

## LEGAL ASPECTS AND ADVANTAGES OF THE INTRODUCTION OF ELECTRONIC LETTER OF CREDIT IN UZBEKISTAN

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### ABSTRACT

In this paper we make analysis of legal aspects and advantages of the introduction of electronic letter of credit in Uzbekistan and the main purposes of this research are creating the effective regulation of economic processes as well as the creation of the firm legal measures. We give information about different countries and their experiences in international settlements in trade relations with their explanations. We point out that it is vital to prevent fraudulent actions of third parties in the use of the letter of credit, taking into account its negative consequences for trading parties. The number of companies which refer to this method are decreasing and we underline that we consider the letter of credit payment method as the safest and most effective in settlement transactions despite this fact.

**Keywords:** settlement transactions, cashless settlement, payment orders, payment requests, letters of credit, collection orders, checks of commercial banks, calculations on plastic cards, interbank settlements system, a letter of credit

### I. INTRODUCTION

Today, one of the most important issues in the world community is the development of cooperation and improvement of trade relations. One of the priorities for each country is to develop and implement an effective mechanism for the implementation of these economic processes. The main task for this is not only the effective regulation of economic processes, but also the creation of a solid legal framework.

In particular, the implementation of trade relations includes settlements and other related transactions. The Republic of Uzbekistan is undergoing significant changes and reforms in this area. In his next Address to the Oliy Majlis on January 24, 2020, the President of the Republic of Uzbekistan Shavkat Mirziyoyev noted that the implementation of consistent changes in the economic sphere is a priority. In particular, «one of the current priorities is to work with the Russian Federation, the People's Republic of China, the United States, Japan, South Korea, Turkey, the United Arab Emirates, the European Union and Asian countries on political, trade, economic, investment and transport cooperation» [1]. Special attention should be paid to the further development of communication and cultural and humanitarian ties. It is no coincidence that the President named 2020 «the Year of Science, Education and the Digital Economy»[2].

Different countries have different experiences and approaches to international settlements in trade relations. These relations are governed by the norms of international public law and international private law. In some cases, there are still inconsistencies in the application of

international law or national law in the implementation of these relations. «It should be noted that in some cases, the contradictions in the application of international law are related not only to the need to protect the interests of foreign parties, but primarily to the best interests of their citizens and the development of their own economy» [3].

Accordingly, each country develops its own national systems based on its national interests, studying the experience of the most optimal and practically developed countries in conducting settlement operations. As we have mentioned above, the effective regulation of economic processes and the creation of a solid legal framework in this area will have the crucial influence on the improvement of this sphere. We have to point out that the most convenient decisions can be reached during the process of analyzing different experiences of the countries and their different approaches.

## II. SETTLEMENT TRANSACTIONS

We are going to give information about the settlement transactions as they are considered as one of the key elements of trade and economic relations, and settlements are considered to be cash and non-cash. The type of international settlement that is recognized as acceptable in world civilization is cashless settlement. The main reason for this is that there are a number of conveniences and advantages for performing cashless transactions. For example:

- the risks are avoided;
- Prevention of corruption, economic and other crimes related to the looting of property;
- Increased efficiency of work in the field;- time efficiency and savings are achieved;
- due to the existence of effective international practice of cashless settlement operations, states can adopt certain experience based on their national interests;
- the existence of norms in international legal instruments that are strictly binding and of a recommendatory nature (this allows states to choose, and each state can choose strict norms or customary law (lex mercatoria));

At present, cashless settlements in the territory of the Republic of Uzbekistan Annex to the Resolution of the Board of the Central Bank of the Republic of Uzbekistan № 9/1 of April 26, 2013 "On non-cash settlements in the Republic of Uzbekistan" (№2465 03.06.2013) in accordance with the Regulations approved by the Central Bank of the Republic of Uzbekistan. Regulations on cashless settlements in the Republic of Uzbekistan The Civil Code, the Law "On the Central Bank", the Law "On Banks and Banking", the Law "On Enterprises of the Republic of Uzbekistan" and Developed in accordance with other regulations of the Central Bank governing cashless settlements in Uzbekistan.

According to the Regulation, “cashless settlements are made through the following forms provided by law and adopted by the Central Bank of the Republic of Uzbekistan:

- Payment orders;
- Payment requests;
- Letters of credit;
- Collection orders;
- Checks of commercial banks;
- Calculations on plastic cards” [4]

One of the most pressing issues today is the further liberalization of foreign trade in our country, increasing the volume and variety of exports of products in high demand in foreign markets, increasing the competitiveness of businesses and ensuring financial stability. In particular, the Resolution of the President of the Republic of Uzbekistan dated November 3, 2017 No PP-3351 “On measures to further liberalize foreign trade and support businesses” [5] provides for the provision of goods, works and services to businesses from December 1, 2017. It provides for the right to export in foreign currency without the need for prepayment, an open letter of credit, a formalized bank guarantee and a policy to insure the export contract against political and

commercial risks. Therefore, in the process of import and export operations, it is important to ensure the protection of the legitimate interests of the parties in the settlement of transactions between business entities and to ensure timely payments for work performed or services rendered.

In addition, the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan dated January 1, 2020 "On measures to further improve the activities of the National Export-Import Insurance Company" UZBEKINVEST "No PP-4337" Uzbekinvest " The set of insurance support services includes buyer credit, short-term receivables, supplier credit, approved letter of credit, exporter's working capital loan, export factor insurance and other means of export support. was set to include Improving the legal framework for the provision of services mentioned in the above resolution, as well as the study of international experience in this area is one of the most pressing issues today. As a result of the steady development of international trade and the expansion of cooperation between countries, various processes are taking place in the field. In particular, the improvement of the establishment and implementation of mutual settlements, which are the main link in the banking and financial system, is a topical issue today.

### III. INTERNATIONAL FRAMEWORK OF TRADE AND ECONOMIC RELATIONS

The establishment of an international framework of trade and economic relations and issues of international settlements in this field are one of the key issues for each country. It should be noted that the process of transition to a market economy as well creating a legal foundation cover certain important aspects of foreign economic activities in the implementation of democratic reforms in the country. As our first president Karimov noted, "... after having a solid legal basis it is possible to rebuild the shackles of the old system with full confidence and construct a new society with a cultural market economy" [6].

The first practical implementation of interbank settlements system in the Republic of Uzbekistan had a unique feature. By the mid-1994 it had been used an accounting system that existed in the former Soviet Union. The banks carried out mutual settlements and payments by post. Therefore, it should be noted that such a form of implementation of bank settlement caused problems (required a lot of time and expenses) [7]. To carry out the control over the implementation of the bank settlements based on the old system, which was in practice and it was hardly effective. In order to solve this problem it was held a joint meeting of the commercial banks in accordance with the Resolution of the Cabinet of Ministers dated March 18 1996 №146. As a result, the department dealing with the problems of various effective aspects (technical and electronic systems) of the banks was established under the Central Bank. The Department managed the implementation of all banks technical base, electronic system and the connection continuity with a new supply. By this way, a new interbank electronic system was launched. Through this, the duration of the payment and *settlement system* was reduced to 3-9 days.

In April 1995, a new system by the Central Bank of the Republic of Uzbekistan, which is the plan to transfer *paper-based payment system into electronic-based payment system* was discussed. In August 19 1995, the Central Bank adopted the Regulation on "Electronic payment" and this bill completely updated payments and settlements system. Since then, this practice has been introduced to the payments system of 5 Banks in the city of Tashkent. In March 1996, the electronic settlements system was introduced to all regions of the Republic and all commercial banks. The current system gave an advantage with a 1-day difference in results in terms of time saving.

In this context, there were many problems and confusion in the existing material-technical and organizational aspects as well as there were also a number of problematic aspects with the legal regulation and legislation. The opportunity to make new changes to the legal system with increased speed in accordance with international standards in a step-by-step manner accomplished.

To pay for the supply of goods and services plays an important role in the practice of international trade. To express different aspects of the payments and settlements in foreign trade

agreements will be agreed in accordance with the mutual desire. These are advance payments, a settlement by draft, a bill of exchange, a *cheque* and a letter of credit, which is a most basic form.

Practical experience shows that today the introduction of a comprehensive system of non-cash payments as well as the proper implementation in this field and the establishment of mechanisms for coordination of the sector can be said that they will determine the future of financing, credit system, budget execution and other types of progresses in the economic system.

Currently, it is considered that a legislative base regulating the legal issues on different forms of non-cash payments is formed in the legislation of the Republic of Uzbekistan. The Civil Code of the Republic of Uzbekistan [8], “About non-cash payments in the Republic of Uzbekistan” [9], “About the Central Bank of the Republic of Uzbekistan” [10], “About banks and banking activity” [11], “About the contractual legal base of activities of business entities” [12], “About execution of court resolutions and acts of other bodies” [13] determines the procedure for carrying out non-cash payments in the territory of the Republic of Uzbekistan.

In fact, a letter of credit is recognized in the present-day practice as one of the most used type of payments in terms of safety performance, and at the same time, the legal regulation applied in practice in terms of easy non-cash payments as the most appropriate means and type of payments. Part 3 of the Civil Code of the Republic of Uzbekistan entitled as Payments on letters of credit and it covers the general *definition* of a letter of credit, its typical process, expire date, types, execution procedure, different formalities related to documents, liabilities under the letter of credit, and aspects such the closing of a Letter of Credit. The Civil code of the Republic of Uzbekistani, article 796 states that in the case of settlements by letter of credit, the bank that has opened the letter of credit on the order of the client (the payor) and in accordance with his instructions (the emitting bank), has the duty to make payments in the case of providing by the recipient of the funds or indicated by him a person (further the recipient of funds) documents and performance of other conditions provided by the letter of credit [14].

In accordance with the Civil Code of the Republic, there is a revocable letter of credit (Civil Code, Article 798) and an irrevocable letter of credit in the practice of the banks of the Republic.

“A revocable letter of credit is one that may be changed or revoked by the emitting bank without prior notification to the recipient of funds. Revocation of the letter of credit does not create any obligations of the emitting bank to the recipient of funds”. (Civil Code, Article 798). “The emitting bank of the payor without dealing with the recipient of funds may change or revoke a revocable letter of credit” [15].

“An irrevocable letter of credit is one that may not be revoked without the consent of the recipient of funds. On request of the emitting bank, the executing bank participating in the conduct of a letter of credit operation, may guaranty an irrevocable letter of credit (guaranteed letter of credit). Such a guaranty signifies acceptance by the executing bank of an obligation supplementary to the obligation of the emitting bank to make payment in accordance with the terms of the letter of credit” (Civil Code, Article 798). “An irrevocable letter of credit guaranteed by the executing bank may not be changed or revoked without the consent of the executing bank” [16].

In legal system of the Republic of Uzbekistan two more types of letters of credit: a covered (deposited) letter of credit and a non-covered (secured) letter of credit are also available. “In case of the opening of a covered (deposited) letter of credit, the bank serving in accordance with client instructions, upon its opening, has the duty to transfer the own funds of the client or of credit given to him to the disposition of the bank serving for the recipient of the funds, for the whole time period of effectiveness of the obligation of the bank serving in accordance with client instructions” [17].

“In case of the opening of a non-covered (secured) letter of credit, the bank serving in accordance with client instructions is given the right to withdraw the whole amount of the letter of credit from the account of the bank serving in accordance with client instructions in the bank serving for the recipient of the funds” [18].

International relations on settlements by a letter of credit are regulated through a set of international rules in the form of an informal codification entitled “Uniform Customs and Practice for Documentary Credits” carried out by the International Chamber of Commerce in 1993. Settlements by the documentary letter of credit are abstract in nature. These relations will form a legal character based on a purchase and sale agreement.

As a result, in the case of settlements by letter of credit, the bank in accordance with the payor’s instructions, has the duty to make payments in the case of providing by the recipient of the funds documents to the emitting bank.

According to the law, period of validity for making settlements by a letter of credit shall be established by the contract between the payor and the recipient of the funds.

Moreover the contract must also include:

- a name of the emitting bank;
- a type of the letter of credit and a method of its execution;
- a method of a notice to a recipient of funds on opening of letter of credit;
- the whole list of and exact description of documents given by a recipient for receiving on the letter of credit;
- the list of providing documents after shipment of goods (rendering services, fulfillment of works);

At the same time, according to the law, in case the recipient of funds shall present to the executing bank documents not confirming the performance of all terms of the letter of credit will be found a refusal and according to the conditions of letter credit, the executing bank immediately shall notice to the payor and the emitting bank about a refusal because of presenting documents not confirming the performance of all terms of the letter of credit.

In the law, the issues of the liability of settlements by non-cash payments are one of the important aspects. At this point, main participants will be taken into account as liable parties in the implementation of the settlements by letter of credit. According to the legal system of the Republic of Uzbekistan, the liability in the operations of letter of credit is following “Liability to the client for violation of the terms of a letter of credit shall be borne by the emitting bank, and to the emitting bank by the executing bank.

In case of groundless refusal of the executing bank to pay monetary funds under a covered or guaranteed letter of credit, liability to the recipient of funds may be imposed on the executing bank.

In case of incorrect payment by the executive bank of monetary funds under a covered or guaranteed letter of credit as the result of a violation of the terms of the letter of credit, liability to the client may be imposed on the executive bank” [19].

Furthermore, according to the national legislation, aspects of the closing and liquidation of letter of credit are also established. These terms are regulated by Resolution on “Settlements by non-cash payments in the Republic of Uzbekistan” and the Civil Code of the Republic of Uzbekistan.

Closing of a letter of credit carried out in accordance with the following: a) on the expiration of the time period of the letter of credit;

b) on statement by the recipient of funds of his decision not to use the letter of credit before the expiration of the time period of its effectiveness, if the possibility of such a decision is provided by the terms of the letter of credit;

c) on demand of the payor for the full or partial recall of the letter of credit, if such a recall is possible under the terms of the letter of credit [20].

The executing bank must make the emitting bank informed of the closing of the letter of credit. The unused sum of a covered letter of credit is subject to return to the emitting bank without delay simultaneously with the closing of the letter of credit. The emitting bank has the duty to credit the returned sums to the account of the payor from which the funds were deposited.

Thus, the legal nature of the international settlements is regulated through the domestic (national) law. The basis of the legal requirements formed in national context is established in accordance with international agreements and standards. The Public law norms have the partial influence in the legal regulation of

international settlements (administrative law, financial law, etc.). We can say that, in accordance with international standards, the Civil Code regulates the following issues:

- to determine the status and the liabilities of the banks carrying out international settlements as well as the liabilities of the centres carrying out settlements;
- to define relevant conditions and grant privileges by setting out legal framework for paper money, metal and foreign money;
- identify the procedures and conditions for opening foreign and local currency accounts of different types in an appropriate manner;
- to establish the conditions and rules for the terms and forms of international non-cash settlements in a strict manner;
- to define the rules for the implementation of the international banking operations;
- to impose sanctions for the violation of rights and rules in the implementation of international non-cash settlements;
- set a legal framework for the making of settlements by bill of exchange, check and other types of settlements;
- to regulate the exchange of various currencies in cash and non-cash forms;
- the issues of legal regulation on requirements of mutual conditions and credit settlements;
- the issues of legal regulation on relations for international settlements between the state with another state or group of states, as well as with international organizations;
- legal regulation on separate regimes of settlements;
- provide the availability of international settlement transactions in accounting documents and other documents;

The rights and obligations of banks and customers on the making of international settlements are based on a variety of laws, resolutions and normative acts. For example, the Resolutions of the Cabinet of Ministers “On *measures to improve control over the use of funds in foreign currency for foreign trade operations*”, “On measures to improve the monitoring of export-import operations”, “on the procedure for the record and payment of import contracts in foreign currency at their own expense of Economic entities”, the law of the Republic of Uzbekistan “About the currency control” are considered as normative acts regulating international settlements. These laws and acts are carried out by the departments of the Ministry of Finance and the Central Bank. For example, there are departments regulating these activities at the Central Bank and they have specific tasks.

The Department of payment system and informatization is an independent structural unit of the office of the Central Bank. The main task of the Department is to launch the efficient operation of settlement systems in the banks of the Republic and develop the technologies of the interbank and international settlements in accordance with the international standards, explore the advanced information technologies in the practice of a global banking system and apply it for the banking system of the Republic and develop these tasks, adopt normative legal acts for the activities of payment system and informatization and control their execution.

The main objective of the department of monetary operations of the Central Bank is to analyze the financial condition of correspondent banks under the classification of international rating agency and evaluate their effectiveness of the cooperation with the Central Bank of the Republic of Uzbekistan and in accordance with it, to develop proposals on the establishment and termination dealer and representation relationships with the partners of the Central Bank.

When all countries in the world establish trade relations with Uzbekistan they choose letter of credit which is considered as the safest type of payment [21]. A letter of credit for the exporter is very convenient and reliable means of payment. But at the same time, this is the most expensive method of payment. The following conclusion relating to one of the international settlements such as letter of credit in the legal system of the Republic of Uzbekistan, has been done as a result of a comparative analysis of the legislation in the US, Germany and the national law:

Firstly, there is no legislation about letter of credit in the Republic of Uzbekistan as there is legislation about letter of credit in the US and this payment practice is carried out on the base of the regulation adopted by the Central Bank of the Republic of Uzbekistan. However, used terms in letters of credit are not given in this regulation. For instance,

- there is no definitions for the subjects of letter of credit such as a client, issuing bank, advising bank and the recipient of fund.

- only two types of letters of credit are defined, but there is no legal basis for the types of letters of credit such as transferrable and revolving letters of credit, which are used in the banks of the world including Uzbekistan. This is a serious legal disadvantage in the practice and this field in our national legal system is gap for the courts to make a decision.

Secondly, the rights and obligations of the subjects of the letter of credit are not reflected in any documents. There is no anything about legal obligations in the regulation on “non-cash settlements” of the Central Bank [22]. I think the main reason is for that the rights and obligations specified in the contract are considered to be made compulsory. But this is not enough, because there is a likelihood not to determine all the rights and obligations in the agreement between the parties in the complex legal relations as a letter of credit.

Thirdly, the US adopted a set of laws “the Uniform Commercial Code” in its legal system, and the courts decide on the basis of this law when there is a case of dispute over letter of credit [23]. Germany does not regulate any issues on letters of credit in domestic law and the banks operate on the basis of The Uniform Customs and Practice for Documentary Credits (U.C.P.). German court practice shows that in Germany these rules accepted by the courts as a regulatory document and decisions are made on the basis of them [24]. But in Uzbekistan, such a practice is not developed. Because Uzbekistan does not accept the recognition of The Uniform Customs and Practice for Documentary Credits (U.C.P.) as a legal document. Therefore, these rules are not applied by the courts. Although the Civil Code of the Republic of Uzbekistan mentioned the implementation of the banking practice for settlements by draft, it did not mention about the implementation of the banking practice for settlements by letters of credit.

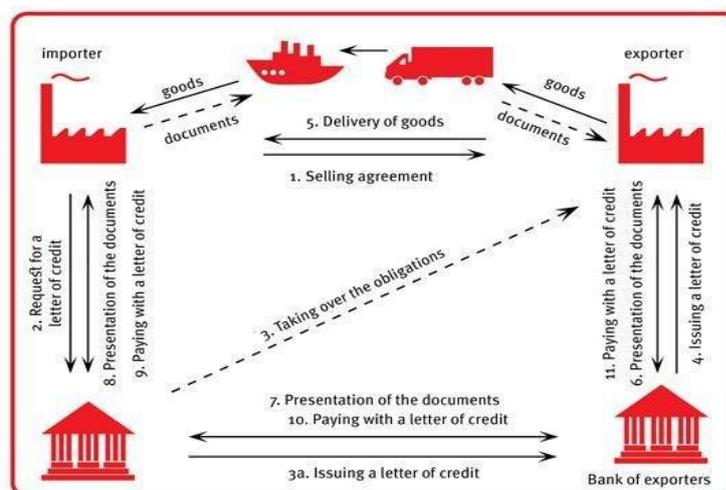
#### **IV. TYPES OF LETTERS OF CREDIT AND ADVANTAGES OF ELECTRONIC LETTER OF CREDIT TRANSACTION**

“Letters of credit are the most popular and widely used form of international settlements around the world. In particular, in the UK practice, a letter of credit is seen as a vital source of international trade” [25] and the equivalence of letters of credit is recognized as equivalent to a cash settlement process. Unfortunately, this popular type of calculation is rarely used in Uzbekistan. One of the main factors hindering the widespread use of letters of credit in Uzbekistan is the lack of theoretical research on the legal regulation of letters of credit, as well as significant differences in the legal structure of letters of credit under Uzbek law and the International Chamber of Commerce (ICC) rules.

Letter of credit is a common method of international payments for international settlement transactions for exporters and importers.

However, as noted in many scientific studies, there are a number of “shortcomings in the implementation of settlements by business entities, banks and companies through letters of credit” [26].

- high interest rates on commissions, which complicates the assessment of the real value of the product;
- It is very difficult to understand all the intricacies of the letter of credit schemes for customers who have not previously conducted operations with this bank;
- complex work process;
- high cost of use;
- cases of falsification of sent documents;
- availability of several invoices for products and goods loaded at once [27];
- the need for a highly qualified specialist to verify the accuracy of the documents, etc.



**Picture – 1. Scheme of implementation of the letter of credit [28].**

Accordingly, participants in foreign trade activities want to use instruments that serve as another alternative solution instead of the traditional type of letter of credit. Examples of these instruments are electronic letters of credit and bank payment obligations. These relatively new types of accounts were unified by the International Chamber of Commerce on June 25, 2019 [29], and the rules for the submission of electronic documents UCP600 (The Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation) [30]. The bank's payment obligations are regulated by the Uniform Rules for Banking Payment Obligations (URBPO), Unified Rules No. 750, issued by XSP in 2018.

The main difference between an electronic letter of credit and a traditional letter of credit is that all document exchange processes are carried out by electronic means of communication, not by paper delivery by courier service. Document verification is almost no different from regular verification. In this case, the bank, which received the documents, such as a simple letter of credit, downloads the documents sent through electronic channels and performs the usual checks by printing

Experts pay special attention to electronic digital signatures [31] in the development of electronic systems. "Electronic digital signature is a special modification of the information in the electronic document using the private key of the electronic digital signature, and using the public key of the electronic digital signature to determine whether there is an error in the information in the electronic document and identify the owner of the private key is the signature you give" [32]

However, it is advisable that the electronic signature code be available only to the person who uses the electronic digital signature and is responsible for the documents in order to use the entire

system effectively. In practice, digital signatures, which are mainly stored in USB memory and on a tablet (in some cases iButton), can easily be signed by people who are not engaged in sending messages or have nothing to do with the transaction.

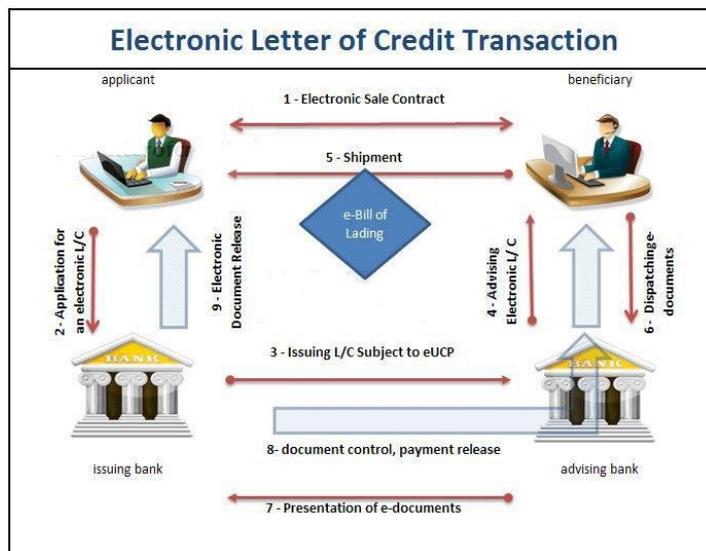
As mentioned above, the International Chamber of Commerce has developed eUCP in addition to the UCP600. This document consists of 14 articles. The norms of the eUCP document do not change the procedures given in the UCP600, but are applied to the practice of using an electronic letter of credit, i.e. the procedure of application in practice is the same as that of a letter of credit on paper. An e-letter of credit is also used to enter into electronic contracts for trade and other transactions between the parties using Internet technology. It must, of course, contain all the conditions for legal recognition. The use of electronic letter of credit serves to achieve time efficiency in the conclusion and signing of sales contracts, trade agreements by counterparties [33] located in remote areas. This eliminates long-term procedures such as opening a letter of credit at the bank.

The contract is concluded in electronic form and attached to the contractor's EDS. All documents are signed in the EDS, and it is not difficult for the parties to determine the authenticity of the document. Documents issued by third parties are also signed through the EDS. These types of documents include insurance, transport documents, bills of lading, air waybills, and more. Thus, the practical application of the electronic form of letter of credit serves to achieve time efficiency, prevent the risk of loss of documents and reduce costs. On average, sending a document through a letter of credit costs \$ 75-100 per transaction, and the average time is 3-7 days. If the terms of the letter of credit provide for partial or partial delivery of goods, then the number of transactions on a single letter of credit can be several dozen.

An electronic letter of credit allows you to avoid the above costs, as well as speeds up the process of raising funds on the basis of a letter of credit. At the same time, it reduces the risk of errors (number of errors) in electronic documentation systems, fraud in their preparation and loss during transit.

The first priority of the electronic letter of credit is the refusal of banks in the majority of cases, ie in 70-80% [34] of cases, when submitting documents for the first time to make payments. If inaccuracies or errors are detected in the settlement operations, the correction of errors in the electronic document (letter of credit) is carried out faster.

All parties using the e-letter of credit must have access to a technically secure online platform where documents can be submitted and verified electronically. There are several companies in the world that offer similar services. Examples include GlobalTrade Corporation, essDOCS and The Bolero [35] Ecosystem [36]. Of the foreign banks, The Royal Bank of Scotland, HSBC, China CITIC Bank, Agricultural Bank of China and others make payments by electronic letter of credit and offer this type of account to their partners. It should be noted that this type of letter of credit is not yet developed in Uzbekistan and is not in great demand



Picture – 2.  
 Credit Transaction

Electronic Letter of  
 [37]

## V. CONCLUSION

Taking into consideration all the facts mentioned above, it can be concluded that the participants of foreign trade relations will not give up the traditional documentary letter of credit in the near future. However, we think that, it is important to prevent fraudulent actions of third parties or third parties in the use of the letter of credit, as this will damage the reputation of the letter of credit relationship and can lead to a lot of dissatisfaction of trading parties. Although the letter of credit payment method is considered to be the safest and most effective in settlement transactions, the number of violations in this process and various violations in the current practice leads to a decrease in the number of companies willing to resort to this method of international settlements. This fact can clearly show that it is crucial to prevent the violations in this process and current sphere as its negative consequences are the main reason for the loss of trust to this method. We would like to point out that, avoiding this method can lead to the difficulties, unnecessary problems in international settlements. We can come to conclusion that, the demand for the convenient methods in international settlements making it vital to introduce electronic letters of credit in Uzbekistan.

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