



BILLS OF LADING

Letters of Indemnity

Executive summary

- A Letter of Indemnity (LOI) should be requested if asked to do something that one is not contractually or legally obliged to do.
- Three International Group LOI wordings exist.
- The financial strength of party offering the LOI must be considered.

A. Who is this article intended for?

This article is written with the member, in-house claims teams or legal counsel in mind and anyone else involved in preparing a LOI.

For the more practical aspects we refer to the Club's publication *'Practical Guide: Letters of Indemnity'*.

B. When should a Letter of Indemnity be requested?

A LOI should be requested whenever a request is made to do something that the party receiving the request is not already contractually or legally obliged to do. It is the party receiving the request that should ask for a LOI to be provided. The reason for requesting a LOI is to avoid exposure to additional risks and to provide a replacement where P&I cover may have been prejudiced in complying with the request.

There are many situations where members are asked to do something for commercial reasons, which prejudices P&I cover and where a LOI ought to be obtained to replace it. Since the member will have to rely on the LOI in the event that something goes wrong, the member has to ensure that it is satisfied with the terms of the LOI it accepts, as well as the financial standing of the party providing it.

It is important to ensure that LOIs are suitably worded and only accepted from parties that have sufficient financial resources to meet the significant liabilities that the beneficiary of the LOI might be exposed to by complying with the request.

The financial strength of the party issuing the LOI is indicative of the strength of the LOI. If a LOI is offered by a company which is a subsidiary, whose financial strength is unknown or unacceptable, it is sensible to ask that the LOI is also signed by the parent company (provided the financial strength of the parent company is acceptable).

Ideally, a LOI should be counter-signed by a first-class bank – albeit this is often costly and time-consuming and is only rarely achievable.

If it is possible to obtain LOIs from more than one party, this is also recommended. Sometimes it is possible to get separate LOIs (on the same wording) from a shipper and charterer.

Some requests involve the commission of fraud. If this is the case, the LOI provided is unlikely to be enforceable in any court of law. That adds an additional negative dimension to the LOI. It is therefore crucial that the party accepting such a LOI must be satisfied that the party giving it will be as good as their word.

C. P&I cover

It is sometimes thought that it is the act of accepting a LOI that will prejudice P&I cover. This is not entirely accurate. Instead, it is the act to which the LOI relates that may prejudice P&I cover.

P&I cover operates on the basis that the carrier adheres to the Hague or Hague-Visby Rules. In cases where the carrier does not follow the obligations under the Hague or Hague-Visby Rules, P&I cover will be prejudiced. As a result, any cargo claim can only be covered by the P&I club on a discretionary basis.

If the carrier is asked to perform an act which falls outside of the obligations under the Hague or Hague-Visby Rules, the carrier may then request that a LOI is provided by the party requesting the carrier to carry out the act.

Where P&I cover has been prejudiced, the prejudice will not be resolved - and P&I cover will not be reinstated - by obtaining a LOI. In such cases, the LOI stands as a replacement for the P&I cover, and not a complement to it.

What this means is that the carrier, in effect, exchanges the P&I club as provider of third-party liability insurance for cargo claims with the LOI.

As a LOI is only as good as the party issuing it - and will probably not be enforceable if issued in respect of an illegitimate or fraudulent request - a LOI should not be regarded as protection for the carrier that is equal to, or as reliable as, their P&I cover.

D. Can a Letter of Indemnity be provided if the P&I cover is not prejudiced?

Since there is no direct correlation between the P&I cover and obtaining a LOI, there is no hinderance from obtaining a LOI even if P&I cover has not been prejudiced. This is, nevertheless, not that common. If a LOI is obtained where the P&I cover has not been prejudiced, the carrier will have two avenues to be compensated if a cargo claim arises which is covered by the LOI:

- The carrier could ask that the party which signed the LOI to indemnify the carrier under the LOI.
- The carrier could ask that the P&I club covers the

cargo claim and reimburses the carrier member. In this second scenario, the applicable cargo deductible will apply.

Given that there is no deductible that applies for a claim under the LOI, it is often financially more advantageous to seek reimbursement under the LOI. Should this fail, then the carrier member can ask for reimbursement under the P&I cover from the club.

E. The International Group of P&I Club's three standard wordings

There are three standard International Group of P&I Clubs (IG) approved wordings. They cover the following situations:

- a. INT GROUP A (& AA): Delivering cargo without production of the original bill of lading.
- b. INT GROUP B (& BB): Delivering cargo at a port other than that stated in the bill of lading; and
- c. INT GROUP C (& CC): Delivering cargo at a port other than that stated in the bill of lading and without production of the original bill of lading.

The AA, BB and CC versions include a bank's countersignature and include the bank's agreement to guarantee the LOI.

It is only infrequently that the AA, BB and CC versions are seen. Frequently even the A, B and C versions are not, in fact, provided but deemed to have been provided in accordance with a specific charterparty term.

F. DIY Letters of Indemnity

There are many situations and requests received that fall outside the terms of the IG scenarios described above. In such situations, it is even more important that an appropriately worded LOI is obtained.

Drafting a LOI may appear to be a daunting prospect.

There is no magic formula other than perhaps for the operative words 'In consideration of your complying with our above request, we hereby agree as follows:-' which are required under English law (see point 5 below) to ensure a 'deal' has been struck.

The following points should assist in drafting a DIY LOI:

- a. Ensure the LOI is on the letterhead of and signed by/on behalf of the party providing it. Using the words 'Authorised signatory' under the space left for the signature, may assist.
- b. Ensure the LOI is correctly addressed to the party receiving it.

c. As with the IG wordings, ensure the vessel, voyage, cargo and bill(s) of lading involved are all correctly identified.

d. Accurately describe what has happened and what the party being given the LOI has been asked to do. If you have sufficiently described, firstly, what has happened and, secondly, what is being asked of the party receiving the LOI, then the generally worded, indemnity paragraphs below ought to be sufficient. Two examples:

1. 'The vessel has loaded a cargo of 'x' and is now being asked to load a cargo of 'y' on top.'
2. 'The vessel has been asked to continue to load the cargo of 'z' during periods of rain.'

e. Insert the operative words:

'In consideration of your complying with our above request, we hereby agree as follows.'

f. Add the indemnity paragraphs, based on the IG 'INT GROUP' wordings, below.

1. *'To indemnify you, your servants and agents and to hold all of you harmless in respect of any liability, loss, damage or expense of whatsoever nature which you may sustain by reason of your complying with our request.'*
2. *'In the event of any proceedings being commenced against you or any of your servants or agents in connection with your complying with our request as aforesaid, to provide you or them on demand with sufficient funds to defend the same.'*
3. *'If, in connection with your complying with our request as aforesaid, the ship, or any other ship or property in the same or associated ownership, management or control, should be arrested or detained or should the arrest or detention thereof be threatened, or should there be any interference in the use or trading of the vessel (whether by virtue of a caveat being entered on the ship's registry or otherwise howsoever), to provide on demand such bail or other security as may be required to prevent such arrest or detention or to secure the release of such ship or property or to remove such interference and to indemnify you in respect of any liability, loss, damage or expense caused by such arrest or detention or threatened arrest or detention or such interference, whether or not such arrest or detention or threatened arrest or detention or such interference may be justified.'*

4. *'The liability of each and every person under this indemnity shall be joint and several and shall not be conditional upon your proceeding first against any person, whether or not such person is party to or liable under this indemnity.'*

5. *'This indemnity shall be governed by and construed in accordance with English law and each and every person liable under this indemnity shall at your request submit to the jurisdiction of the High Court of Justice of England.'*

Note: Paragraph 4 is only appropriate where more than one party is providing the LOI but, if included when only one party is signing, it will do no harm.

It is important to note that the bail and security indemnity set out in paragraph 3 above is not a guarantee that the issuer of the LOI will provide bail or security in order to release a vessel which is arrested or detained as a result of complying with the request of the issuer of the LOI.

In 'Tenacity Marine Inc' v 'NOC Swiss LLC' [2020] EWHC 3214 (Comm) a mandatory order enforcing the terms of a letter of indemnity given to the defendant charterer to obtain discharge of a cargo without production of the original bills of lading, was discharged where the defendant had established that its financial position was such that it was impossible for it to comply with the order.

G. Conclusion

- LOIs are a commercial reality in the industry, particularly in the carriage of hydrocarbon cargoes such as crude oil. They frequently risk prejudicing P&I cover in one way or another.
- Members must satisfy themselves that they are comfortable in accepting the LOI offered and the financial standing of the party giving it, where it may well replace P&I cover.
- Members must also bear in mind they may not be able to legally enforce a LOI.