

Piskarev, D.I. (2022). Application of a letter of credit in the fuel business. *Actual Issues of Modern Science. European Scientific e-Journal*, 6 (21), 59-66. Ostrava: Tuculart Edition.

Пискарев, Д.И. (2022). Применение аккредитива в топливном бизнесе. *Actual Issues of Modern Science. European Scientific e-Journal*, 6 (21), 59-66. Ostrava: Tuculart Edition. (на англ.)

DOI: 10.47451/ecn2022-05-01

The paper will be published in Crossref, ICI Copernicus, Academic Resource Index ResearchBib, J-Gate, ISI International Scientific Indexing, Zenodo, OpenAIRE, BASE, LORY, LUASA, ADL, eLibrary, and WebArchive databases.



Daniil I. Piskarev, Head of the educational project “P-phenomenon”, Moscow, Russia.

Application of a letter of credit in the fuel business

Abstract: Trade in petroleum products has specific features that radically distinguish this type of business from other foreign trade transactions. Working in the fuel business is very difficult, because the spot market is very volatile. Almost every contract exceeds the approximate cost of 2 million dollars US. Also, it should be remembered that oil is taken into account in barrels during production, but in trade it is taken into account both in barrels and in tons. This article discusses the important elements that make up foreign trade contract work in the fuel business, as well as the use of a letter of credit in oil trading. The purpose of the study is to show in practice the use of a letter of credit and its role in the fuel business. Currently, a small number of scientific papers have been published on the application of a letter of credit in the fuel business. The author concludes that in the fuel business, haste will be a bad helper in the conclusion and execution of contracts. Details that are overlooked, even the most insignificant and unprincipled, can become an obstacle when disclosing a letter of credit.

Keywords: oil trading, letter of credit, oil, trade, fuel business, tanker.



Даниил Игоревич Пискарев, руководитель образовательного проекта «Р-phenomenon», Москва, Россия.

Применение аккредитива в топливном бизнесе

Аннотация: Торговля нефтепродуктами имеет специфические особенности, которые кардинально отличают данный вид бизнеса от других внешнеэкономических сделок. Работа в сфере топливного бизнеса очень сложна, ведь спотовый рынок весьма изменчив. Практически каждый контракт превышает примерную стоимость в 2 миллиона долларов. Также, нужно помнить о том, что нефть при добыче учитывается в баррелях, но в торговле ее учитывают как в баррелях, так и в тоннах. В данной статье рассматриваются важные элементы, составляющие внешнеэкономическую контрактную работу в сфере топливного бизнеса, а также применение аккредитива в нефтетрейдинге. Цель исследования – показать на практике использование аккредитива и его роль в топливном бизнесе. В настоящее время опубликовано небольшое количество научных работ, посвященных применению аккредитива в топливном бизнесе. Автор приходит к выводу, что в топливном бизнесе спешка будет плохим помощником при заключении и исполнении контрактов. Детали, которые упускаются из виду, даже самые незначительные и непринципиальные, могут стать препятствием при раскрытии аккредитива.



Introduction

The relevance of this problem lies in the fact that in the process of preparing a trade transaction, a trader uses the established forms of trade contracts. In these contracts, only some data changes, such as: the description of the goods, its quantity, the method of payment and the terms of delivery. It is this information that becomes a source of risks when drawing up a contract.

The subject of the study is the properties of the letter of credit form of payments in the fuel business.

The purpose of the study is to show in practice the use of a letter of credit and its role in the fuel business.

Based on the study purpose, the following tasks were set:

- show the distinctive features of this type of business;
- show the role and impact of a letter of credit in the fuel business;
- consider the components of foreign trade contract work in the fuel business: the description of the goods and their quality, the terms of delivery of the goods, the conclusion and execution of the ship's freight contract, payment methods for the goods;
- consider possible problems arising in the fuel business.

Currently, a small number of scientific papers have been published on the application of a letter of credit in the fuel business.

Product quality description

Since almost all calculations in the fuel business are made with the help of a letter of credit, the parties to a foreign trade contract must strictly adhere to the rule of exact correspondence of all information entered into the documents: in the bill of lading, in the letter of credit, and in the contract, all data must fully correspond to each other (*Karashev, 2014*).

However, despite this, there are still quite often a lot of problems due to the description of the quality of the goods. Often, the contract and letter of credit stipulate the quality of petroleum products according to one rule, and in the bill of lading it is indicated according to completely different ones. It would seem obvious that the description of the quality of the goods should be identical in both documents, which in practice often does not happen. There is a need for an emergency replacement of documents, even if the main parameters of the product are specified, such as: water content, number of bacteria, density. At the same time, the maximum permissible values may differ slightly in the applicable standards. However, if this technical information gets into the instructions for the letter of credit, then any deviation will become the basis for the bank's rejection of the document. Thus, we can conclude that it is not necessary to resort to excessive detailing of the description of the goods in the documents.

It is not very difficult to persuade the tanker captain to make changes to the bill of lading, but it can be extremely problematic to perform this operation physically. There are cases when to replace the originals of the bill of lading bearing the captain's handwritten signature, it was necessary to hire a helicopter, or to start a ship on a transit port raid. The seller suffered

unplanned losses, but this is nothing compared to the delay in payment for the goods for a month or more. The losses occurred despite the fact that both names denote the same product.

Also, problems may lie in the difference in the name of the goods in the documents. One name is international, and the second is intended for the domestic Russian market.

Methods, conditions, problems of delivery of goods

It is generally assumed that in the fuel business, the main money is earned between FOB and CIF (*Lorenzon & Baatz, 2012*). FOB and CIF are the two main types of delivery in which the goods are purchased from the manufacturer on FOB terms, that is, the port of shipment, and sold on CIF terms, that is, the port of destination. Earnings on freight and related operations alone can bring a professional trader up to three dollars for each ton of goods. At the same time, in the case of delivery of goods on CIF terms, it is assumed that the goods are sold at the port of destination. Indeed, according to this delivery condition, the seller is obliged to charter a vessel and pay for transportation to the port of destination, but the goods are considered to have been transferred to the buyer at the time of loading at the port of departure. At that moment, all responsibility and all risks passed from the seller to the buyer. Nevertheless, the buyer always checks the quality of the delivered goods and in case of serious deviations may simply not accept it, although the goods are already considered delivered. However, in practice, it is customary to inspect the quality of light petroleum products up to three times: during ship shipment and at the port of destination, before unloading, and in some cases “en route”. In order to minimize the risks of quality loss, the seller and the buyer nominate inspection companies that issue a quality certificate, which is a quality guarantee in case of disagreement.

The problem of both choosing a vessel for transportation and the principles of building a freight policy is quite acute for traders. One of the main problems in the fuel business is the problem of the optimal sales contract and cargo characteristics of a chartered vessel. Usually, an oil trader is bound by long-term contractual obligations with producers of petroleum products. The essence of such contracts boils down to the fact that the trader is obliged to buy a certain amount of goods from the manufacturer within a certain time. Very often it is necessary to put the ship under loading, without having reliable information about who exactly will be the buyer, and what size of the batch he wants to buy. There is a situation of a slightly different kind – the buyer already exists and his need is clear, but there are free vessels in the operational vicinity that differ significantly in tonnage from the vessel of the required carrying capacity. In such a difficult situation, it is necessary to persuade the client to accept, in fact, a batch of a larger or smaller volume than the option in the contract allows. The trader needs to be able to avoid paying for the dead freight of the vessel or the risk of under-delivery of a relatively small batch of goods.

The vessel can be chartered for one flight, for several consecutive flights, as well as for a long-term lease. The tactics of tonnage chartering is primarily determined by the type of relationship between a trader and a seller of petroleum products. If there is a long-term contract with the manufacturer or processor, under which the trader is obliged to regularly buy back certain volumes of goods, it is more logical to charter a vessel for a long time period. In such a situation, it is reasonable for a trader, in order to fix freight rates for a long time period, to conclude a freight forward contract in addition to the charter

In the market of crude oil and petroleum products transportation, there is no attachment to any specific proforma charters. Independent charters are being developed by various tanker fleet operators. Both large operators and smaller firms have their own proforma charters. Flight charters are very popular with small carriers. But if oil traders do not make special requirements for the proforma charters, then there are quite a lot of requirements for bills of lading issued for each specific flight. The bill of lading of the corresponding charter party is used for the registration of a specific transportation of each consignment, and it is mandatory in the order form, that is, the bill of lading is negotiable. The defense capability of the bill of lading is mandatory, due to the fact that the goods are either sold “en route”, or a letter of credit form of payment is used for payments for the goods. Often both of these factors are combined. In the event that the parties have agreed on a letter of credit form of settlement, bills of lading are issued by order of the issuing bank of the letter of credit (*Semikova, 2014*). The registration of a bill of lading for the transportation of oil and petroleum products has a number of specific features that are not found in bills of lading for the transportation of general cargo, dry bulk cargo or containers

For example, for a clearer identification of the carrier, the SCAC code (Standard Carrier Alpha Code) must be specified in the bill of lading for tanker transportation, and expanded. The expanded code also allows you to determine the nationality of the carrier. The mandatory indication of the SCAC code may be due to the fact that tanker bills of lading usually do not contain information about the carrier company, only about the vessel. The bill of lading must be signed by the ship’s captain, and not only the position of the signatory is indicated, but also his first and last name. Banks should be considered the source of this very specific requirement. Regarding the conditions for identifying the person who signed the bill of lading, there is only one requirement: the person who signed the bill of lading must be clearly identified as a carrier, captain or agent.

The bill of lading, regardless of the applicable pro forma charter, always contains standard reservations about the unknown, made by the captain. The essence of these reservations boils down to the fact that the captain tries to protect the carrier by all possible legal means from any possibility of claims from the shipper. It is believed that such reservations do not affect the purity of the bill of lading, despite the complete denial of information about the cargo being transported. Very often, a trader appeals to the ship’s captain to put the date of issue of the bill of lading on the bill of lading earlier than the actual date of loading. This situation is called anti-diting, and the unsecured bill of lading itself is known as “friendly”. The shipper seeks to obtain a “friendly” bill of lading in order to have evidence that the goods sold under the contract have been transferred to the carrier for transportation, thereby the seller has fulfilled his obligations under the contract. As a general rule, the carrier is obliged to issue a bill of lading at the time of acceptance of the cargo for carriage. Issuing a bill of lading before receiving the cargo is considered as an unusual and illegal action of the carrier. Such a bill of lading is considered illegal in transport practice. After all, in fact, we are talking about the issuance of a commodity-free document. The rule on issuing a bill of lading only after the cargo is received by the sea carrier can be considered as a legal guarantee of the protection of the bill of lading’s turnover. If it is proved that the bill of lading was intentionally issued with anti-diting, then by right it can be declared invalid.

The issuance of a “friendly” bill of lading, as well as the issuance of cargo without a bill of lading, or for an incomplete set of originals of the bill of lading refers to the personal risk of the ship’s captain. In such cases, in order to partially protect the captain, the shipper issues him a special letter guaranteeing the absence of any claims against the captain personally, the ship or the carrier. Such a letter is called a “letter of trust”. The practice of issuing cargo without handing over the originals of the bill of lading or an incomplete set when transporting oil cargo is very common, much more common than when transporting dry and even more containerized cargo. And this is another feature of the fuel business. A trader buys goods from a seller, almost always using a settlement with a letter of credit. At least one copy of the bill of lading goes to the bank to disclose the letter of credit. On the way, the goods are usually resold, often more than once. But it is impossible to change the bill of lading, due to the lack of a complete set of documents, so you have to ask the carrier to issue the cargo with an incomplete set of originals or without the original bill of lading at all. The shipper transmits to the carrier a “letter of confidence” in which he asks to deliver the cargo to the named recipient and guarantees the absence of any claims against the captain personally, the ship and or the carrier. Usually, a “letter of trust” is accompanied by a bank guarantee, according to which the carrier will receive serious monetary compensation if someone presents a complete set of originals of the bill of lading and demands delivery of the cargo to him.

When making a decision to issue a bill of lading retroactively, or to issue cargo for an incomplete set of originals of the bill of lading, the ship’s captain takes a risk and this risk is known to him, and the consequences are clear. However, captains almost always meet oil traders halfway and accept a “letter of confidence” from them. In today's realities, this has become a common practice.

International trade in crude oil and petroleum products plays a huge and fundamental role for the economies of different countries. However, the technology of contract work in oil trading contains many aspects that fundamentally distinguish this type of trade from trade in other types of goods.: You should never overload the contract and the instructions for the letter of credit with technical details and figures. It is quite enough that the parties have carefully and accurately described the quality of the goods in the annex to the contract. The rejection of some indicator will mean that the bank will reject such a document, and the process of receiving money for the goods can become very complicated and take a long time. All Russian producers of crude oil and finished petroleum products sell their products mainly on FOB terms (*European Business Statistics methodological manual for STS – 2021*), losing very significant money on this, which becomes the earnings of foreign trading firms. The execution of the contract of sea transportation takes place using the proforma charter, usually offered by the carrier. There are no specific requirements for the content and form of the charter. Traditionally, settlements are made using a letter of credit, which imposes certain conditions on the registration of the bill of lading of the charter party. Unlike other types of tram transportation, a bill of lading for oil cargo is recognized as clean even if the captain refuses to confirm the weight, quantity, quality, condition and volume of the cargo.

Another feature of the fuel business is that a trader’s representative may not always be physically present at the port of loading. To represent their interests, oil traders hire freight forwarders who work with cargo and documents at the port of loading (*Kovalev & Yatsenko 2016*).

Consequently, another block of problems arises, which is closely related to the mistakes of freight forwarders. Traders very often make mistakes in the names, grades and labeling of petroleum products, in the quality and quantity of goods. The elimination of these problems requires time, effort, and sometimes material costs. To minimize such risks, the trader should:

- 1) carefully select the forwarder;
- 2) clearly define in advance the range of issues and tasks that are transferred to the forwarder;
- 3) within the limits of the assigned powers, the forwarder must receive from the oil trader not only all the necessary information, but also extremely clear instructions on the appearance and content of documents that will have to be born with the direct participation of the forwarder;
- 4) all problems that have arisen when the forwarder departs from the instructions received must be eliminated by the forwarder himself, and if this is not possible, then at his expense. This point should be clearly reflected in the contract of the transport expedition.

There are also many problems with the date of the bill of lading. More precisely, with the correspondence of this date and the deadline for the execution of the contract for the purchase and sale of petroleum products. According to generally accepted practice, the date of shipment of the goods, and therefore the date of execution of the contract, is the date of the bill of lading. It is necessary to understand that it is objectively impossible to ensure the arrival of a vessel at the port of loading strictly on a specific day and hour. Therefore, in all standard proforma charters, a time period is stipulated – the earliest and latest dates when the vessel should be loaded. The latest date is called “cancelling”. A vessel that has submitted a notice of readiness even an hour before the onset of cancelling is considered to have arrived on time and is subject to acceptance. Participants in a foreign trade transaction should know this principle.

Required documentation

The formation of a set of documents is another very common problem, because it is not only a set of requirements, but also the ability of the seller to form it from documents suitable for each specific situation.

The standard set for a tanker with cargo usually consists of the following documents:

- 1) a bill of lading drawn up in a specified number of originals and copies;
- 2) quantity certificate – a document indicating the weight amount of cargo loaded on the tanker;
- 3) quality certificate – a document indicating the quality of the cargo;
- 4) timesheet – a complete report on the time spent loading the tanker;
- 5) cargo manifest – a document that brings together data on all bill of lading shipments loaded on a tanker. The manifest is required for the procedure of customs clearance of the vessel and the cargo on it at the port of destination;
- 6) ship inspection certificate;
- 7) notification of the readiness of the vessel;
- 8) receipts of the captain or his representative in receipt of documents (*The Uniform Customs and Practice for Documentary Credits...*, 2007).

Documents 2, 3, and 6 are prepared by independent surveyors hired by the interested party. These documents are very important, and their availability is almost always mandatory. They will

be included in the set that the sender will have to provide to the bank for the disclosure of the letter of credit.

Conclusion

Thus, it is seen that in the fuel business, haste will be a bad helper in the conclusion and execution of contracts. Details that are overlooked, even the most insignificant and unprincipled, can become an obstacle when disclosing a letter of credit.

Also, it is necessary to involve only professionals who know how to act in a particular situation in their own practice. Specifying the deadline date of shipment in the contract, it is necessary to provide for the possibility of extending the period if objective reasons arise that prevented the timely completion of loading on time. In the case of a letter of credit form of settlements, it is necessary to charge the issuer of the letter of credit to make changes to the terms of the letter of credit upon the occurrence of such reasons, with their documentary certification. Also, do not overload the instructions for the letter of credit with technical details. It will be enough that the parties carefully describe the quality of the goods in the contract. The deviation of any indicator in the instructions to the letter of credit, although it can be settled by the parties to the contract among themselves, however, the bank will not accept such a document, which will complicate the process of receiving money for the goods.



References:

- European Business Statistics Methodological Manual for STS – 2021. (2021).
- International Standard Banking Practice: on verification of documents on documentary letters of credit: ICC Publication №681. Edition of 2007 for UCP600. (2011). Moscow: Infotropic Media. (in Russian)
- Katjuha, P.B. (2015). *Trade in hydrocarbons on the world energy markets: a textbook*. Moscow: I.M. Gubkina Russian State University of Oil and Gas. (in Russian)
- Karashev, K.V. (2014). *Letter of credit legal relationship: concept, essence, comparative legal analysis: Monograph*. Moscow: IC RIOR: SIC INFRA-M. (in Russian)
- KG Bominfl ot Bunkergeellschaft fur Mineralole MBH & CO v Petroplus Marketing AG (THE “MERCINI LADY”) / [2010] EWCA Civ 1145. (in German)
- Kopytin, I.A., & Zhukov, S.V. (2015). *The influence of the world oil price on the stock markets of oil exporting countries*. Moscow: Magister. (in Russian)
- Kovalev, R.N., & Yatsenko A.V. (2016). *Forwarding activity: textbook. Part 1*. Yekaterinburg: Ural State Forestry University. (in Russian)
- Lorenzon, Filippo, & Baatz, Yvonne (2012). *CIF and FOB Contracts* (5th edition). Andover, GB, Sweet & Maxwell [British Shipping Laws].
- Poul, Todd. (2007). *Bills of Lading and Bankers' Documentary Credits / (Maritime and Transport Law Library) Informa Law from Routledge* (4th edition). Routledge.
- Semikova, P.V. (2002). Letters of credit as payment instruments. *Finances and Credits*, 3(117), 62-68. Moscow: Edition House “Finance and Credit”. (in Russian)
- The Uniform Customs and Practice for Documentary Credits: Publication ICC №600, editorial office. (2007).

Trifonov, A.V. (2005). *Marketing in shipbuilding (Fleet supply). Part 1. Theory. Textbook.* Moscow: MGAVT. (in Russian)

Trifonov, A.V. (2005). *Marketing in shipbuilding (Fleet supply). Part 2. Practice: Textbook.* Moscow: MGAVT. (in Russian)