitute its own invoice and draft, if any, for those of a second beneficiary for an amount not in excess of that stipulated in the credit and upon such substitution the first beneficiary can draw under the credit for the difference, if any, between its invoice and the invoice of a second beneficiary.¹⁷⁰ Moreover, if the first beneficiary is to present its own invoice and draft, if any, but fails to do so on first demand, or if the invoices presented by the first beneficiary create discrepancies that did not exist in the presentation made by the second beneficiary and the first beneficiary fails to correct them on first demand, the transferring bank has the right to present the

¹⁶⁴*Id.*

¹⁶⁵ZsuzsannaTóth, *Supra* note 1, at 27.

¹⁶⁶*Id.*

¹⁶⁷*Id.*

¹⁶⁸Raymond Jack, *Documentary Credits*(1991), as cited in ZsuzsannaTóth, *Supra* note 1, at 27.

¹⁶⁹ UCP, *Supra* note 2, article 38(c).

¹⁷⁰ UCP, *Supra* note 2, article 38(h).

documents as received from the second beneficiary to the issuing bank, without further responsibility to the first beneficiary.¹⁷¹ So, the issuing bank is strict responsibility the first beneficiary.

When we come to Ethiopian commercial code article 967 of the code defines transferable documentary credit. The code also provide that a credit is only transferable on the express order of the bank opening the credit and transferable once only, unless otherwise provided. But unlike the UCP and the USA uniform commercial code, Ethiopian commercial code does not provide a clue about rights and responsibilities of the buyer, the issuing bank, transferee and transferor. So, it is difficult to resolve controversial issues about transferable letter of credit based on the current Ethiopian law on documentary credit.

3.6.6 Back-To-Back Letter Of Credit

A Back-to-Back Documentary Credit is used in transactions where a seller, who entered into a contract of sale of certain goods, has to purchase those goods from his supplier and no transferable credit is used in the transaction.¹⁷² Although not recorded on a letter of credit, back-to-back is a term used in transactions involving two irrevocable letters of credit.¹⁷³ a documentary credit opened by the buyer in favor of the seller and another documentary credit opened by the seller in favor of the supplier on the security of the first credit. The original credit, and the second opened in favor of the supplier, will be in identical terms apart from the price.¹⁷⁴ Such transactions originate when a seller receives a letter of credit covering goods which must be obtained from a third party that in turn requires a letter of credit. The “second” issuing bank looks to the first issuing bank for reimbursement after paying under the second letter of credit. The difference between back-to-back letters of credit and transferable letters of credit is such that in a transferable letter of credit, the rights under the existing letter of credit are transferred.¹⁷⁵ In a back-to-back transaction, different letters of credit are actually issued. Because technical problems can arise in back-to-back transactions, banks tend to discourage their use.

¹⁷¹ UCP, *Supra* note 2, article 38(i).

¹⁷² ZsuzsannaTóth, *Supra* note 1 at 29.

¹⁷³ Jacqueline D. Lipton ,*Supra* note 94, at 1967.

¹⁷⁴ ZsuzsannaTóth, *Supra* note 1, at 30.

¹⁷⁵ Jacqueline D. Lipton ,*Supra* note 94, at 1968.

When we look at Ethiopian law on documentary credit revocable, irrevocable, confirmed, unconfirmed and transferable LCs has been recognized.¹⁷⁶ Moreover, the practice, as we can infer from application form of LC, shows that almost all the above mentioned types of letter of credit are functional in Ethiopia.

3.7 Accompanying Documents of Letter of Credit

There are different documents required in LC forms. Below let see documents most commonly seen in a letter of credit transaction.

3.7.1 Commercial Invoice

The commercial invoice is an itemized account issued by the beneficiary and addressed to the applicant, and must be supplied in the number of copies specified in the letter of credit.¹⁷⁷ The invoice description of the goods must be identical to that stipulated in the letter of credit. Unit prices and shipping terms, i.e., CIF, FOB, etc., must be as stipulated in the letter of credit.¹⁷⁸ A commercial invoice normally contains the name and address of the seller ,date of issue ,invoice number , name and address of the buyer , quantity and description of the goods , unit price , total invoice price ,terms of delivery and payment, shipping details and other information required by the documentary credit.¹⁷⁹ In UCP and UCC the nature and the contents of commercial invoice have been included. But, Ethiopian law on documentary credit lacks provision about commercial invoices.

3.7.2 Bill of Lading

It is a receipt issued by a carrier for goods to be transported to a named destination, which details with the term and condition of transit.¹⁸⁰ Bill of lading serves as a receipt by the ship-owner acknowledging that the goods were received for shipment, proof of contract of carriage between the shipper and the carrier and document of title enabling the person entitled to the goods to dispose of them while the goods are in transit.¹⁸¹ There are two different types of bill of lading: -

¹⁷⁶ Commercial code, *supra* note 27, articles 961-964 and 967.

¹⁷⁷ Jacqueline D. Lipton ,*Supra* note 94, at 1987.

¹⁷⁸ *Id.*

¹⁷⁹ ZsuzsannaTóth, *Supra* note 1, at 78.

¹⁸⁰ Jacqueline D. Lipton ,*Supra* note 94, at 1977.

¹⁸¹ Jacqueline D. Lipton ,*Supra* note 94, at 1978.

The first is Straight Bill Of Lading which is one that names a specific consignee to whom goods are to be delivered. It is a non-negotiable document.¹⁸²The second is Order Bill Of Lading which is one that is written “to order” or to order of a named party making the instrument negotiable by endorsement. Letters of credit usually call for an order bill of lading blank endorsed; meaning the holder of the bill has title to the goods.¹⁸³

Given that each bill of lading shall be either “straight” or “order”, the following is a list of more common types of bill of lading:

- **An Ocean Bill Of Lading** is one issued by an ocean carrier in sets, usually three signed originals comprising a complete set, any one of which gives title to the goods.¹⁸⁴
- **A Charter Party bill of Lading** is one which shippers may, when large or bulk cargoes are concerned, lease the carrying vessel for a stated time or specific voyage under a charter party contract with the owner.¹⁸⁵ Goods carried are then covered under a form of bill of lading issued by the charterer and indicate as being shipped, subject to the term and conditions of the charter party. Charter party bills of lading are not acceptable unless specifically authorized by the letter of credit.
- **A Multimodal Transport Document** means a document which evidences a multi modal transport contract, the taking in charge of the goods by the multimodal transport operator, and an undertaking by him to deliver the goods in accordance with the terms of that contract.¹⁸⁶Even if the credit prohibits transshipment, banks will accept a multimodal transport document which indicates that transshipment will or may take place, provided that the entire carriage is covered by one and the same multimodal transport document.¹⁸⁷
- **Air Waybill** -An air waybill is a receipt issued by an air carrier indicating receipt of goods to be transported by air and showing goods consigned to a named party.¹⁸⁸ Airway bill is a non-negotiable receipt. Only the goods invoiced and specified in the letter of credit may be covered by the air waybill. The airport of departure and airport of

¹⁸² ZsuzsannaTóth, *Supra* note 1, at 91.

¹⁸³ ZsuzsannaTóth, *Supra* note 1, 85.

¹⁸⁴*Id.*

¹⁸⁵ ZsuzsannaTóth, *Supra* note 1, at 78.

¹⁸⁶ United Nation Convention on International Multimodal Transport of Goods ,United Nations Conference On Trade And Development, New York, 1981 Article 1.

¹⁸⁷Jacqueline D. Lipton ,*Supra* note 94, at 1975.

¹⁸⁸*Id*

destination must be as stipulated in the letter of credit. The air waybill is usually issued in a set of twelve copies, out of which the first three samples are deemed to be originals. The first original is signed by the consignor (or its agent), the second original, which accompanies the goods, is signed by the carrier, and the third original is signed by the carrier, and is handed to the consignor or its agent after the goods have been accepted for carriage.¹⁸⁹

3.7.3 Insurance Policy or Certificate

Under the terms of a CIF contract, the beneficiary is obliged to arrange insurance and furnish the buyer with the appropriate insurance policy or certificate.¹⁹⁰ The extent of coverage and risks should be agreed upon between the buyer and seller in their initial negotiations and be set out in the sales contract. The insurance document must be issued and signed by an insurance company, or an underwriter or their agent.¹⁹¹ If the insurance document indicates that it has been issued in more than a sole original, all originals must be presented to the bank.¹⁹² The insurance document must indicate the amount of insurance coverage and be in the same currency as the credit.¹⁹³ According to the UCP600 the minimum coverage of the insurance is 110% of the CIF value of the good. Even if Ethiopian law on documentary credit is silent on this issue, in the practice, as the researcher noticed from insurances given to different public contracts by national insurance of Ethiopia, the amount insured is 110% of the value of the good.

3.7.4 Certificate of Origin

As the name suggests, a certificate of origin certifies as to the country of origin of the goods described and should comply with any stipulations in the LC as to originating country and by whom the certificate is to be issued.¹⁹⁴ The certificate should be consistent with and identified with the other shipping documents by shipping marks and numbers, and must be signed.

3.8 Legal Framework of Letter Of Credit

Many of LC's operative rules, regardless of geography or legal system, have emerged from the customs of the bankers dealing with importers and exporters, and with shipping and insurance

¹⁸⁹ ZsuzsannaTóth, *Supra* note 1, at 75.

¹⁹⁰ Jacqueline D. Lipton, *Supra* note 94, at 1989.

¹⁹¹ UCP, *Supra* note 2, article 28(a).

¹⁹² UCP, *Supra* note 2, article 28(b).

¹⁹³ UCP, *Supra* note 2, article 28(f) and (i).

¹⁹⁴ ZsuzsannaTóth, *Supra* note 1, at 36.

companies.¹⁹⁵ Today, these customs are embodied in a Code drafted by the ICC under the title Uniform Customs and Practice for Documentary Credits (UCP).¹⁹⁶ Since banks worldwide in most cases subject their letter of credit to the UCP, this forms the primary, but not the sole, source of letter of credit law. UCP is not an international convention as it does not create a formal agreement between states nor it is law, as the ICC, being a non-governmental organization, does not possess legislative authority.¹⁹⁷ The UCP is a “compilation of internationally accepted banking customs and practice regarding the letter of credit. But, UCP is the most successful harmonizing measure in the history of international commerce, which has removed a plethora of technical problems that would have undermined the smooth operation of letter and credit.¹⁹⁸UCP has gone through different revision. UCP600 is the recent revised version. So, by UCP the researcher is referring to UCP600. Although the UCP is not a law, we cannot deny that it is forceful since it has been incorporated by reference in the majority of letters of credit used worldwide.¹⁹⁹ But, LC application forms prepared by commercial bank of Ethiopia lack cross reference clauses to UCP.

When we come to the major contents of UCP, it starts by determining Scope applicability of UCP. Accordingly, when the letter of credit expressly states that it is governed by the UCP 600 the contracting parties are bound by the rules set out in the UCP 600 and may exclude or modify its application by express wording to that effect in the credit document.²⁰⁰ As per article 1 of the UCP600, UCP is a rule.

Definition of important terms of LC is also included. Important terms like advising bank, applicant, beneficiary, confirmation, confirming bank, credit, honor, issuing bank, negotiation and others have been defined.²⁰¹In order to simplify certain procedural matters and interpretation of important terms, UCP 600 also contains provision which show how to interpret terms.

The UCP600 also recognizes the principle of autonomy, the principle of strict compliance and fraud exceptions. The principle of autonomy is reflected under article 4(a) of UCP600 as follows.

¹⁹⁵Boris Kozolchik, Letters of Credit, International Encyclopedia of Comparative Law, as cited in ZsuzsannaTóth, *Supra* note 1, at 53.

¹⁹⁶ZsuzsannaTóth, *Supra* note 1, at 56.

¹⁹⁷ZsuzsannaTóth, *Supra* note 1, at 8.

¹⁹⁸ZsuzsannaTóth, *Supra* note 1, at 8.

¹⁹⁹*Id.*

²⁰⁰ UCP, *Supra* note 2, article 1.

²⁰¹ UCP, *Supra* note 2, article 2 .

*A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honor, to negotiate or to fulfill any other obligation under the credit is not subject to claims or defenses by the applicant resulting from its relationships with the issuing bank or the beneficiary.*²⁰²

Both the buyer and the seller cannot extend the rights and duties under the underlying contract to the letter of credit.

The principle of strict compliance also reflected under article 14 (d), (e), j), Article 18(c) of UCP600. In LC transaction, exporter must present the documents to the bank in order to claim payment for the goods. These documents must be in strict compliance with LC's requirement. Should the exporter's presentation contain discrepancies, the bank will not honor. It is established that the percentage of documentary rejection due to non-compliance on the first presentation by the exporter is amount to 75%.²⁰³ Unlike the UCP500 the UCP600 has softened the requirement of compliance by using the phrase 'need not be identical to, but not conflict: which impliedly rejected the mirror image or literal approach of the data in documents with the LC terms.²⁰⁵ Spelling mistakes and missing commas do not make a document discrepant. The two types of LC (revocable and irrevocable) mentioned in UCP600 but irrevocable LC is a default letter of credit.

In addition to UCP, ICC has also introduced other regulations including eUCP, Uniform Rules of Contract Guarantees, Uniform Rules for Demand Guarantees International Standby Practices for Independent Guarantees and Standby Documentary Credits (ISP98).²⁰⁶

²⁰²UCP, *Supra* note 2, article 4(a).

²⁰³RosmawaniCheHashim, *The UCP 600 rules in Letter of Credit (LC): Selected Issues*, 2015, at 280.

²⁰⁵*Id.*

²⁰⁶Jacqueline D. Lipton, *Supra* note 94, at 1986.

Domestically, Civil Law countries like Colombia, El Salvador, Greece, Guatemala, Honduras, Lebanon, Mexico, and Syria have statutory rules on the letter of credit.²⁰⁷ Among the common law countries it is only USA that has codified law on LC.²⁰⁸

Like the above mentioned countries Ethiopia has enacted law on documentary credit (letter of credit) in 1960. But unlike the above mentioned countries Ethiopian law on letter of credit is very general and some key issues of letter of credit were not addressed.

²⁰⁷ ZsuzsannaTóth, *Supra* note 1, at 111.

²⁰⁸ *Id.*

Chapter Four

Analysis of the Practice and Problems Associated With Import LC in Public Contracts

Import LC comes into operation when the public body, according to public procurement laws, decides to conduct international competitive bidding (ICB). As examined in the preceding chapters, operation of import LC has different stages. The present chapter examines procedures and problems that exist from the opening to closure of LC.

4.1 Application for Opening of LC

Before mentioning problems that exist in application for opening of LC, it is better to examine the procedures to be followed in order to open LC.

4.1.1 Procedures of Application

When public bodies advertize international competitive bidding, foreign suppliers participate in such bidding. If the winner is an international company having its resident and main branch office outside of Ethiopia the issue of payment will be given special emphasis during signature of the contract. Payment provisions of both general and special conditions of the contract lay down that the public body shall effect payment by letter of credit.²⁰⁹

When the payment involves foreign companies the first duty expected from public body is applying to CBE for foreign exchange permit.²¹⁰ For foreign exchange permit CBE has its own foreign exchange permit application form. The form has different terms and conditions to be fulfilled by the applicant. One of the most important features of the form is the provision that prohibits the public bodies from transfer of foreign exchange license to third party and the

²⁰⁹ Ethiopian public procurement standard bidding document of public contracts, Ethiopian public procurement agency, Addis Ababa , 2011, general conditions contract (GCC) 12.1 and GCC 16.1 and their respective special condition

²¹⁰ Interview with w/t Genet Abebaw, Addis Ababa University Procurement and Property Administration Directorate, customs issues officer, April 18, 2018.

license is available for one payment only.²¹¹ Split license²¹² will however be issued on request. Secondly, the permit will be issued subject to availability of foreign exchange.²¹³ The commitment entered by CBE will not have effect if foreign exchange is not available. Thirdly, the public body undertakes to repatriate to Ethiopia any commission or discounts resulting from the importation.²¹⁴ Fourthly, the public body undertakes to produce to NBE proof of entry of goods into Ethiopia (customs import declaration and all other documents which the NBE may require) within four months of the date under which payment is made.²¹⁵ The public body also undertakes to return the application to CBE if not utilized within the validity date.²¹⁶

The public body, while applying for foreign exchange permit, has to come with the contract made between the supplier and the public body. The proforma invoice of the bid winner shall be attached with the contract.²¹⁷ The license will be issued with that specific proforma invoice number and can only be utilized for that contract and proforma. After such application is accepted and allowed, the public body again applies to CBE for opening of LC in favor of the winner of the bid (the supplier) by filling the pre-prepared LC application form.²¹⁸ Here the public bodies are expected to apply to CBE two times. First, they apply for foreign exchange permit and secondly apply for opening of LC. Even though the practice of applying for foreign exchange exists in Addis Ababa University, application for foreign exchange is not required in Ministry of finance and economic cooperation (MOFEC) federal government payment directive.

MOFEC directive on federal government payment only lay down three preconditions of LC application. First, the public body, before applying for LC, need to check the existence of enough allowed budget for the purchase.²¹⁹ Second, the public body is expected to ask and get written daily exchange rate from the bank.²²⁰ Third, by fulfilling all other required things the public body

²¹¹ See Commercial Bank of Ethiopia application form for foreign exchange permit, annexed at the end of this paper.

²¹² Split license is a license which enables the applicant to pay part by part.

²¹³ Genet, *Supra* note 207.

²¹⁴ Genet, *Supra* note 207.

²¹⁵ Genet, *Supra* note 207.

²¹⁶ Genet, *Supra* note 207.

²¹⁷ Genet, *Supra* note 207.

²¹⁸ Interview with Zegeye Bekele , Jimma University Procurement and Property Administration Directorate Director, March 24, 2018.

²¹⁹ *Supra* note 81, at article 13(1) .

²²⁰ *Id* ,article 13(2).

needs to apply for LC to commercial bank of Ethiopia.²²¹The third requirement can be interpreted broadly in order to justify the practice of application for foreign exchange permit.

4.1.2 Problems Associated With Application for LC

As per article 14(4) of ministry of finance and economic development directive no.4/2003 the public body is not required to make any payment in advance. CBE requests the public body to pay LC value and other related payments after the LC is approved (opened). On the contrary, Article 7.3 of NBE directive on Transparency in Foreign Currency Allocation and Foreign Exchange Management (Directives No.FXD/46/2017) prohibits a bank from approving application without collecting minimum of 30% of the LC value in cash up front. NBE, while enacting this directive, intended to create transparent and sound foreign currency allocation and foreign exchange management.²²² On the other hand MOFEC directive has been enacted with the aim of creating good federal government payment management. So, the NBE directive enacted by seeing things from the perspective of creating sound foreign currency allocation, while the directive by MOFEC is from the perspective of controlling government payments. Even if the two directives enacted with different aim, they obviously create confusion on the process of LC operation. The practice, as the researcher recognized from interview made with officials in the selected institutions, confirms that the public bodies were not required to pay advance payment while processing import LC. The experiences in other countries also show that there is no advance payment before the LC is opened. Moreover, the literatures on LC reveal that there is no advance payment before the LC is opened. So, in the opinion of the researcher, NBE's directive which requires 30% of advance payment before opening of LC is against the essence of LC. Such law cannot bring the sought advantage in LC.

4.2 Terms and Conditions of the Current CBE Letter Of Credit Application Form

As discussed in chapter three, LC shall clearly indicate its type. Despite there exist many types of LCs, as mentioned in chapter three, the current CBE letter of credit seems only issuing three types of LC. This is because the form puts only confirmed, irrevocable and transferable LCs.²²⁴An irrevocable and confirmed LC represents both the undertaking of the issuing bank and the undertaking of the confirming bank. So, it gives the beneficiary (supplier) a double assurance

²²¹*Id*, article 13(3).

²²² Transparency in Foreign Currency Allocation and Foreign Exchange Management directive, Directives No.FXD/46/2017, National Bank of Ethiopia, 2017, preamble.

²²⁴ See article 1 of CBE letter of credit application form which is annexed at the end of this paper.

of payment. Hence, in this regard the CBE form has been prepared in a way of safeguarding the interest of the suppliers.

Most of the accompanying documents of LC discussed in chapter three also appear in CBE letter of credit forms. Accordingly, public bodies are expected to indicate whether bill of exchange (draft) is required or not.²²⁵ Most of the time, as inferred from opened LCs; bill of exchange is marked as a required document. The form also mentions that the public bodies have to fill the number of originals and copies of commercial invoice.²²⁶ The CBE form also requires that the commercial invoice shall be signed and certified by chamber of commerce. Such requirement decreases the probability of documentary fraud which ultimately protect the interest of the public body. There is also optional list of transport documents like bill of lading, airway bill, truck way bill, parcel post receipt, railway receipt, courier bill and others in CBE form.²²⁷ Some of the required bills are qualified. For instance ocean bill of lading must be full set of clean onboard ocean bill of lading.²²⁸ Similarly the airway bill shall be original airway bill.²²⁹ Such qualified requirements again have advantages of avoiding forged documents. In addition to documents discussed under chapter three CBE form also requires original and copies of *packing list*.²³⁰ Certificate of origin issued by competent authority and insurance policy are also some of the required list of documents in the current CBE letter of credit application form.

One of the well known principles of letter of credit, as discussed in chapter three, is the principle of autonomy. The idea of this principle has been directly incorporated in CBE letter of credit application form. Let us see article 24 of the form quoted below to show how the principle of autonomy has been incorporated.

It is expressly understood that I /we hold you and your correspondents free of responsibility for the form, sufficient, accuracy, genuineness, falsification or legal effect of any documents and in respect of any difference whether in goods, material, make, brand,

²²⁵*Id.*, article 15.

²²⁶*Id.*, article 17; see the discussion under chapter three to know what commercial invoice mean.

²²⁷*Id.*, art.20.

²²⁸*Id.*

²²⁹*Id.*

²³⁰ Packing list is itemized list of articles usually included in each shipping package, giving the quantity, description and weight of the contents.

*quantity, quality or other that may emerge between the description in the documents and what is actually shipped.*²³¹

CBE and its correspondent bank can be relieved from any liability in case the delivered good is below the quality and quantity agreed in the main contract. The form also prohibits any claim against the bank after the documents are settled.²³² One of the obligations of issuing bank is to check the strictly compliance of the documents. But, what if the good is delivered with low quality due to CBE's failure to check the strictly compliance of the documents? There is no provision which gives solution to such problem in the CBE letter of credit form. In other word the principle of strict compliance has not been incorporated in the CBE's LC form. Moreover, just like Ethiopian law on documentary credit, the CBE form of LC has no a single provision which reflects fraud exception.

Generally, most of the provisions of CBE's LC tend to protect the interest of CBE by ignoring the interest of the applicant (public body). For instance there is no provision which impose liability on CBE when it failed to open and send the LC within a defined period of time. This is because LC form is prepared by CBE without giving the chance to negotiate on the contents of LC to the applicant. The LC application form which governs the contractual relationship between the public body and CBE is an adhesive type of contract.²³³ The public body fills and signs the pre prepared LC form.

4.2.1 Analyses of Problems Associated With CBE Letter Of Credit Application Form and Directives of LC

The commercial bank of Ethiopia, after accepted the application, will open the LC in favor of the foreign supplier. The opened LC will be notified either directly to the supplier or through his advising/confirming/ bank by the address on proforma invoice. The practice in Addis Ababa University shows that the bank notifies (mail) the public body the fact that the bank forwarded the LC to the supplier.²³⁴ The bank also notifies identification number of the opened LC, so that the parties to the LC follow and implement it using the identification number given to them.

²³¹*Supra* note 220, art.24.

²³²*Supra* note 220, art.24 which reads "it is expressly understood that on no account shall any claim be made against the bank after the documents are settled".

²³³ An adhesion contract is a contract where one party has substantially more power than the other in creating the contract. For a contract of adhesion to exist, the offeror must supply a customer with standard terms and conditions that are identical to those offered other customers. Those terms and conditions are not negotiable.

²³⁴ Genet, *Supra* note 207.

After the supplier received the LC he/she has to ship the goods with the mode of delivery agreed in the contract before the expiry of the LC. The supplier then sends the documents which show the shipment of the goods to the issuing bank in order to get the payment from the public body. The practice in the selected institutions shows that CBE sends the documents to the institutions, so that the institutions checks the correctness of the documents sent from the supplier and if it is correct allow the bank to release 80% of the payment to the supplier.²³⁵ Then the public body receives the goods shipped by the supplier and check if the quality and quantity of the good is as agreed in the contract. There are experts (employees of the public body) to each goods who check the quality of the goods.²³⁶

If the quality and quantity of the delivered good confirm with the agreed quality and quantity, then, the public body requests CBE to release the retained 20% of the payment for the supplier.²³⁷ For instance in a contract between Jimma University and Kenlife medical equipment enterprise Co.Ltd in Bid Ref No.: JU-CB-ICB-I-2009/2010, Kenlife (the supplier) agreed to supply hospital instruments, equipments, furniture and related services with the specified quality and quantity.²³⁸ But, the supplier has not delivered the instruments with the required quality.²³⁹ Most of the instruments were broken and could not be installed.²⁴⁰ According to Mr. Melka Jimma University rejected some of the instruments and the supplier replaced the rejected goods with the proper instruments. Some other instruments were also modified by the supplier. Until the supplier replaces the rejected instrument and modifies some of the instruments, 20% of the payment was not released.²⁴¹ This indicates that 20% of the payment is retained in order to consider it as compensatory if the delivered good is not in conformity with the agreed quality and quantity. Moreover the 20% retained also serve as a security in case the supplier refused to cover local costs.²⁴² Local costs are all costs incurred after the good is brought to the home country of the buyer. It includes costs to deliver the goods from port to specific place of the public body, costs to install the instruments and costs to give training about the good. The 20% retained can also be used as a security where the supplier failed to cover the cost of installation and training.

²³⁵ Genet, *Supra* note 207.

²³⁶ Genet, *Supra* note 207.

²³⁷ Genet, *Supra* note 207.

²³⁸ Interview with Melka Emanu , Procurement Head Of Jimma University Medical Center, March 4, 2018.

²³⁹ *Id.*

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.*

But what if the low quality good caused damage beyond 20% of the total payment? Or what if 20% of retained is not sufficient to cover the above mentioned local costs? Moreover, CBE cannot refuse to pay the 20% of the payment, even if the delivered good is below the required quality and quantity. This is due to the fact that letter of credit is independent of the underlying contract (principle of autonomy²⁴³) which is recognized by Ethiopian law on documentary credit. The principle of autonomy also recognized as one term and condition of LC. Therefore, in the existence of the above facts, in the opinion of the researcher, 20% retention has no role for proper performance of the underlying contract.

The other serious problem in the operation of LC is the fluctuation of foreign exchange in the country. The value of foreign exchange may fluctuate from time to time. Article 15(4) of MOFED directive no.3/2004 requires the public body to pay 1.5% as a reserve for foreign exchange fluctuation to commercial bank of Ethiopia. The public body is expected to pay 1.5% for foreign exchange fluctuation but, nothing is required from the supplier for foreign exchange fluctuation even if the difference on the value of LC caused by such fluctuation as a result of the delay of the supplier. There is no a single provision in public procurement laws and SBD which impose obligation on the supplier to bear foreign exchange related risks even though such risk is caused due to the delay of the supplier. There should be a law which sets shared responsibility both on the public body and on the supplier regarding risks associated with foreign exchange fluctuation. One practical problem faced by the selected institutions as a result of government's recent act of devaluating Birr against foreign currency in Ethiopia was that the values of LC ,opened but not finalized before the devaluation, rose and CBE started to ask public bodies to cover such gap happened due to government action.²⁴⁴ For instance in Jimma University currently there are import LCs opened when exchange value of 1USD was 19 Birr. Currently exchange value of 1USD is above 27 Birr. Due to such foreign exchange variation Jimma University's debt was increased by around 52 million Birr.²⁴⁵ Such significant variation is caused only by foreign exchange fluctuation without any change on the price of the goods.

²⁴³ According to this principle the credit is independent of and separate from the underlying contract between the seller and the buyer, and also from the agreement between the applicant and the issuer. For details see the discussion on chapter two.

²⁴⁴ Genet, *Supra note* 207.

²⁴⁵ Interview with Fasika Mengistu , Jimma University Finance Administration Directorate Capital Finance Team Leader, March 5, 2018.

The following two possible legal arguments can be raised as possible solutions to resolve the above problem. The first argument is that the gap caused by government law is not a market action and CBE cannot expect such act of the government and take precautionary measures. The exchange difference came as a result of government law cannot be covered by foreign exchange fluctuation commission which is only 1.5 % of the value of LC. Furthermore, there is one obligatory commitment provision on CBE letter of credit application form which reads “*please debit my/our account number----- for all your charges, LC values and any conversion difference related with this LC*”. CBE has contractual right to claim any conversion differences, including conversion differences caused by government act of devaluation, from the public body by citing the above quoted commitment. So, the public body which signed the above quoted commitment cannot refuse to cover the conversion difference caused by devaluation of Birr. If the public body refused to cover such conversion difference it can be considered as violation of contractual obligation. Hence, CBE should not bear the risk associated with foreign exchange fluctuation due to government’s law.

The second argument is, according to MOFEC federal government payment directive the value of LC shall be calculated by foreign currency conversion value on the opening date of LC.²⁴⁶ For future foreign exchange fluctuations the public body is required by the directive²⁴⁷ only to pay 1.5 % as a commission for foreign exchange fluctuation. According to the directive both the minimum and the maximum liability of public bodies for risks associated with foreign exchange fluctuation is only up to 1.5% of the total value LC. The cause for foreign exchange fluctuation could be government action or the market itself. Whatever the cause is making the public body to cover conversion differences above 1.5% of the total value is against the directive and it also make the liability of the public body unpredictable. Moreover, public bodies cannot create legal agreements with CBE to cover conversion differences above 1.5% of the total value. That means the above quoted commitment by public bodies which appeared on CBE letter of credit application form is against the MOFEC directive.

The following factors can be mentioned as the main causes to the above mentioned problems. The fact that the contract governing the relationship between public body and CBE is being an

²⁴⁶*Supra* note 81, Article 15(6).

²⁴⁷*Id*, Article 15(4).

adhesive contract is the first and the main reason for the above problems. Had the contract not been adhesive contract, the public body would have been given the chance to incorporate provisions which better protect their interest in the contract. The other reason for the above problems is the law which dictates public bodies to arrange LC process only with CBE. This law made CBE to control LC process of public bodies with monopoly. Public bodies are denied to choose effective and efficient bank to process LC with better speed and low cost. Moreover, currently CBE is not giving service of opening LC in Jimma branch. Public bodies which are located in Jimma need to send LC application to Addis Ababa CBE branches which could be one factor for delaying of the process.

4.3. Ways of Transferring LC Payments from Public Body to CBE

4.3.1 Legal Procedures of Transferring Payments

According to directive 4/2003 the public body cannot directly transfer LC payments to CBE. The directive mentions a complex way of effecting LC payments. As per article 15(1) of the directive ministry of finance and economic cooperation opens one common LC bank account (pool account) in CBE in order to facilitate government import LC. This account shall be controlled by the MOFEC. When a public body opens import LC it shall transfer all LC related payments to this pool account.²⁴⁸ When the supplier sends documents which show the shipment of the goods to CBE, the LC payments shall be effected by withdrawing from the pool account.²⁴⁹ So, the chain of payment is shortly as follows: - First the public body transfers the LC value and related payments to the pool account which is owned (controlled) by MOFEC, and then MOFEC transfers the payment to CBE reserve account and finally CBE pay to the supplier. According to the interviewed employees of the selected institutions there is a practice of transferring import LC payments directly from the public body account to commercial bank of Ethiopia without the need to transferring it to the pool account. Such practices may have advantage of simplifying import LC procedures. But, it also has a disadvantage, for the reason that such practice decreases the control and involvement of MOFEC in government import LC.

²⁴⁸*Id.*, article 15.

²⁴⁹*id.*, article 15(5).

4.3.2 Problems Associated With Transfer of Payment

In relation to the transferred LC values, one may raise a question as to the fate of the transferred money in case where CBE become insolvent after the LC value have been transferred from the public body to CBE, but before paying it to the supplier. Can we make the public body liable to pay for the supplier without considering the money transferred to CBE before it has become insolvent? Or can we say it is up to the supplier to deliver the goods and receive the payments from CBE before it has become insolvent. There is no law which specifically address such problem both in Ethiopian commercial code and public procurement laws. Even the general and special conditions of Ethiopian public contracts do not have a single provision which solve such problem.

Even if Ethiopian law fails to cover this issue, it is submitted that there are two possible solutions to this problem. The first possibility is that the transferred money was allocated to meet the supplier's drafts; in this case the supplier will be entitled to payment in preference over the general creditors of the insolvent issuing bank. The Uniform Commercial Code of United States (UCC) gives similar solutions to such problem. The second possibility is that such money was not appropriated to meet the supplier's drafts; in this case the supplier will be treated as a general creditor of the insolvent bank and will be entitled to payment from the public body for the unsatisfied part of the price of the goods.

It is unjust to require the public body to pay almost twice the price of the goods, but the situation is that one of two innocent parties should bear the loss caused by the insolvency and it is fairer that it should be the public body rather than the supplier, because first the buyer is under an obligation to provide a solvent paymaster and he failed to fulfill this obligation. Second the public body is in a better position to evaluate the financial status of the issuing bank than the foreign supplier. So, if the public body pays issuing bank with a doubtful solvency it would be expected to bear the loss rather than the supplier.

4.4. Controlling Mechanisms of the Pool Account (LC Common Account)

The common LC account opened for all federal public bodies has to be regulated by one responsible body. MOFEC controls the common government LC account by collecting reports and making sure the correctness of the reports from CBE and from the respective public bodies. As per article 16(2) of directive no.4/2003 CBE shall send monthly report of all LC payments

made from the pool account to the ministry of finance and economic cooperation. There is agency contract between MOFEC and CBE for the purpose of controlling the pool account.²⁵¹CBE is an agent of MOFEC for the purpose of controlling public bodies' common LC account. In addition to the monthly report of CBE, the public body also expected to send quarterly report to MOFEC regarding the movement of LC opened in its name.²⁵² The public body is also required to check the correctness of LC payments made by CBE and shall ask a return of LC values of terminated/cancelled/ LCs due to different reasons to the central government account.

Hence, MoFEC controls government import LC by checking the correctness of the reports from CBE and the concerned public bodies. MOFEC also controls timely submission of the above reports and according to the interviewed employees there is no way of inappropriate use of government import LC budget.²⁵³Ministry of finance and economic cooperation has one team which regulates government LC accounts. The interviewed employees in ministry of finance and economic cooperation showed me a reporting form of opened government LC. The form is a tabular form consisting the list of name of the public body, Ref number of LC, the starting date of the LC, expiry date of the LC, amount of money transferred from the public body to the common LC account, amount of commission paid, amount of reimburses under LCs, current status of the LC and current balances after deduction all payments.

4.5. Closure of the Transaction of Import LC

4.5.1 Procedures of Closure

As learned from the interviewed employees in the selected institutions, after the agreed goods have been delivered, the public body issues model 19 receipt invoices for the delivered goods.²⁵⁵After the issuance of model 19 receipts, the LC transaction opened in the name of the public body shall be cleared within a short period of time (as written in foreign exchange permit form it shall be cleared within four months). In order to close the LC transaction in CBE, the public body is required to come with customs clearance declaration and model 19 receipt

²⁵¹ Interview with W/R Emebet Akililu, Ministry Of Finance And Economic Cooperation, Government Income And Bank Account Administration Team Leader, April ,20/2018.

²⁵²*Supra note 81*, article 16(1).

²⁵³*Id.*

²⁵⁵*Supra note*, 207.

invoice.²⁵⁶The public body cannot apply for another LC before finalizing (closing) the previous LC. The obligation to clear the transaction is also imposed on public body under MOFEC directive.²⁵⁷ So, in this regard the practice is going on in conformity with the law.

4.5.2. Examination of Problems Relating With Closure of LC

One practical problem raised on closure of LC transaction, by interviewed employees, is the problem they encounter when LC transaction opened in one budget year is not finalized in that budget year.²⁵⁸When import LC budget in one year is paid in next year, such payment is considered as payment without the second year's budget. The interviewed employees have responded that not finalizing all payments of a budget year in that specific budget year in turn creates intricacy on government budget management by increasing the amount of account receivable. The major reason the respondents mentioned for delay of letter of credit is a prolonged time to get foreign exchange permit. Due to shortage of hard currency foreign exchange permit applicants are required to wait for months.

²⁵⁶*Supra note 207.*

²⁵⁷*Supra note 81, article 15(4).*

²⁵⁸ Interview with w/ro Aster Haile Sillase, Finance Head in Ministry of Finance And Economic Cooperation, March 19, 2018.

Chapter Five

Conclusions and Recommendation

5.1 conclusions

Countries cannot satisfy all their need of public goods only with domestically produced goods. Importing of goods is major means of satisfying the need for public goods. The extent of such import is very high when we come to least developed countries like Ethiopia. For instance the latest statistical report show that Ethiopia has imported goods the value of is 16.29 billion USD in 2017. Importation of public goods by public bodies constitutes the major share of such total import. Importation by public body involves public interest and hence shall be regulated by special law for the sake of public interest. The procedure to effect payment is one of the things that should be regulated with special public law. The way of effecting payment for public goods imported from abroad might not be as simple as the way of payment for domestically bought public goods. The distance between the buyer and the seller, the existence of different mercantile system and different currency in the buyer's and seller's country makes the mode of payment difficult. In order to simplify such difficulty international traders have developed different mode of payment through custom and practice.

Payment through letter of credit (documentary credit) is one of the well known modes of payment in importation of goods. Al most all public bodies in Ethiopia effect payment of imported goods by foreign supplier through letter of credit. Letter of credit starts to operate after it has been opened by issuing bank based on the application of the public body. Letter of credit creates binding contractual relationship between four major actors (i.e. applicant, issuing bank, supplier and confirming bank) of LC. There are different legal frameworks both at international level and at the national level. Even if it is not binding convention, Uniform Customs and Practice for Documentary Credits (UCP), which is prepared and compiled by international

chamber of commerce (ICC), is the major rules on letter of credit. There are also countries which have their own domestic law on letter of credit. Ethiopia is one of such countries since it has devoted one section of the commercial code for documentary credits. Ethiopian laws on public procurement also have provisions which deal about letter of credit in internal competitive biddings. In addition to the above laws, ministry of finance and economic cooperation has enacted directive on the procedures to be followed in order to process government import letter of credit.

In this paper some practical issues of LC have been examined *visa- vis* the above Ethiopian laws on letter of credit. To start with the effect of delay of the main contract on opened LC, even if Ethiopia laws on letter of credit failed to address its effect on LC, the practice in the selected institutions shows that delay in the main contract results in either cancellation of the opened LC or amendment of the LC before its expiration date. Amendment of the LC in turn results in payment of new service charge for the amended LC which shall be covered by the party who demanded amendment of the LC.

Moreover, the current Ethiopian law on LC cannot give a clear insight about rights and responsibilities of the public body, issuing bank, supplier and confirming bank unless we made a reference to the custom and the practices in the transaction of LC. Absence of clear law which determines rights and responsibilities of the parties involved resulted in practical controversy when NBE recently devaluated birr against foreign currencies. The conversion value of LC values before the devaluation might not be equal to the conversion value after devaluation. A thorough examination of MOFEC directive on federal government payment and CBE application form of letter of credit reveals that there are two possible ways of argument regarding the party that should be liable to cover the conversion difference resulted due to devaluation of birr. The first is that all conversion differences shall be covered by the public body as per the commitment that the public body signed to cover all conversion differences while applying for letter of credit. The second argument tends to conclude that the public body shall pay only 1.5% of the total value as a reserve for foreign exchange fluctuation by citing the MOFEC directive.

As the whole process of letter of credit shall be conducted with document, there might be fraudulent act by one of the parties. The current Ethiopian law on letter of credit has no way to

challenge frauds in the process of LC. This is because ‘fraud exception’, which is common in other countries documentary credit laws, is not part of Ethiopian law.

In the transaction of LC there might be a situation whereby issuing bank become insolvent after the LC value is transferred to it. In Ethiopia there is no clear standard as to the party that should bear the risks relating with the insolvency of the issuing bank. USA law on documentary credit gives detailed solutions to such problem based on different conditions.

The operation of letter of credit ends when the goods have been delivered and the supplier received all payments. There is a practice of retaining 20% of the total payment until the delivery of the goods. The purpose of such retention, as learned from the interviewed employees, is to serve as a compensatory if the good is delivered with low quality and quantity. But, this is against the basic principle of LC (principle of autonomy). Moreover, there might be a situation whereby the damage encountered by the public body is more than 20% of the total price.

5.2 Recommendations

Based on the examination made and findings of the research, the researcher would like to recommend as follows.

Recommendation to HPR

- HPR needs to revise the current law on documentary credit which is enacted in 1960. The new law on LC should incorporate the following important provisions:
 - ✓ Provisions about rights and duties of parties to LC.
 - ✓ List of accompanying documents to LC with their effect.
 - ✓ All types of LC with their corresponding effect on the parties.

Recommendation to CBE

- CBE’s LC application form, which set up contractual relationship between public body and CBE, should not be an adhesive type of contract. It should give public bodies the opportunity to negotiate on terms and conditions of the LC.

Recommendation to MOFEC

- MOFEC directive which obliges public bodies to open LC only in CBE creates monopoly by CBE. Such monopoly control results in delay of the process of LC. So,

MOFEC should amend directive no. 4/2003 in a way of enabling public bodies to purchase LC related service from any bank.

Recommendation to NBE

- NBE should amend No.FXD/46/2017 which requires 30% advance payment in LC.

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List of interviewees

- W/t Genet Abebaw, Addis Ababa University Procurement and Property Administration Directorate, customs issues officer.
- Ato Zegeye Bekele , Jimma University Procurement And Property Administration Directorate Director.
- Ato Melka Emana , Procurement Head Of Jimma University Medical Center.

- Ato Fasika Mengistu , Jimma University Finance Administration Directorate Capital Finance Team Leader.
- W/ro Emebet Aklilu, Ministry Of Finance and Economic Cooperation, Government Income and Bank Account Administration Team Leader.
- W/ro Aster Haile Sillase, Finance Head in Ministry of Finance And Economic Cooperation.
- Ato Sirawbizu Mola, Commercial Bank of Ethiopia Jimma Main Branch Manager.

ANNEX - I

Interview Questions

1. Do you have experience of importing goods by arranging payment through LC?
2. What are the steps you follow in such importation?
3. Is there any practical problems encountered relating with LC?
4. If yes, how do you solve such problem?
5. What are the contributing factors to such problems?
6. Do you think that the present law of LC solves practical problems?

Annex II

Scanned copy of CBE's LC Application Form and Other Related Documents