

## The Whys and Wherefores of Letters of Indemnity

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**Letters of Indemnity (“LOI’s”) may be offered by charterers and/or cargo interests (the Requestor) in numerous situations in return for taking some non-contractual risks where a voyage is not completed in accordance with the terms and conditions of the contract.**



Nowadays, cargoes are frequently traded whilst being carried onboard ship, however, the shipowner remains liable for all the consequences arising from the fact that documents do not move fast enough to catch up with the chain of transactions and possible changes. The LOI is an undertaking by charterers and/or cargo interests to protect and indemnify the carrier against the risk of delivering cargo to a party other than that holding the original Bill of Lading and/or delivering cargo to a port other than stated in the original Bill of Lading. Within this article, the Club aims to address the basic issues concerning the acceptance of the LOI's by carriers as well as provide guidance on how to avoid additional risks by carriers.

## MAIN CIRCUMSTANCES IN WHICH THE LOI'S ARE ISSUED

### a. Delivery of cargo without production of Bill of Lading;

The most common situation is where the vessel has arrived at the discharge port but the Bill of Lading (“B/L”) is not available. In the circumstances where the B/L cannot be presented to the carrier by receivers requesting delivery of cargo, traditionally the shipper or receivers will persuade the carrier to accept an LOI instead. Sometimes the B/Ls may be held up in the banking chain or simply delayed in the post. This situation will put commercial pressure on the carrier to deliver the cargo in order to avoid delays whilst the original B/L's are presented. In an LOI, the charterers or cargo interests undertakes to indemnify the carrier for the consequences of delivery. It must be stressed that the carrier is not bound to accept such an LOI (except in circumstances where say the C/P calls for such an arrangement to be agreed in the absence of the original B/L).

Under English law, a Master is not obliged to give delivery against the LOI. Delivery without the original bill of lading is at the carrier's risk. In any event, acceptance of this arrangement is a commercial decision taken by the carrier and may have consequences with regard to Club cover which could be prejudiced (see Rule 29.2.6 which excludes cover where cargo is delivered without presentation of the original B/L).

### b. Delivery of cargo at a port other than stated in the Bill of Lading;

Charterers and/or cargo interest may also ask carriers to deliver cargo at a port other than that specified on the face of the B/L. Again, this situation may also give rise to a request for the carrier to accept an LOI in the same way as described in point “a” and with the same consequences.

### c. Delivery of cargo without production of Bill of Lading and delivery of cargo at a port other than stated in the Bill of Lading.

It is not infrequent for charterers and/or cargo interest to combine a request to deliver without production of the B/L and at a port other than the port named in the B/L. The consequences of accepting such an LOI will be identical to those mentioned in the two preceding points of the article.

## THE LOI COUNTERSIGNED BY A BANK

If an LOI is indeed required to be accepted, the Club recommends that where possible all LOI's should be countersigned by a bank which should be the charterers and/or cargo interest's bank. However, it is rare for banks to cooperate with such a request because they are aware of the risks associated with the issue of such LOI's and would not like to be party to a fraud or potential fraud. That said, if a bank did agree to countersign, there would be far more commercial pressure on them to honour the LOI and would be difficult to resist given that they would not wish to risk any such dispute being aired in court.

## A SITUATION IN WHICH THE ACCEPTANCE OF THE LOI CONSTITUTES A FRAUD – ‘CLEAN’ BILLS OF LADING

It is becoming increasingly rare for charterers and/or carriers to ask carriers to issue LOI's for cargo to be shipped under “clean B/L” where it is known that the cargo is damaged and should be the subject of claused BL's. This is a fraudulent practice and many jurisdictions will refuse to enforce the LOI contract. It is also irreconcilable with a general contractual principle of good faith. A carrier who issues a clean “B/L” in exchange for an LOI is estopped from claiming for any damage or defects that were present at the time of loading.

Further a third party B/L holder is entitled to receive sound cargo if a “clean B/L” is issued and may sue the carrier if the cargo is damaged or defective at the point of shipment. No court will uphold an LOI issued to a carrier by charterers and/or receivers arising from such a fraud or misrepresentation and the Club’s cover will of course be excluded.

## CASE LAW RELATING TO THE LOI’S

There are circumstances where the courts have upheld LOI’s. The English High Court decision in *Farenco Shipping Co Ltd v Daebo Shipping Co Ltd* (The “*Bremen Max*”) [2008] considered issues of construction in respect of the LOI for discharge of cargo without production of the original B/L where the commercial purpose and intention of the letter was that the owners should not have to incur the costs of providing security. Consideration was given to the wording of the LOI and the distinction between “discharge” and “delivery”. The terms and conditions of the charter party allowed the charterers to discharge the cargo in return of the LOI, however it did not identify the party to which delivery was to be made. Shipowners should take some precautionary measures when

accepting an LOI for delivery of cargo without production of the original B/L by obtaining appropriate verification from charterers as to the identity of the party to whom delivery is to be given and ask them directly to identify the intended receivers. The owners are then recommended to assess and check that they are indeed delivering the cargo to the person nominated by charterers. If an allegation is subsequently made against the carriers stating that they mis-delivered the cargo, accompanied by a security demand from the claimant, the carrier is advised to give notice to the issuer of the LOI immediately.

In *The Laemthong Glory* [2005] where an LOI was issued by receivers to voyage charterers requesting delivery of cargo without production of the bill of lading, the English Court held that the shipowner who is not a party to a contract can enforce a term of that contract to benefit him. The case is significant from a legal standpoint and vital for the shipowners.

In *The Great Eastern Shipping Company Ltd v (1) FEC Ltd and (2) Binani Cement Ltd* [2011] the English Court concluded that the shipowners in the dispute were entitled to enforce the LOI on the ground that they were acting as charterers’ agents; therefore the indemnity was extended to agents of charterers.



## CLUB'S RECOMMENDATIONS

Our P&I Rules 2011/12, contain recommended wordings of the standard form used by issuers of letters of indemnity, for use in circumstances where they are requested to deliver cargo without production of the original bills of lading and/or deliver the cargo at a port other than that stated in the bill of lading. The standard form letters of undertaking are designed to cover a broad range of trades and operations. Further, the Club can offer advice regarding any proposed modification, should Assureds wish to modify the standard forms to suit their particular requirements.

In circumstances where the carrier is requested by the charterer to agree clauses under which they are to accept LOI's in the event that delivery of cargo may not be achieved against B/L, the carrier should resist such requests and contact the Club for further advice.

The Club does not recommend the acceptance of letters of indemnity, however, the Club will provide assistance to its Assureds in circumstances where they wish to accept LOI's.

## CONTACT INFORMATION

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