

Delivery of Cargo against Letter of Indemnity

As a matter of English law, owners are only obliged to deliver cargo against the original bill of lading. If not presented, the Master or owner can refuse delivery, and the vessel will continue to wait with the cargo onboard. A waiting vessel is neither commercially beneficial to a charterer or cargo interest who are likely to continue to incur demurrage or owners who are unable to plan the vessel's next employment. Further, there remains the risk of cargo claims if the cargo is perishable or prone to deterioration, which is likely to be for owners to deal with.

To avoid these complications, the shipping industry formulated a commercial arrangement with owners agreeing to deliver cargo to a party the charterers instruct without the presentation of the original bill of lading in return of the letter of indemnity. From being a discretionary commercial arrangement, most modern charterparties (either on time or voyage charter basis) now have a clause obligating owners to deliver cargo against a letter of indemnity.

The International Group of P&I Club recommends wording for such letters of indemnity, but with the disclaimer that delivering cargo without presentation of the original bill of lading is a commercial decision outside the scope of their standard P&I cover.

"Delivery of cargo without presentation of the original bill of lading will take an owner/carrier or other recipient of a Letter of Indemnity outside the scope of their P&I cover. Acceptance of a Letter of Indemnity in the form set out below does not reinstate P&I cover and you may be at risk of significant financial exposure. You should therefore satisfy yourself of the financial standing of the party providing the Letter of Indemnity."

The exposure in reality is for an owner or disponent owner or charterer who are usually not involved in the underlying sale transaction, and we explore some of the risks and safeguards parties may want to consider when delivering (or agreeing to delivery) cargo without presentation of the original bill of lading and in return of a Letter of Indemnity ("LOI").

What is the purpose of the LOI for delivering cargo without presentation of the original bill of lading?

A letter of indemnity is a unilateral guarantee provided by the charterers or other party usually to an owner or disponent owner undertaking to indemnify owners or disponent owners from any financial or legal repercussions that may arise as a result of delivering cargo without the presentation of the bill of lading.

What is the risk for an Owner or Carrier in delivering cargo without presentation of the original bill of lading?

The primary risk is mis-delivery claims which may be initiated by an unpaid shipper, seller, trader, bank, cargo financier or a receiver who has paid for the cargo but not received it. These claims can be extremely high value and even exceed the value of the ship. As delivering cargo without presentation of the bill of lading is outside the standard P&I cover, the exposure primarily lies with the owner or carrier.

In cases where the owners or carrier have received a LOI governed by English law, they would, in the absence of any fraud, be able to enforce the LOI. However, complications may arise in cases where the party issuing the LOI is not financially able to indemnify the owner or carrier or is based in a jurisdiction which does not recognise English judgments or the validity of such LOIs.

Are Owners or Carriers obliged always to deliver cargo against the LOI?

No, unless there is an express clause in the charterparty obligating delivery of cargo in return of a LOI, then subject to the terms agreed and some limited exceptions (*fraud or bills of lading not being issued*), an owner or carrier is obliged to deliver the cargo against the LOI, and if they fail or refuse to do, they would be a breach.

If parties contractually or otherwise agree to deliver cargo in return of a LOI, it is imperative that the party receiving the LOI undertakes checks on the financial credibility of the indemnifier at the time when the charterparty is entered into, and at the time of making delivery.

Is the Letter of Indemnity Issued by an Authorized Person?

The issue of whether a person is authorized or not authorized to bind a company is a complex area of law and without any universal standard practice. To avoid technical defences that may be raised to resist enforcement of a LOI, the recipient of a LOI is recommended to check and obtain documents proving the signatory of the LOI is authorized to sign and bind the company.

Who to Issue a LOI to?

For a party giving the LOI, it is important to whom the LOI is being issued to. The more parties named, the wider the exposure. For example, a registered owner was able to successfully pursue a cargo buyer (*who issued an LOI to its counterpart and not the registered owners*) under a LOI as it had been addressed "*The Owners/Disponent Owners/Charterers of...*" – see *The Jag Ravi* [2011] EWHC 1372.

The standard IG P&I recommended wording proposes a wider definition of parties:

*"To: [insert name of Owners and/or Managers as appropriate...
The Owners and/or Managers of the [insert name of Vessel..."*

The party issuing the LOI must be mindful of the risks it is exposing itself to, and it is recommended that they, if possible, restrict the parties who they agree to indemnify – in particular they must attempt to restrict it to their counterparty.

Should bills of lading be accompanied with the LOI?

While delivering cargo against a LOI implies bills of lading have been issued, in the absence of any contractual clause to the contrary, there is no legal obligation for a charterer or a party requesting such delivery to provide the bills of lading along with the LOI. In practice, an owner or carrier rarely even sights the bills of lading (original or copy) until after the cargo has been delivered and/or a claim has been received.

An owner or carrier agreeing to clauses in the charterparty obliging them to deliver cargo against a LOI, are recommended to have provisions requiring the bills of lading to be annexed or provided with the LOI, to ensure that they are aware of the bills of lading on the basis of which delivery is being made, and that such bills of lading are consistent with and/or contain the remarks relating to cargo (if any).

When does the liability under the LOI end?

Under English law, the limitation period for a mis-delivery claims is one (1) year. On the other hand, the statutory limitation for initiating a claim under a LOI is six (6) years from the date when the cause of action arose. This effectively is a potential exposure in an accounting book for a long time.

The standard IG P&I Club however allows a contractual mechanism to cease the liability under the LOI before the statutory limitation period: "*As soon as all original bills of lading for the above Cargo shall have come into our possession, to deliver the same to you, whereupon (always provided that the said bills of lading have been properly tendered by the party to whom the Cargo was actually delivered) our liability hereunder shall cease."*

Although not common, it is in the interest of all parties, and in particular the party issuing the LOI to have the original bills of lading delivered to indemnified party, to cease any potential liability they may have under the LOI.

Is the LOI for discharge and delivery the same?

No. Although, "discharge" and "delivery" are used interchangeably commercially, they have completely different implications. First, "discharge" is a delegable duty from an owner to a charterer (*for e.g.: Clause 8 NYPE 1946 and 1993 or Clause 5 (a) of Gencon 1994*), but delivery is not – therefore any liability for mis-delivery remains with the owner and carrier of the cargo. Second, "discharge" refers to the exercise of removing cargo from the vessel and does not mean delivering or releasing the cargo to a specified party. It is arguable that an indemnity for discharge is limited in its scope and does cover mis-delivery claims. The standard IG P&I Club recommended wording also only refers to "*delivery*" and not "*discharge*", a point which parties must take note of.

Parting Comments

Delivering cargo in return of a LOI is an indispensable practice in shipping, and it is almost unusual for cargo to be delivered against original bills of lading. Parties must be cautious that this remains a practice for commercial convenience, and it is important that both the issuer and recipient understand the purpose, scope and exposures which can come with issuing or receiving LOIs.

At Binnacle Legal, we assist clients with drafting and reviewing letters of undertaking, guarantees and letters of indemnity including non-standard letters of indemnity issued from time to time. We also assist clients in pursuing and/or defending claims or liabilities which arise from such contracts.