

## Claims Guides

# Bills of Lading 2 - Letters of Indemnity

This note is intended to provide members with some general guidance regarding the issues which commonly arise when letters of indemnity (LOIs) are provided. This includes advice on how Club cover may be affected when LOIs are provided.

### Common practices in shipping

Owners are required to comply with charterers' lawful orders under the charter party. Owners have an implied general indemnity against charterers under English law to recover losses which they may suffer as a result of following charterers' orders under the charter party. However this implied indemnity does not cover all situations.

LOIs are often provided to owners so that they have an express indemnity in consideration for following charterers' orders which may give rise to cover issues as well as increased cargo claim risks. The LOIs may be provided by charterers and/or another third party.

LOIs are commonly requested in the following situations:

#### a) Issuing clean bills of lading or bills of lading containing other misrepresentations against letters of indemnity

The shipper and/or charterer may often pressurise the master to issue a clean bill of lading even where cargo is noted to be damaged upon loading, or issue a bill of lading showing shipment on date different to that on which the goods were actually shipped so they can present the bills of lading to the banks under the letter of credit system and be paid under the sale contract.

The interests of the shippers/charterers arising under letters of credit are of no concern to the carrier,

who should be focussed on their liabilities arising under the contract of carriage and charter party. Owners are obliged, where the bills of lading are to be issued "for and on behalf of the master" to check the bills of lading contain accurate information.

The master may be requested by the shipper or charterer to issue bills of lading which do not contain correct information regarding the condition, quantity or order of the cargo received in exchange for a LOI. Often the charter party expressly provides that the master is only permitted to issue a clean bill of lading against a LOI.

**In such cases, if there are any concerns with the quantity, order or condition, the master should consider:**

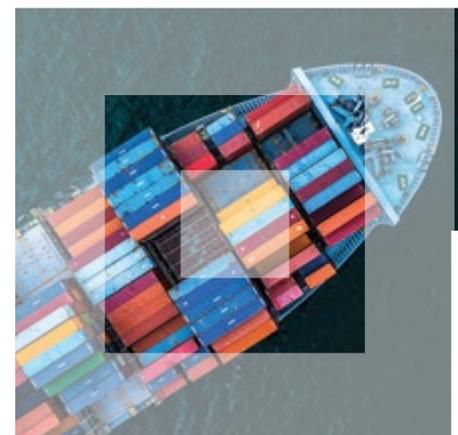
- (i) issuing a clean bill and rejecting any goods which do not conform with the clean bill of lading description; or
- (ii) Accepting the goods on board but issuing a claused bill of lading

If the master issues a clean bill of lading when he knows, or has reason to believe that the bill of lading does not accurately reflect the true condition of the cargo loaded (i.e. not rejecting the goods which do not conform), then P&I cover in relation to any cargo claims which arise as a result will likely be prejudiced. For example, if the shipper's figures are clearly not accurate and the bills of

lading are issued using those figures, P&I cover may be prejudiced in respect of any shortage claims.

Bills of lading issued with misrepresentations (such as wrong shipment dates and wrong cargo descriptions) which the carrier knows are inaccurate, could be relied upon by an innocent third party receiver or transferee. P&I cover for such cargo claims will also be prejudiced. Any LOI provided in such cases may not be enforceable.

These restrictions or even exclusions from Club cover are set out in Rule 2 Section 16 (C) (e).



### b) Delivering the cargo without production of an original bill of lading

One of the key functions of a bill of lading is that of a document of title. It is important to remember that an original bill of lading, not a copy, should be presented to the ship by the rightful holder to take delivery of the goods at the discharge port.

Where delivery of cargo is made without surrender of an original bill of lading, the risk of a misdelivery claim increases because the original bills could still be traded on.

For commercial reasons charterers often require discharge of the cargo against a LOI and this requirement is also inserted into the charter parties. If there is no such clause in the charter party and the master has concerns with regards to misdelivery, the owner can refuse to deliver the cargo until the original bill of lading is presented.

Where there is an express obligation in the charter party requiring the owner to deliver the cargo against a LOI, the owner should first ask charterers to clearly identify the specific receivers and then verify that the party demanding delivery is in fact the same party i.e. that they are the lawful holder of the bill of lading. The owner is obliged under the contract of carriage to deliver the cargo to the lawful holder of the bill of lading.

If the owner has reason to suspect charterers are ordering delivery of the cargo to a party who is not the lawful holder of the goods, then the owner should consider his position carefully and ask for further evidence from charterers that this is the party entitled to take delivery of the goods. The owner is entitled to consider charterers' orders within a reasonable time and is entitled only to follow charterers' lawful orders.

If the owner wrongly delivers the cargo against an LOI to the wrong party, for example, not the specific party named in the LOI, Club cover is likely to be prejudiced for the misdelivery claim and the LOI is unlikely to be enforceable. Owners must always be careful when checking the identity of the receiving party at the discharge port.

Cargo is sometimes discharged into a bonded warehouse, customs controlled warehouse or holding area in port against an LOI, pending collection by the cargo owner. In such cases Owners remain under a duty as carrier or bailee to ensure that the cargo is delivered to the lawful holder of the bill of lading after discharge. Regard must also be given to the local law at the country of discharge which may provide that delivery has taken place when cargo is discharged into the control of a third party. Members are advised to ensure the cargo is discharged to a warehouse owned by an independent third party who has agreed with the owners (or carriers) that the cargo will only be delivered upon surrender of an original bill of lading. The risk of misdelivery is higher in such cases and care should be taken when verifying endorsements on the original bills of lading.

Members should also be aware that discharge of the cargo to a warehouse or holding area in port pending collection by the receiver is quite distinct from delivery of the cargo to a third party who is not the lawful holder of the bill of lading. Owners may face a claim for misdelivery from the lawful holder of the bill of lading and P&I cover will be prejudiced. Therefore special attention must always be given when considering who is intended to take delivery of the goods and whether that party is entitled to do so.

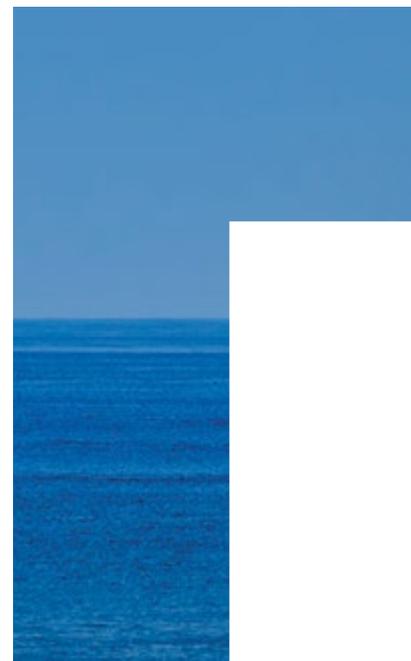
### c) Delivering the cargo after retention of original bill(s) of lading on board

A risky but commonplace practice has developed whereby the carrier retains one or more of the original bills of lading on board the ship, then gives them to the ship's agent at the discharge port who then "presents" the original bill(s) of lading back to the master to take delivery of the cargo.

The Club does not recommend that owners agree to this because there is a danger that the ship's agent at the discharge port may fail to identify the true cargo receiver; the practice increases the risk of a competing claim for the cargo. P&I cover will in these circumstances be prejudiced.

If Owners still wish to do this, we would suggest the following words be shown on the front of all the original bills of lading to give potential cargo receivers notice of the situation:

**"One original bill of lading retained on board against which bill delivery of cargo may properly be made on instructions received from shippers/charterers."**



## d) Switch bills of lading

Charterers may order the master to switch the original set of bills of lading issued with another set of bills of lading in a different term or form, against a LOI. It is important to ensure that the full original set of bills are surrendered before issuing new bills to reduce the risk of misdelivery claims arising.

Switch bills of lading may be ordered for various reasons. For example, the buyer may wish to be the named shipper for commercial reasons, so as to conceal the identity of the supplier from the sub purchaser, or the trader may wish to revise the port of delivery or add an additional delivery port.

Whether the reason for issuing switch bills could be construed as a legitimate commercial request would be a question of fact on a case by case basis.

If switch bills of lading are issued which contain false representations of fact which deceive the receiver or transferee of the bills of lading then P&I cover may be prejudiced as regards any cargo claims which arise as a result. See the exclusions to cover referred to above.

P&I cover will nearly always be prejudiced in respect of any misdelivery claims (i.e. whether such claims are brought under the original set or the switched set of bills of lading).

## e) Summary: problems with LOIs

Although the IG Group has issued recommended LOI wordings (see part (f) below), this does not mean that if such wordings are used, the LOIs will be enforceable or that Club cover remains in place for any claims. The LOIs are often provided in situations which may prejudice P&I cover, as has been described above.

Accepting a LOI does not reinstate cover and the LOIs will have the effect of taking the place of P&I cover in such situations but the value of the LOI is only as strong as the party providing it. Members are therefore strongly advised to consider carefully before they agree to accept a LOI and to evaluate the financial standing of the party offering it.

### Before agreeing to accept an LOI, owners should therefore firstly:

- (i) Check that the person who is giving the LOI is authorised to bind the company in question.
- (ii) Check that the company providing the LOI is creditworthy. If the owners are not satisfied that this is the case, they should request a countersignature from a first class bank.
- (iii) Consider if the LOI is likely to be enforceable in any relevant jurisdiction.

LOIs are not likely to be enforceable if they were not issued for legitimate commercial reasons but for the purposes of deceiving an innocent third party, for example:

- (i) Clean bills of lading are issued against an LOI but the carrier knew or ought reasonably to have known that the bills of lading should have been claused.
- (ii) Bills of lading or switch bills of lading are issued against an LOI but the bills / switch bills of lading contain false information e.g. wrong shipment date, wrong cargo amount, and wrong place of loading or any other false information that would deceive a receiver or transferee of the bill of lading.
- (iii) Bill of lading issued against an LOI to conceal the fact that the cargo was commingled with another parcel after shipment.



## f) IG Group standard letter of indemnity forms:

- (i) Delivery of cargo without production of a bill of lading (P&I Club form A)
- (ii) Delivery of cargo without production of original bill of lading with bank's agreement to join the LOI (P&I Club form AA)
- (iii) Delivery of cargo at a port other than stated in the bill of lading (P&I Club form B)
- (iv) Delivery of cargo at a port other than that stated in the bill of lading incorporating a bank's agreement to join in the letter of indemnity (P&I Club form BB)
- (v) Delivery of cargo at a port other than that stated in the bill of lading and without production of the original bill of lading (P&I Club form C).
- (vi) Delivery of cargo at a port other than that stated in the bill of lading and without production of the original bill of lading incorporating a bank's agreement to join in the letter of indemnity (P&I Club form CC)

The above referenced LOI wordings can be adapted to suit most situations. However, as the issue of LOIs is usually rather fact specific, we would recommend members contact the Club Managers to review the proposed wordings on a case by case basis.

As a general point, the scope of the LOIs should be kept broad so that they cover all risks associated with any particular situation and also, ensure that no time limit is imposed.

For each of the IG recommended LOI wordings, visit the claims guide section for Bills of Lading 1-5.

## Conclusions

Members are advised to use extreme caution when considering whether to accept an LOI.

They should bear in mind that a long time may lapse after receiving an LOI before a claim is brought under it. Owners will often have to deal with cargo claims in the first instance before looking for recovery of losses because the charterers or traders are often unwilling to put up security directly. The Charterers or company providing the LOI may no longer be solvent by the time Owners look to enforce it, rendering the LOI effectively worthless.

When circumstances arise where LOIs are being involved by any party, Club cover is likely to be prejudiced. It is recommended that before accepting any LOI Members should discuss the situation and all the ramifications of accepting such an LOI with the Managers.

Finally, Members should bear in mind that issues surrounding the use of LOIs for delivery of cargo without production of original bills of lading are largely resolved by the use of electronic bills. Details of the electronic systems approved by the International Group of P&I Clubs for the purposes of cover can be found in the relevant Claims Guide.

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