

SOCIO-LEGAL ANALYSIS OF THE UTILIZATION OF LETTER OF CREDIT IN INTERNATIONAL BUSINESS TRANSACTIONS IN BATAM CITY

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Abstract: *The provisions governing the Letter of Credit (L/C) in the form of customs and practices commonly used in international trade are called the Uniform Customs and Practice for Commercial Documentary Credit (UCP), issued by the International Chamber of Commerce (ICC). This research aims to analyze the effectiveness issues of the letter of credit in international transactions in the banking sector using Soerjono Soekanto's Theory of Legal Effectiveness. The research adopts empirical legal research through a socio-legal approach. Primary data is obtained from in-depth interviews, while secondary data is collected from literature studies. All data are analyzed using qualitative methods. It has been found that the application of the Letter of Credit (L/C) in international transactions in the banking sector in Batam City is not effectively implemented based on legal factors, law enforcement factors, and societal factors. There are still obstacles and solutions needed for the creation of an effective Letter of Credit (L/C) in international transactions in the banking sector in Batam City.*

Keywords: Letter of Credit (L/C); Banking; Business Transactions; Batam City.

1. Introduction

The rapid development in the business field in modern times has led individuals and entrepreneurs to seek convenience and security, especially in the field of trade.¹ In international trade transactions, commonly known as exports and imports, at its core, it is a simple transaction of buying and selling goods between entrepreneurs located in different countries.² however, in practice, complex issues often arise among these entrepreneurs due to national borders (geopolitics), geographical, social, and demographic structures, which affect the characteristics of the transaction, including the form of agreements and payment methods.³

¹ Reza Toorajipour et al., "Block by Block: A Blockchain-Based Peer-to-Peer Business Transaction for International Trade," *Technological Forecasting and Social Change* 180 (2022): 121714, <https://doi.org/https://doi.org/10.1016/j.techfore.2022.121714>.

² Maryam, "Mekanisme Pembayaran Melalui Letter of Credit (L/C) Dalam Transaksi Perdagangan Internasional Pada PT. Semen Bosowa Maros," *Sulesana: Jurnal Wawasan Keislaman* 8, no. 2 (2013): 179–85, <https://doi.org/https://doi.org/10.24252/v8i2.1292>.

³ Roselyne Hutabarat, *Transaksi Ekspor Impor* (Jakarta: Erlangga, 1997).

International trade activities, including export and import transactions, can be carried out effectively when payment arrangements are conducted smoothly and guaranteed for all parties involved.⁴ Payment refers to any voluntary execution or fulfillment of an agreement, such as the payment of a certain amount of money or the completion of work by laborers, among others.⁵ As stated in Article 1513 of the Civil Code, it is also stipulated that "the primary obligation of the buyer is to pay the purchase price, at the time and place as determined in the agreement".

The most ideal payment method in export-import trade activities is through the use of a Letter of Credit (L/C) or Documentary Credit because it provides security for both parties involved.⁶ The seller (exporter) feels secure because there is certainty of payment for the goods shipped to the buyer (importer). On the other hand, the buyer (importer) feels secure because the payment for the transaction will only be realized by the bank once the seller has presented the required documents for the specified goods according to the agreement.⁷

The existence of a Letter of Credit (L/C) provides numerous benefits⁸ and conveniences for business practitioners in international trade transactions.⁹ When conducting business transactions using an L/C, banks play a crucial role as intermediaries for payment in the agreed-upon sales agreement, ensuring the smoothness of transactions carried out by business practitioners. One of the responsibilities of the opening bank, as one of the involved parties, is to open/issue the Letter of Credit (L/C) as agreed upon with the importer as the customer. The role of the opening bank is vital for the continuity of international trade, particularly for the importing party, i.e., the importer.¹⁰

In international trade transactions, which are commonly known as exports and imports, it is essentially a simple transaction of selling goods between entrepreneurs located in different countries. International business transactions play a crucial role in economic activities, such as the purchase and sale of goods between exporters and importers, which are documented in international sales agreements.¹¹ Exporters and importers are companies or individuals located in

⁴ Soepriyo Andhibroto, *Letter of Credit: Dalam Teori & Praktek* (Semarang: Dahara Prize, 1992).

⁵ Hartono Hadisoeparto, *Kredit Berdokumen (Letter of Credit) Cara Pembayaran Dalam Jual Beli Perniagaan* (Yogyakarta: Liberty, 1991).

⁶ Sophia M. Malikanzi and Mouni Gekara, "Factors Contributing to the Use of Commercial Letter (S) of Credit on International Business Transaction(S): A Case of Manufacturing Industries in Kenya," *International Journal of Sciences: Basic and Applied Research (IJSBAR)* 12, no. 1 (2013): 103-14.

⁷ Hamed Alavi, "Documentary Letters of Credit, Legal Nature and Sources of Law," *Journal of Legal Studies* 17, no. 31 (2016): 106-21, <https://doi.org/10.1515/jles-2016-0012>.

⁸ Agus Dedi Subagja, "Letter of Credit (L/C) Sebagai Cara Pembayaran Yang Paling Aman Dalam Transaksi Pembayaran Perdagangan Internasional/Ekspor-Import. (Studi Kasus Pada PT. San San Saudaratex Jaya)," *International Journal of Demos* 2, no. 1 (2020): 78-89, <https://doi.org/10.37950/ijd.v2i1.38>.

⁹ Atharyanshah Puneri, "Conventional and Islamic Letter of Credit: Comparison and Implementation," *Airlangga International Journal of Islamic Economics and Finance* 4, no. 2 (2021): 124-42.

¹⁰ Shuchih Ernest Chang, Hueimin Louis Luo, and YiChian Chen, "Blockchain-Enabled Trade Finance Innovation: A Potential Paradigm Shift on Using Letter of Credit," *Sustainability* 12, no. 1 (2020): 188, <https://doi.org/https://doi.org/10.3390/su12010188>.

¹¹ Alavi, "Documentary Letters of Credit, Legal Nature and Sources of Law."

different countries, using different currencies, and subject to the legal regulations of their respective countries.

Based on Article 8 of Bank Indonesia Regulation No. 5/11/PBI/2003 on Import Transaction Payments, there are several payment methods that can be used for export and import transactions, including:

1. Advance Payment: Payment made in advance by the buyer to the seller before the goods are delivered.
2. Collection Draft (Wesel Inkaso) with the following conditions: a. Document Against Payment (D/P): The buyer must make payment before receiving the documents related to the goods. b. Document Against Acceptance (D/A): The buyer accepts the documents, and payment is made at a later agreed-upon date.
3. Open Account: Payment is settled at a later agreed-upon date, typically after the goods have been delivered. This method requires a high level of trust between the buyer and seller.
4. Consignment: The goods are sent to the buyer, but the ownership remains with the seller until the goods are sold. Payment is made by the buyer after the goods are sold.
5. Other common payment methods in international trade as agreed upon between the seller and the buyer.

The complete definition of a Letter of Credit (L/C) can be found in Article 2 of the UCP 500 (Uniform Customs and Practice for Documentary Credit), which can be summarized as follows:

A Letter of Credit is a written agreement issued by an issuing bank at the request and instructions of the applicant (buyer) to provide payment, either immediately or at a future specified time, to the beneficiary (seller) for a specified amount of money, subject to the required documents.¹² In other words, a Letter of Credit (L/C) is a conditional payment agreement provided by a bank.¹³ Letter of Credit (L/C) is one of the banking services provided to the public, particularly to facilitate the procurement of goods from one place to another for businesses.¹⁴ In Indonesia, Letters of Credit (L/C) are issued by foreign exchange banks. Foreign exchange banks refer to commercial banks in Indonesia that have been granted permission by Bank Indonesia to engage in international transactions.¹⁵ The term "foreign exchange banks" is commonly used in Bank Indonesia's Director's Decisions and Circular Letters.

The usefulness and role of the Letter of Credit (L/C) in international trade are as follows:¹⁶

1. Facilitating payment settlement for export transactions.

¹² Trisna Alysianingrum, Budiharto, and Sartika Nanda Lestari, "Perlindungan Hukum Bagi Advising Bank Yang Menerima Dokumen Palsu Dalam Transaksi Menggunakan Letter of Credit (L/C)," *Diponegoro Law Journal* 8, no. 4 (2019): 2823-34, <https://doi.org/https://doi.org/10.14710/dlj.2019.27786>.

¹³ Hutabarat, *Transaksi Ekspor Impor*.

¹⁴ Joni Emirzon, *Hukum Surat Berharga Dan Perkembangannya Di Indonesia* (Jakarta: Prehallindo, 2002).

¹⁵ Pasal 7 Undang-Undang Nomor 7 Tahun 1992 tentang Perbankan Sebagaimana Telah Diubah dengan Undang-Undang Nomor 10 Tahun 1998.

¹⁶ Amir M. S., *Letter of Credit Dalam Bisnis Ekspor Impor* (Jakarta: Taruna Grafica, 1999).

2. Securing funds provided by the importer for the payment of imported goods.
3. Guaranteeing the completeness of shipping documents.

The Letter of Credit (L/C) serves as a mechanism to ensure smooth and secure transactions by providing assurance to both exporters and importers in terms of payment and documentation compliance.

In other words, the purpose of the Letter of Credit (L/C) is to address difficulties faced by both the buyer and the seller in their trade transactions. These difficulties include:¹⁷

1. For the seller, meeting the requirements specified by the buyer.
2. For the buyer, ensuring a secured payment if the seller can fulfill the specified requirements.

Although the Letter of Credit (L/C) is the most commonly used form of international payment due to its high level of protection for both the exporter and the importer,¹⁸ many Indonesian businesses, especially small-scale enterprises, are still unfamiliar with and do not fully understand the concept of the Letter of Credit (L/C). This lack of understanding may stem from the limited knowledge about the types and characteristics of Letters of Credit (L/C), as well as the procedures for their use. Consequently, Indonesian businesses, particularly small-scale enterprises, rarely utilize this payment instrument. Additionally, the lack of clear and specific legislative regulations in Indonesia concerning the Letter of Credit (L/C) may contribute to its underutilization.

Indeed, the Letter of Credit (L/C) is not a new payment instrument in international trade. However, not all national laws in every country worldwide regulate it through specific legislation, including Indonesia. In the international arena, the provisions governing the Letter of Credit (L/C) are embodied in the customs and practices commonly used in international trade, known as the Uniform Customs and Practice for Documentary Credits (UCP), published by the International Chamber of Commerce (ICC).^{19,20} UCP is voluntarily accepted by the international banking community as the standard for Letter of Credit (L/C) transactions, with the current version being UCP 500.

The regulation regarding the Letter of Credit (L/C) is stated in Government Regulation Number 1 of 1982 on the Implementation of Export, Import, and/or Cross-Border Trade. Article 1 of the regulation states: "Any person may freely obtain and use foreign exchange, and this principle of freedom shall not discriminate against the sources of the foreign exchange in question, so that both foreign exchange from exports and foreign exchange from other sources may be freely obtained and possessed by anyone".

In Bank Indonesia's Circular Letter No. 26/34/ULN dated December 17, 1993, it is regulated that L/Cs issued by foreign exchange banks may or may not be subject to the UCP (Uniform Customs and Practice for Documentary Credits) because there

¹⁷ Emirzon, *Hukum Surat Berharga Dan Perkembangannya Di Indonesia*.

¹⁸ Edward G. Hinkelman, *Metode Pembayaran Bisnis Internasional* (Jakarta: PPM, 2002).

¹⁹ Ramlan Ginting, *Letter of Credit: Tinjauan Aspek Hukum Dan Bisnis* (Jakarta: Salemba Empat, 2000).

²⁰ Ibid, P. 59.

is no specific regulation that comprehensively governs the Letter of Credit (L/C) in detail. Therefore, banks in Indonesia cannot fully rely on existing regulations, which creates various risks, such as non-delivery, loss or damage of goods, breach of contract, document forgery, natural disasters, and occurrences of war that prevent the goods from reaching their destination as agreed upon in the sales agreement.

In the national law of Indonesia, although the Letter of Credit (L/C) is not explicitly regulated in a separate law or within the Commercial Code (Kitab Undang-Undang Hukum Dagang) like checks, drafts, and others, it is generally governed by Government Regulation No. 1 of 1982 concerning the Implementation of Export, Import, and Foreign Exchange Transactions. However, this government regulation does not provide detailed rules specifically for the Letter of Credit (L/C). Currently, there are still many cases where small or large businesses misuse empty Letter of Credit (L/C) for personal purposes, resulting in significant losses for banks and violations of the predetermined agreements by those businesses. With the advancement of modern trade, it becomes easier for unscrupulous entrepreneurs to commit violations in transactions using the Letter of Credit (L/C), thereby causing harm to banks in Indonesia. However, these issues can be addressed through various dispute resolution efforts undertaken by banks and the involved businesses.

Previous studies in this field have explored various aspects of Letters of Credit (L/C). For instance, Sri Maya Sari²¹ discusses the responsibilities of the advising bank when discrepancies occur in the L/C. The bank is responsible for promptly notifying the exporter and importer to revise and return the L/C. If the specified time limit is exceeded, the bank is not liable for non-payment due to the L/C's expiration. However, in the case of fraud, as seen in the Bank DBS incident, where a fictitious exporter sent goods that didn't match the importer's order, the advising bank is not responsible for refunding the funds. Agus Setiawan²² addresses the risks faced by banks in implementing L/C agreements, as governed by government and banking regulations referring to UCP 600. These risks include non-compliance with specifications, discrepancies in goods compared to the commercial contract, loss or damage during transit, importer's inability to pay or bankruptcy, fraud, failure to meet L/C requirements, payment delays, counterfeit goods or invalid documents, fake or fictitious L/C, as well as wars, economic crises, and natural disasters. All these factors contribute to increased risks in L/C payment transactions, benefiting exporters/importers. In contrast, Zaned Zihan Sosa Elsera Lubis et al.²³ focus on the application of the principle of balance in L/C agreements as international business transactions. The standardized agreement for L/Cs is still unbalanced, with the issuing bank having a strong bargaining position. Prohibited clauses, such as tariff provisions and exemptions, are still present in the agreement between the applicant and the issuing bank. Moreover, the agreement lacks provisions requiring

²¹ Sri Maya Sari, "Tanggung Jawab Hukum Advising Bank Dalam Pembayaran Barang Dengan Menggunakan 'Letter of Credit' (Studi Pada The Development Bank of Singapore (Bank DBS) Jakarta)," *Premise Law Journal* 13 (2016): 1-15.

²² Agus Setiawan, "Resiko Yang Dihadapi Bank Dalam Transaksi Pembayaran Dengan Letter of Credit (L/C)," *Jurnal Ilmiah Mahasiswa Bidang Hukum Keperdataan* 1, no. 1 (2017): 13-28.

²³ Zaned Zihan Sosa Elsera Lubis, M. Nur, and Sanusi, "Asas Keseimbangan Dalam Perjanjian Penerbitan Letter of Credit Sebagai Transaksi Bisnis Internasional," *Jurnal Magister Hukum Udayana (Udayana Master Law Journal)* 8, no. 2 (2019): 261-81, <https://doi.org/https://doi.org/10.24843/JMHU.2019.v08.i02.p09>.

compliance with laws and regulations, including those of the Financial Services Authority. It is important for banks issuing L/Cs to comply not only with the Uniform Customs and Practice for Documentary Credits but also with government, Bank Indonesia, and Financial Services Authority regulations. Thus, achieving fairness and equity in the implementation of L/Cs necessitates a balanced bargaining position in the agreement between the applicant and the issuing bank. In this research, the focus shifts to the effectiveness of L/Cs as payment transactions in the banking sector specifically in Batam City, with an emphasis on the effectiveness of banking in that locality, distinguishing it from previous studies.

Based on the description as explained in the background above, the research problems in this study are as follows:

1. What is the effectiveness of Letter of Credit (L/C) in international transactions in the banking sector of Batam City?
2. What are the obstacles in efforts to enhance the effectiveness of Letter of Credit (L/C) in international transactions in the banking sector of Batam City?
3. How can solutions be implemented to ensure the effective implementation of Letter of Credit (L/C) in international transactions in the banking sector of Batam City?

2. Method

The methodology employed in this research is empirical legal research through a socio-legal approach as explained by Sulistyowati Irianto²⁴ that law can be studied from both the perspective of legal science and social science, as well as a combination of both. Socio-legal studies involve the examination of law using approaches from both legal science and social sciences using secondary data as the initial data, followed by primary data or field data,²⁵ to examine the effectiveness of Letter of Credit (L/C) in international transactions in the banking sector of Batam City. The data collection methods consist of document study and interviews. The socio-legal approach is directed towards understanding the reality by examining the effectiveness of the law, observing the intended legal rules (*Das Sollen*) and the actual facts (*Das Sein*) in enhancing the effectiveness of Letter of Credit (L/C) in international transactions in the banking sector of Batam City.

To address the research problems, the researcher conducted the following research steps:

1. Primary data: field research by conducting structured interviews with PT. Bank Mandiri (Persero) Tbk, represented by Mr. Andrew Mulyadi as the Manager of Trade Service Batam Transaction Banking Region I (Sumatera 1), PT. Bank Negara Indonesia, represented by Ms. Apri Annisa Yusuf as the Trading Transaction Customer Services, PT. Bank CIMB Niaga, represented by Mr. Agano Wira Wijaya Putra Suparno as the Small Medium Enterprise, Bank Indonesia Kota Batam, represented by Mr. Herbert Manurung as the Staff of Bank Indonesia Kota Batam, PT. Sri Indah Aluminium Extrusion, represented

²⁴ Sulistyowati Irianto et al., *Kajian Sosio-Legal* (Denpasar: Pustaka Larasan, 2012).

²⁵ Florianus Yudhi Priyo Amboro and Lily Persyadayani, "Efektivitas Pelaksanaan Pengawasan Metrologi Legal Terhadap Peningkatan Retribusi Daerah Di Kota Tanjungpinang," *Journal of Law and Policy Transformation* 6, no. 1 (June 2021): 120–39, <https://doi.org/10.37253/jlpt.v6i1.4948>.

- by Ms. Shinta as the Manager, and PT. Cahaya Abadi Teknologi, represented by Ms. Merry Agustina as the Accounting representative; and
2. Secondary data: library research on relevant legal regulations²⁶ related to Letter of Credit (L/C), banking, and literature review consisting of books and journals related to the research issue.

All data was analyzed by using qualitative approach.

3. Analysis or Discussion

3.1. Effectiveness of Letter of Credit (L/C) in International Transactions in the Banking Sector of Batam City

Article 4 of UCP-DC-500 explicitly states that in the implementation of a credit, all parties involved deal with documents and not with goods, services, or other aspects related to the respective documents. Therefore, careful examination and scrutiny of all documents related to export-import transactions are imperative for all parties involved. Banker's Trust Company has long sought to provide guidelines for field practitioners, and the International Chamber of Commerce (ICC) has introduced similar guidelines in the ICC Guide to Documentary Credit Operations.

The applicant who requests the issuing bank to issue a Letter of Credit (L/C) has the right to the goods paid under the Letter of Credit (L/C) but is obliged to repay the issuing bank on behalf of the applicant for the payment of the goods' price under the Letter of Credit (L/C) to the beneficiary presenting the required documents representing the sold goods to the applicant. If the issuing bank authorizes a nominated bank to make the payment of the goods' price to the beneficiary, the issuing bank is obligated to reimburse the nominated bank for the amount paid to the beneficiary. The rights and obligations of each party are in accordance with the agreement based on the contract approved by the parties, specifying the payment amount to be realized as a substitute for the receipt of goods by the beneficiary from the applicant. The exercise of rights and obligations is also carried out by referring to the respective agreements based on the contract. The same applies to cost players in terms of order rights and obligations.

In this regard, to assess the effectiveness of implementing Letter of Credit (L/C) in international transactions in the banking sector of Batam City, a theory of legal effectiveness proposed by Soerjono Soekanto is utilized, which uses five criteria for assessing legal enforcement effectiveness, as follows:

1. Legality: Whether the implementation of Letter of Credit (L/C) complies with legal regulations and requirements.
2. Certainty: Whether the terms and conditions of Letter of Credit (L/C) are clear and unambiguous, providing certainty to all parties involved.
3. Accessibility: Whether the procedures and requirements for utilizing Letter of Credit (L/C) are easily accessible and understandable by stakeholders, including banks and traders.

²⁶ Rina Shahriyani Shahrullah and Henry Hadinata Cokro, "Penegakan Hukum Bagi Pedagang Usaha Mikro, Kecil Dan Menengah Terhadap Para Pelaku Usaha Monopoli," *Journal of Law and Policy Transformation* 5, no. 2 (December 2020): 113-27, <https://doi.org/10.37253/jlpt.v5i2.1391>.

4. Efficiency: Whether the use of Letter of Credit (L/C) streamlines and expedites international transactions, ensuring prompt payment and secure trade.
5. Justice: Whether the implementation of Letter of Credit (L/C) ensures fairness and protects the rights of all parties involved, including the beneficiary, applicant, and issuing bank.

These criteria serve as a framework to assess the effectiveness of Letter of Credit (L/C) in international transactions in the banking sector of Batam City and provide a basis for analyzing the research findings and discussing the challenges and potential solutions in enhancing its effectiveness.

a. Legal Factors

Government Regulation No. 1 of 1982 concerning the Implementation of Exports, Imports, and Foreign Exchange Traffic serves as the legal basis for L/C in Indonesia. However, detailed provisions regarding the implementation of Letter of Credit (L/C) are not explicitly stated in this regulation. It is a known fact that in Indonesian banking practices, UCP has been used as the standard for Letter of Credit (L/C) since the 1970s, and Bank Indonesia supports the adoption of this practice. Bank Indonesia sees UCP as a reliable framework for Letter of Credit (L/C) transactions.

Based on the interview with Mr. Andrew Mulyadi, Manager of Trade Service Batam Transaction Banking Region I (Sumatera 1) at PT. Bank Mandiri (Persero) Tbk, it is stated that UCP does not have binding legal force (Force of Law) as it is not a legislative product. UCP is also not a judicial product. Instead, UCP represents a compilation of international customs and practices regarding Letter of Credit (L/C). Therefore, UCP can be considered as the prevailing international law governing the implementation of Letter of Credit (L/C) in the banking sector.²⁷

Bank Indonesia, in Circular Letter No. 26/34/ULN dated December 17, 1993, stipulated that Letter of Credit (L/C) issued by foreign exchange banks (commercial banks) may or may not be subject to UCP. Based on the interview with Mr. Herbet Manurung, staff of Bank Indonesia Kota Batam, it is stated that Bank Indonesia formally grants freedom to foreign exchange banks in Indonesia to determine their stance. The content of the Bank Indonesia circular is influenced by the status of UCP, which is not a legal product with binding legal force. If Bank Indonesia explicitly requires Letter of Credit (L/C) issued by commercial banks to be subject to UCP, it means that Bank Indonesia considers UCP as part of national law and deems it legally binding.²⁸

Bank Indonesia does not require this. However, implicitly, Bank Indonesia supports the idea that Letter of Credit (L/C) issued by commercial banks should be subject to UCP. This stance reflects Bank Indonesia's trust in UCP as

²⁷ Hasil Wawancara dengan Bapak Andrew Mulyadi sebagai Manager Trade Service Batam Transaction Banking Region I (Sumatera 1) pada PT. Bank Mandiri (Persero) Tbk, pada tanggal 19 Oktober 2020.

²⁸ Hasil Wawancara dengan Bapak Herbet Manurung, Bank Indonesia Kota Batam pada tanggal 26 Januari 2021.

the only internationally applicable regulation for Letter of Credit (L/C), but at the same time, Bank Indonesia avoids granting UCP the status of Indonesian national law to maintain flexibility in issuing Letter of Credit (L/C), especially for countries like the People's Republic of China, where UCP compliance may not be required. Furthermore, if a Letter of Credit (L/C) is intended to be subject to UCP, the issuing bank must take action by including a clause in the Letter of Credit (L/C) stating that it is subject to UCP. Article 1 of UCP 500 states:

“The Uniform Customs and Practice for Documentary Credits, hexie 1993 Revision, ICC Publication No. 500, shall apply to all Thane Documentary Credits (including to the extent to which they at may be applicable, Standby Letter(s) of Credit) where they are www incorporated into the text of the Credit. They are binding on We all parties thereto, unless otherwise expressly stipulated in the Credit”

In line with UCP 500, Article 1 of UCP 600 states:

“The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600 (“UCP”) are rules that apply to any documentary credit (“credit”) (including, to the textent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit.”

UCP is not the sole source of law for Letters of Credit (L/C). Other sources of law include international customary law, court decisions, and legislation. Courts often rely on UCP because it has been widely accepted internationally. However, it should be noted that the inclusion of a clause stating the applicability of UCP in a Letter of Credit (L/C) does not restrict judges from considering other sources of law in resolving Letter of Credit (L/C) cases. To support this view, the ICC states:

“Because of its incorporation into the Documentary Credit, the UCP governs Documentary Credits primarily, but not solely. Courts and arbitration tribunals often apply the UCP because it is the most universally followed set of customery Documentary Credit rules and because it is perceived as being quite close to the level of perfection permitted by the “laws” of international compromise. However, it must be recognised that incorporation of the UCP into the Documentary Credit does not prevent a court from applying its country’s national law.”

The ICC's statement suggests that courts can use their national laws, considering that not all aspects of Letter of Credit (L/C) are regulated in UCP. For example, fraud is not addressed in UCP but is covered by national law. This means that courts can utilize both national law and UCP simultaneously in resolving Letter of Credit (L/C) cases. Furthermore, courts can also consider

international customary law. UCP is a compilation of international customs and practices concerning Letters of Credit (L/C). It is sometimes referred to as a codification of practices. UCP aims to create uniformity in the international practices of Letters of Credit (L/C). It serves as a guide for the implementation of Letters of Credit (L/C), minimizing differences or misinterpretations among the parties involved.

Letter of Credit (L/C) is a contract²⁹ between the issuing bank and the beneficiary. Michael Rowe, a renowned English lawyer, states that a Letter of Credit (L/C) binds the issuing bank as soon as it is notified to the beneficiary, but the beneficiary is not obligated to the Letter of Credit (L/C) itself. The beneficiary is free to either execute or not execute the Letter of Credit (L/C). If the beneficiary agrees to execute it, they become bound by the terms of the Letter of Credit (L/C) from the submission of the required documents.

Since a Letter of Credit (L/C) is a contract, it can also be regarded as a standard contract. This view aligns with Sutan Remy Sjahdeini's opinion³⁰ that a Letter of Credit (L/C) is a standard agreement. Regarding this standard contract, Bernard S. Whebel from ICC states:

"The natural corollary to any unification and harmonisation of PATE practice is the standardisation of the forms used in applying that practice"

Therefore, the purpose of the standard format is essentially for the standardization and simplification of Letter of Credit (L/C) procedures. The use of the standard format is not coercive. ICC only recommends its usage. ICC recommendations are not legally binding, so if a Letter of Credit (L/C) does not adhere to the recommended standard format, it does not have any legal consequences that would render the Letter of Credit (L/C) cancellable or legally invalid. Furthermore, not only can parties deviate from the ICC standard format, but they can also choose not to fully or partially comply with the provisions of the UCP in the Letter of Credit (L/C). This means that parties can independently arrange certain clauses in the Letter of Credit (L/C) based on their agreement in the sales contract, and for matters beyond those clauses, they may either be subject to the UCP or not subject to it at all. The explicit statements of the parties in the Letter of Credit (L/C) serve as the governing law for them.

Such explicit statements render the provisions of the UCP that regulate the same matter but contradict the explicit statements inapplicable. This is in line with the principle of freedom of contract as stipulated in Article 1338 of the Civil Code. The principle of freedom of contract applies to Letter of Credit (L/C) because it is a contract. Moreover, even if a Letter of Credit (L/C) is not subject

²⁹ Renee Martin-Nagle, "Injunctions of Letters of Credit: Judicial Insurance Against Fraud," *Journal of Law & Commerce* 3 (1983): 305.

³⁰ Sutan Remy Sjahdeini, "Bank Indonesia Penggerak Utama Reformasi Peraturan Perundangan Perbankan," Pidato pada Peresmian Penerimaan Jabatan Guru Besar dalam Mata Pelajaran Ilmu Hukum Perbankan pada Fakultas Hukum Universitas Airlangga di Surabaya pada Hari Senin Tanggal 16 Desember 1996.

to the UCP, it does not render the Letter of Credit (L/C) cancellable or legally invalid.

b. The Factors of Law Enforcement

Bank Indonesia, as an independent central bank, has the authority and responsibility for enforcing laws and regulations related to its functions. The legal framework for Bank Indonesia's independence was established with the enactment of Law No. 23 of 1999 concerning Bank Indonesia, which was subsequently amended by Law No. 6 of 2009. This law grants Bank Indonesia the status and position as an independent state institution in carrying out its tasks and authority, free from interference by the government or other parties, except for matters explicitly regulated by the law.

Bank Indonesia has issued regulations, such as Bank Indonesia Regulation No. 21/14/PBI/2019 regarding Export Proceeds and Import Payment Foreign Exchange. This regulation was issued to improve the provisions on the receipt of export proceeds, which were previously regulated by Bank Indonesia Regulation No. 16/10/PBI/2014, incorporating the provisions on the receipt of export proceeds from the management and processing of natural resources as stipulated in Bank Indonesia Regulation No. 21/3/PBI/2019, and to regulate the reporting obligations for import payment foreign exchange. The objective is to enhance the efficiency of monitoring the receipt of export proceeds and the expenditure of import payment foreign exchange through the banking system in Indonesia, in order to optimize the utilization of export proceeds and monitor import payment foreign exchange.

In addition, Bank Indonesia has also issued Bank Indonesia Regulation No. 5/11/PBI/2003 concerning Payment for Import Transactions. Based on research interviews with several banks in the city of Batam, they have requested Bank Indonesia to revise Bank Indonesia Regulation No. 5/11/PBI/2003. The bankers argue that the existing policy is no longer relevant to international standards, as it still refers to UCP 500, while the current international reference is UCP 600.³¹

c. Factors of Infrastructure and Supporting Facilities

Banks play a significant role in facilitating import-export transactions to provide benefits for both importing and exporting countries. Through the issuance of Letters of Credit (L/C) to their customers, commercial banks, especially those in Batam City, have been at the forefront of promoting trade and investment for the countries involved in L/C implementation in Batam City. Banks can be considered as instruments that facilitate the flow of goods and capital into and out of the country.

Exporters rely on banks to finance their production and sell their products. Importers depend on commercial banks for financing their purchases of goods from abroad, and commercial banks assist these exporters and importers in various ways. In doing so, commercial banks have become integral parts of the international monetary network through which rapid

³¹ Berdasarkan Hasil Wawancara dengan Bapak Andrew Mulyadi sebagai Manager Trade Service Batam Transaction Banking Region I (Sumatera 1) pada PT. Bank Mandiri (Persero) Tbk, pada tanggal 19 Oktober 2020.

international financing transactions occur with increasing amounts. Commercial banks are indeed the heart of our financing system and represent one of the oldest industries in the world. They provide many financing facilities for importers and exporters, both for conducting import-export transactions and for supporting the facilitation of these transactions.

Here are various types of facilities or financing for foreign transactions that can be utilized by exporters-importers based on interviews with several banks in Batam City:

1. Supporting Services for Import-Export Transactions:
 - a) Bank researches the application for opening a Letter of Credit (L/C) from the importer and immediately notifies the bank by telephone if there are any discrepancies or reasons for rejecting the L/C application.
 - b) The bank sends a preliminary advice via telegraph of a Letter of Credit (L/C) to the beneficiary, charging minimal telegraph fees.
 - c) Immediate telephone advice from the bank if any discrepancies are found in the documents.
 - d) Money transfers abroad via telegraphic transfer and letters. Advice of the telegraphic transfer is promptly sent to the correspondent bank by mail or telegraph as instructed, and with the use of a "private code" with other banks, telegraphic fees can be kept as low as possible.
 - e) The bank provides "status reports/credit information" from export-import companies overseas, which can be obtained by customers upon request. If the bank does not have the most up-to-date information from certain companies, the bank will conduct its own investigation or correspond with foreign banks. If the information is needed quickly, the bank will use a brief report by sending a telegraph to the foreign bank, and the customer will only be charged the out-of-pocket expense (telegraphic fees).
 - f) Purchase and sale of foreign currencies in "Spot," "Forward," and "Swap" transactions to protect importers, exporters, and banks from the risk of exchange rate fluctuations in L/C.
 - g) Payment orders to and from abroad through banks are considered secure because the funds can only be received by the designated person after providing identification to the bank that receives the payment order. This bank payment order is considered secure because if the original message is lost, a duplicate can be sent to the bank.
 - h) Banks can draw drafts in US dollars in many countries and in other foreign currencies that are payable at bank units.
2. Financing for Exporters: Banks can provide financing facilities needed by exporters in two stages: pre-shipment financing/pre-export financing (financing before shipment) and post-shipment financing/post-export financing (financing after shipment).

In the first case, exporters can obtain funds to finance the cost of preparing their goods for shipment, provided that there is a confirmed order. In the second case, exporters receive immediate payment after the goods are shipped. Exporters can obtain this financing primarily from their own bank, where they have an account or other transactional relationship. Such facilities can be provided in the form of loans or acceptances, such as overdrafts, loans, back-to-back L/Cs, and discounting facilities. As for Financing for Importers, generally, importers approach banks to request financing facilities when their funds are insufficient. The funds are needed for:

- a) Payments to be made for imported goods.
- b) Allowing importers to sell their goods in advance.

For these purposes, banks can provide facilities such as Letters of Credit (L/Cs) and Trust Receipt (T.R) facilities.

d. The Societal Factor

In Letter of Credit (L/C) transactions in banking, particularly in the city of Batam, involves three parties: the Issuing Bank, the importer, and the exporter.

1. **Issuing Bank.** As mentioned earlier, the initial role of the bank in export-import transactions is to process and execute the opening of a Letter of Credit (L/C) for the importer. Based on the agreed sales contract between the exporter and the importer, outside the involvement of the bank, the order for goods is placed. Based on the research interviews conducted regarding Letter of Credit (L/C) transactions in Batam's banks such as Bank Mandiri, Bank Negara Indonesia, and CIMB Niaga, the opening of a Letter of Credit (L/C) is based on the requirements set by the importer related to the sales contract. These requirements are detailed in the application for the opening of the Letter of Credit (L/C) addressed to the issuing bank. The bank that opens the Letter of Credit (L/C) is called the "opening bank" or "issuing bank". The terms "opening bank" and "issuing bank" have similar meanings and are performed by the same bank, although there is a possibility that the bank opening and issuing the Letter of Credit (L/C) may be different banks. Once the issuing bank approves the application for the opening of the importer's Letter of Credit (L/C), the bank opens the Letter of Credit (L/C) addressed to the bank in the exporter's location as required in the application form. If the name of the bank in the exporter's country is not specified by the importer, the opening bank (issuing bank) usually selects its own advising bank, which may be its branch or commonly its correspondent bank. The advising bank, upon receiving the Letter of Credit (L/C) from the issuing bank, will then forward or advise/confirm the Letter of Credit (L/C) to the exporter in accordance with the requirements stated in the Letter of Credit (L/C). The advising bank at the exporter's location then performs payment, acceptance, or negotiation of the documents of the Letter of Credit (L/C) and the bill of exchange presented by the exporter. A bank, like the advising bank selected earlier, can be referred to as a correspondent bank of another bank if there is a

cooperative agreement or arrangement between the two banks to secure transactions conducted between them. This agreement is known as "Agency Arrangements". The level of cooperation can range from a regular relationship, such as exchanging signatures and test keys for wire transfers without a depository relationship, to maintaining a depository account (depository correspondent).³² Therefore, a bank will carry out the mandates from its correspondent bank in terms of opening, forwarding, and processing Letter of Credit (L/C) transactions channeled to it until the payment settlements are completed. The opening of a Letter of Credit (L/C) by a foreign exchange bank, channeled through its correspondent bank, to be forwarded to the exporter can be done through various methods according to the importer's request in the application for the opening of the Letter of Credit (L/C).

2. **Importer.** In the context of import transactions using Letter of Credit (L/C) in Batam's banking, the researcher interviewed Ms. Merry, the accounting representative of PT. Cahaya Abadi Teknologi. The procedure for importing using a Letter of Credit (L/C) is as follows: a) The importer and the overseas supplier establish correspondence regarding the purchase of specific goods. Prior to this, the importer must have an Importer Identification Number (API) and a Taxpayer Identification Number (NPWP). b) The supplier sends a reply letter containing brochures and a price list to the importer. c) After negotiation, the exporter and the importer enter into a sales contract. d) The importer opens a Letter of Credit (L/C) at a foreign exchange bank, and a copy of the Letter of Credit (L/C) is sent to the surveyor (SGS) in the exporting country. e) The correspondent bank (Advising Bank) informs the exporter about the opening of the Letter of Credit (L/C). f) At the exporter's request and in accordance with the requirements stated in the Letter of Credit (L/C), the surveyor conducts a physical examination of the goods, matching the details specified in the copy of the Letter of Credit (L/C) regarding the type, quality, quantity, and other relevant information, in accordance with the applicable import trade practices. g) The surveyor (SGS) issues a Report of Examination (LKP) for the respective goods (LPS-1). h) The exporter contacts a foreign Shipping Company to send the goods. i) The Shipping Company issues a bill of lading (B/L). j) The Shipping Company, which issued the B/L, then transports the goods to the designated port in Indonesia. k) The exporter negotiates shipping documents with the Negotiating Bank, including the submission of the B/L and other documents required in the Letter of Credit (L/C). l) The Negotiating Bank forwards these shipping documents to the foreign exchange bank that opened the Letter of Credit (L/C) (Opening Bank) in Indonesia. m) After receiving notification from the Opening Bank regarding the arrival of the shipping documents, the importer

³² Hasil Wawancara dengan Bapak Agano Wira Wijaya Putra Suparno selaku Small Medium Enterprise Manager PT. Bank Cimb Niaga, Tbk pada Tanggal 03 November 2020.

completes the Import Notification Form (PIUD) and settles the Letter of Credit (L/C), pays customs duties, and other charges with the Opening Bank. n) Once the ship arrives, the importer, either directly or through a Shipping Cargo Consolidator (EMKL), contacts customs authorities to obtain clearance for the goods by presenting the PIUD form and proof of payment of customs duties. o) Customs authorities contact PT. (PERSERO) Indonesian Port III and the Customs Warehouse Hangar, accompanied by a General Notification. p) PT. (PERSERO) Indonesian Port III contacts the Warehouse Hangar and then returns to PT. (PERSERO) Indonesian Port III to provide approval for the release of the goods to be transported to the Importer's Warehouse.

3. **Exporter.** In terms of Letter of Credit (L/C) transactions in the banking sector in Batam, the researcher interviewed Ms. Shinta, the manager of PT. Sri Indah Aluminium Extrusion, which frequently engages in export activities using Letter of Credit (L/C). PT. Sri Indah Aluminium Extrusion is a company operating in the aluminum industry. Since its establishment in 2003 in Batam, the company has focused on the export market, particularly in neighboring countries such as Singapore and Malaysia. Its main products are aluminum extrusion and billets 6061/6063. Due to its strategic location in the Free Trade Zone (FTZ) and its proximity to Singapore and Malaysia, PT. Sri Indah Aluminium Extrusion has the advantage of exporting products to Singapore and Malaysia within less than 24 hours through maritime routes. With the passage of time and changes, PT. Sri Indah Aluminium Extrusion stated the need to develop L/C transactions, especially in protecting exporters. During the interview, Ms. Shinta, the manager of PT. Sri Indah Aluminium Extrusion, stated that the export procedure at PT. Sri Indah Aluminium Extrusion involves the activities carried out by the exporter, starting from preparing the goods for export until the goods are loaded onto the ship (FOB condition). If the export is conducted using L/C, the procedure includes the following steps:³³
 - a) The exporter establishes correspondence with the overseas importer until an agreement is reached on price, quality, delivery, and other terms.
 - b) The exporter and the importer enter into a sales contract.
 - c) The importer opens a Letter of Credit (L/C) through its correspondent bank.
 - d) The correspondent bank forwards the Letter of Credit (L/C) to the designated Foreign Exchange Bank in Indonesia as appointed by the exporter.
 - e) The Foreign Exchange Bank forwards the Letter of Credit (L/C) to the exporter.
 - f) The exporter prepares the ordered goods for export.

³³ Hasil Wawancara dengan Ibu Shinta sebagai Manager PT. Sri Indah Aluminium Extrusion pada Tanggal 06 November 2020

- g) The exporter books cargo space with the Shipping/Airline Service.
- h) The exporter or Freight Forwarding Company (EMKL/EMKU) arranges for the goods to be loaded at the Customs and Excise facility.
- i) The exporter or the Freight Forwarding Company (EMKL/EMKU) delivers the goods to the ship and handles the completion of export documentation.
- j) The exporter submits an application to the Regional Office of the Ministry of Industry and Trade/Trade Office to obtain a Certificate of Origin (if required).
- k) After the ship departs, the exporter receives the Bill of Lading (B/L) from the shipping company.
- l) The exporter prepares all necessary export documents, such as the Commercial Invoice, Packing List, Bill of Lading, Certificate of Origin, Customs Declaration (PEB), and fills out the first draft of the Foreign Exchange Bank.
- m) The exporter negotiates the bill of exchange at the Foreign Exchange Bank to receive payment.
- n) The Foreign Exchange Bank (as the Negotiating Bank) forwards the shipping documents to the Opening Bank.

The relationship between the three parties is documented in various agreements/contracts. Table 1 shows parties involved in Letter of Credit (L/C) transactions.

Table 1. Parties Involved in Letter of Credit (L/C) Transactions

No	Parties	Agreement/Contract Form
1	Importir/Applicant with Eksportir/Beneficiary	Sales Contract
2	Importir/Applicant with Issuing Bank	Letter of Credit (L/C) Application
3	Issuing Bank with Eksportir/Beneficiary	Letter of Credit (L/C)

e. Cultural Factors

Cultural factors in Letter of Credit (L/C) transactions in the banking sector of Batam city are effectively utilized to support international trade, particularly export and import transactions. Letter of Credit (L/C) is used as a means of financing transactions, where the opening of a Letter of Credit (L/C) requires the importer to provide funds to pay for the imported goods to the exporter. On the other hand, the exporter must provide the intended goods. In such transactions, there is an obligation to make payments in foreign currency, leading to foreign exchange transactions between two different currencies. Export and import transactions can result in the issuance of documentary evidence of shipment for exported goods as well as documentary evidence of ownership for imported goods.

4. Conclusion

Based on the research findings discussed in the previous chapter, the following conclusions can be drawn that to assess the effectiveness of implementing Letter of

Credit (L/C) in international transactions in the banking sector of Batam city, the theory of legal effectiveness by Soerjono Soekanto is needed. It uses five criteria for assessing the effectiveness of law enforcement, as follows:

1. Legal factor: Government Regulation No. 1 of 1982 on the Implementation of Export, Import, and Foreign Exchange Transactions serves as the legal basis for L/C in Indonesia. Detailed provisions governing Letter of Credit (L/C) are not yet available in the implementation provisions of Government Regulation No. 1 of 1982. It is a reality that UCP has been used as the provision for Letter of Credit (L/C) in Indonesian banking practices since the 1970s, and Bank Indonesia supports this practice. Bank Indonesia supports the use of UCP as the provision for Letter of Credit (L/C). Bank Indonesia sees that security is ensured when Letter of Credit (L/C) adheres to UCP.
2. Law enforcement factor: Bank Indonesia, as an independent central bank, carries out its duties and authority. Based on the research interviews with several banks in Batam city, they requested Bank Indonesia (BI) to revise Bank Indonesia Regulation No. 5/11/PBI/2003. Bankers believe that the old policy is no longer relevant to international provisions, as the current applicable reference is UCP 600.
3. Facilities and supporting factor: Various types of facilities or financing for foreign transactions can be utilized by exporters-importers, as stated in the interviews conducted with several banks in Batam city, including Export-Import Transaction Support Services, Financing for Exporters, and Financing for Importers.
4. Societal factor: In terms of Letter of Credit (L/C) transactions in the banking sector, particularly in Batam city, it involves three parties: the Issuing Bank, the importer, and the exporter. The relationship between these parties is documented in various agreements, such as the Sales Contract, which is the beginning of the export-import transaction with Letter of Credit (L/C). After the Sales Contract is signed or agreed upon by the buyer/importer and seller/exporter, the buyer/importer will contact their bank to act as the Issuing Bank. With the Issuing Bank, the buyer/importer enters into an agreement documented in the Letter of Credit (L/C) application or request for the issuance of Letter of Credit (L/C). Finally, the Letter of Credit (L/C) is issued, and once the Letter of Credit (L/C) application is signed by the buyer/importer, the Issuing Bank will send information regarding the Letter of Credit (L/C) to the seller/exporter.
5. Cultural factor: International trade transactions, commonly known as exports and imports, involve buyers and sellers who come from different backgrounds in terms of politics, economy, society, culture, and other aspects. In particular, in export and import transactions, Letter of Credit (L/C) is used as a means of financing, which requires the importer to provide funds to pay for the imported goods to the exporter upon the opening of the Letter of Credit (L/C). On the other hand, the exporter must provide the intended goods. In such transactions, there is an obligation to make payments in foreign currency, resulting in foreign exchange transactions between two different currencies. Export and import

transactions can lead to the issuance of documentary evidence of shipment for exported goods and documentary evidence of ownership for imported goods.

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