

LOI for Dummies

M JAGANNATH / NAU



Letter of Indemnity

○ Definitions



Indemnity – a contract by one party to keep the other harmless against loss

- Gives rise to a primary obligation
- Owed to the debtor because he has performed his obligation



Guarantee – an undertaking to answer for the payment or performance of another person's debt or obligation in the event of a default of the person primarily responsible for it

Development

Initially issued
to iron out
certain
problems such
as genuine
differences in
interpretations
in quality

Business
practice drove
traders to
incorporate this
in their C/P's to
avoid costs for
delays

P&I Clubs
refuse
insurance
cover for cargo
released
without B/L's

Liner Industry: Switch B/L's, second sector B/L's, change of cargo description,

Letter of Indemnity

Where used



Clean Bills



Discharge without Bills / Presentation



Change of Destination

Clean Bills

Bills of Lading



Receipt



Evidence of Contract of Carriage



Negotiable document of Title

Issues with the quality of the cargo i.e. apparent good order and condition of the cargo

- ❖ Bonafide dispute
- ❖ No dispute on the quality and purported fraud

In Johanna C: The shippers, a company belonging to a large multi agribusiness group, shipped a cargo of “feed beans” in Tilbury, UK, consigned to Seville, Spain. Under the sale contract, the parties had agreed that the quality and condition of the cargo was to be final at loading as per the certificate issued by the control company. The cargo arrived in Seville. It contained dead insects and 16% of the cargo had visible external holes. The cargo was initially rejected by its final receivers who ultimately accepted it against a price reduction. The issues under dispute were: (i) whether the cargo was in good order and condition at the port of loading; and (ii) whether the Master ought to have claused the bill of lading.

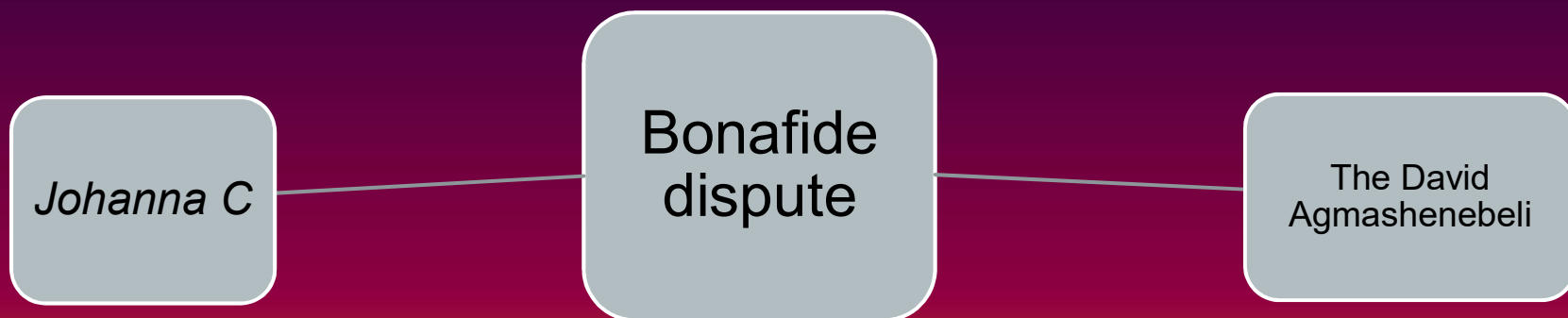
The shipper argued that despite the perforations evident in 16% of the total cargo of beans, the cargo was nevertheless in apparent good order and condition, as it was intended for feeding animals and the holes did not prevent the beans from being of merchantable quality. The receiver argued that its string buyer had asked for, and obtained, a reduction in the price of the goods, since they were defective by virtue of the holes in the beans. An apparent bona fide dispute arose therefore as to whether the cargo had been shipped in apparent good order and condition. The shipowners contended that at the loading port the dust resulting from the loading operation prevented the owners from checking the holes of the beans. This case illustrates the fine line that may exist between a genuine bona fide dispute and a deceit.

In this type of situation, where both parties are acting in good faith and it is difficult to ascertain which factual contention is correct, and where, favouring the shipper will automatically have a detrimental effect on the rights of the receiver. The letter of indemnity can be a useful tool to ensure that carriers are not unfairly prejudiced by the technicalities arising from the cargo description.

The David Agmashenebeli: In this case the Master refused to sign clean bills of lading against a proposed letter of indemnity. The delay at loading resulted in substantial demurrage costs as the Master insisted on issuing a bill of lading bearing remarks affecting the whole or a substantial part of the cargo, in fact whereas only 1% of the cargo was affected. The court considered that the Master should not have included an objectively unjustified clausing which would have had the effect of rendering the bill unclean and unmerchantable. This is the sort of case where the use of a letter of indemnity would have avoided the demurrage costs inherent in delaying the ship at the port of loading. Such use would have occasioned no harm or damage to third parties. Thus, in circumstances such as those in *The David Agmashenebeli*, it is submitted that the enforcement of a letter of indemnity should be permitted. Accordingly, where there is a genuine dispute as to the apparent good order and condition of the cargo and the carrier is genuinely not certain whether clean bills should be issued or not or where he is not provided with a credible survey reports confirming that the cargo is in apparent good order, it is submitted that in either of these cases the carrier should be able to obtain redress by enforcing the letter of indemnity, as he is acting bona fide, and is not himself at fault.

Clean Bills

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Brown Jenkinson v Percy Dalton

Ratio: The claimants owned a vessel on which the defendants shipped a cargo of orange juice, packed in barrels which were old, frail and leaky. The claimants said they would issue a claused bill of lading stating the defects in the barrels. The defendants could only sell the juice with a clean bill of lading stating that the cargo was shipped in apparent good order and condition. The defendants offered an indemnity to the claimants for any losses that might result from the issue of a clean bill. It was found at trial that the claimants believed that the issue of clean bills in such circumstances was an acceptable practice permitting the question of the condition of the cargo to be litigated later. Upon receiving the indemnity, the claimants issued a clean bill. The claimants had to pay damages to the buyers of the orange juice for the loss occasioned by the poor barrels, and they claimed on their indemnity from the defendants. Held: The contract was unenforceable because it had as its object the commission of the tort of deceit.

Moralice (London) Ltd v EDF Man:

Sellers and buyers had agreed the sale of 5000 bags of sugar "CIF Tripoli and insurance to Baghdad". Payment was to be made through a letter of credit. In a falling market for sugar, the sellers shipped 4997 bags of Sugar instead of the agreed 5000. The confirming bank refused to make payment against the shipping documents, as it knew that by accepting non-confirming documents the bank would be exposed to risk under the strict compliance rules. The bank finally accepted the documents against an indemnity from the sellers holding the bank harmless against any consequences, which might flow from the missing three bags resulting in short shipment. Eventually the buyers rejected the documents until a reduction in price had been agreed. The sellers then sought to enforce the indemnity given to them by their supplier. The latter denied the sellers right of redress, arguing a lack of consideration. The court held that the fact that the plaintiffs, as sellers, were prepared to pay the supplier (the defendant), notwithstanding their honest

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Brown
Jenkinson v
Percy Dalton

Heskell: The reason why a bill of lading is a document of title is because it contains a statement by the Master of a ship that he is in possession of cargo and undertaking to deliver it.

The Stettin: English Law and English mode of conducting business, a shipowner is not entitled to deliver goods to the consignee without production of the bills of lading.

The Jag Ravi: Great Eastern Shipping Co. Ltd v. Far East Chartering Ltd. and Binani Cement Ltd (The Jag Ravi). The owners of the Jag Ravi sought to enforce a letter of indemnity given in exchange for delivery without production of the bill of lading. The shippers, having sold the goods on FOB terms, changed the payment terms with their buyers (who were string sellers, called Visa) but also agreed that “original bills of lading of mother vessel to be released by the vessel agents directly to Visa”. However, the string contract of sale on CIF terms between Visa and the receivers, Binani, included the following, contradictory clause; “In case the vessel reaches discharging port prior to Buyer receiving the original documents, Seller will make prior arrangement with ship owners to allow unloading against Buyers Letter of Indemnity”. Therefore in The Jag Ravi each contract of sale contained conflicting terms regarding the way delivery was to be dealt with where the goods arrived at the port of destination in the event no original bill of lading was available.

To protect itself against the consequences of any such disparity in the terms of the underlying contract the carrier should only deliver the goods in accordance with the strict letter of the presentation rule. If it does not the carrier acts at its peril. Further complications may arise where the charterparty contains terms expressly agreed between the charterer and the shipowners to cover the case where bills of lading are not available at the port of discharge.

For example, in The Jag Ravi the Charterparty stated at paragraph 11: “In case of non availability of original b/l's a discharge port, owners to allow discharge for cargo against charterers's LOI in owners P&I Club format, Fax copy if LOI it be acceptable, copy of the b/l's to be attached with the LOI”. The recap also provided that other terms were to be the same as the previous charter concluded between the parties, clause 67 of which had provided: “In case the original Bills of Lading not be available upon vessel's arrival discharge port, Owners/Master agree to discharging/release cargo against presentation of Charterers Letter of Indemnity in Owners P&I Club wording signed by Charterers only. Fax copy of Letter of Indemnity to be acceptable. Copy of bill of lading to be attached with the Letter of Indemnity.”

The Jag Ravi illustrates the conflicting interest between shippers, carriers, and their counterparts in the sale and carriage contract well. These conflicting interests are often recorded in the terms agreed by these parties under the different contracts of sale and carriage of goods by sea included in the bill of lading and, or in the charterparty. The disparity of terms and conflicting interests makes it difficult for the parties to these contracts to ascertain the correctness of their position and to understand fully the risks they are running by making use of (?) or allowing the goods to be discharged against a letter of indemnity. As put it by HHJ Mackie QC in his judgment in The Jag Ravi “The law is already complex enough in this area of trade without developing this aspect of public policy so as to cause further uncertainty”

Delivery without Presentation



Heskell v Continental Express Ltd



The Stettin (1889)



The Jag Ravi

Delivery without Presentation



Delay in receiving the OBL's

Whether OBL's issued in the first instance – if not issued then contractual provisions in C/P may not apply

Change of Destination

If the initial Bills
returned, little risk

Otherwise, Carriers
will be exposed to
the holders of the
Bills for breach of
contract

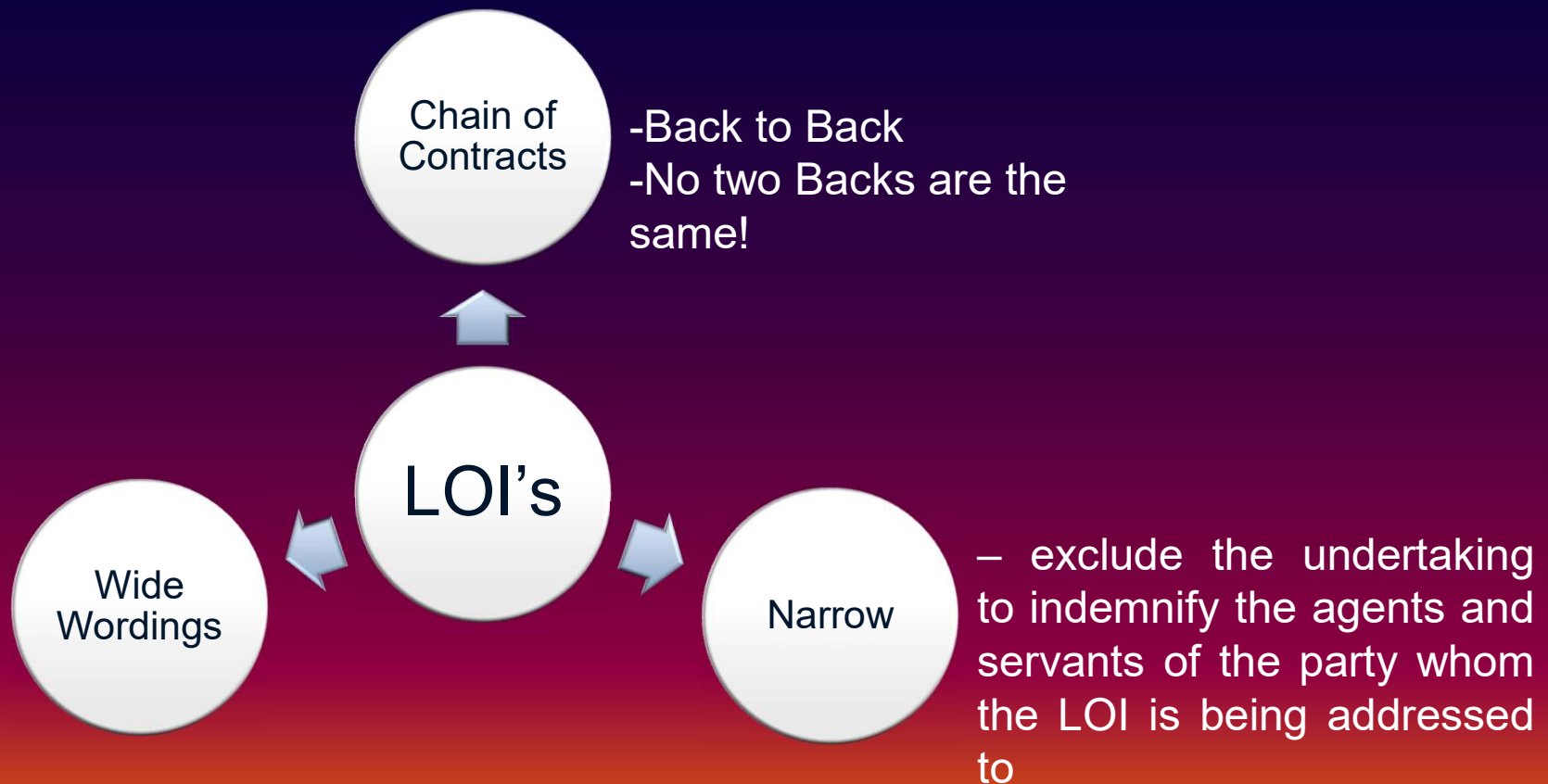
No cover under the
P&I Rules for
change of
destination in
exchange of LOI

The Laemthong Glory (No 2): The Court of Appeal held that the shipowners were entitled to enforce the receivers' letter of indemnity. According to the Court: "the terms of the receivers' LOI relied upon by the owners purported to confer a benefit upon the owners within the meaning of s.1(1)(b) of the 1999 Act" and "there was nothing in the receivers' LOI to lead to the conclusion that the parties did not intend cl. 1 and 3 to be enforceable by the owners. The whole purpose of the receivers' letter of indemnity was on the one hand to ensure that the receivers received the cargo from the ship without production of the original bills of lading, and on the other hand to ensure that the owners were fully protected ...".

The Jag Ravi: A letter of indemnity had been issued by the cargo receivers to the charterers was unknown to the shipowners until proceedings were commenced. Accordingly, the receivers submitted not only that in ignorance of the offer the terms of the indemnity could not be enforced as unilateral contract, but also that this case had to be distinguished from the *The Laemthong Glory* as there was no contract which triggered any rights under the Contracts (Rights of Third Parties) Act 1999. The LOI in *The Laemthong Glory* was addressed by intended receivers to voyage charterers, and when its terms were performed by delivery of the cargo it became a binding and enforceable contract of indemnity between receivers and voyage charterers. In contrast, the receivers submitted that the LOI issued by them was provided to the Charterers only and the email it was sent with expressly anticipated "owners' confirmation". Without an underlying contract between these two parties, the receivers submitted that no question of enforcement by owners could arise. The shipowners contended that the situation in both cases was indistinguishable except in irrelevant respects from that which arose in *The Laemthong Glory* and that owners were therefore entitled to be paid. Owners submitted that the LOI in *The Jag Ravi*, unlike in *The Laemthong Glory* was addressed not only to charterers but also to owners and therefore the Owners had a direct right to enforce against Binani.

In subsequent proceedings before the Court of Appeal, upholding the judgment of HHJ Mackie QC in the High Court, the Court of Appeal considered the process by which delivery had been carried out and concluded that the owners were entitled to enforce the letter of indemnity as agents for the charterers. On the facts of the case the goods had been delivered by the owners to the receivers and therefore they were entitled to enforce the LOI. According to the judge at first instance "LOIs, particularly those in standard form, are important commercial instruments which need to be interpreted robustly and in a straightforward way. They are often issued and relied upon by those for whom English is not their first language and whose opportunities for close textual analysis before committing to a wording are in the real world very limited." The Court of Appeal went further and held that the reference in the text to the addressees of the LOI as "The Owners/Disponent Owners/Charerers" meant that the LOI was addressed to three different categories of party. The natural and proper meaning of the LOI was that it was addressed to both the owners and the charterers. Accordingly, on a proper construction of the LOI it could be addressed and accepted by the charterers themselves as well as by the Owners.

LOI's



Art IV 5 of the Hague Rules states: Neither the carrier nor the ship shall in any event be or become liable for any loss or damage to or in connexion with goods in an amount exceeding 100 pounds sterling per package or unit, or the equivalent of that sum in other currency unless the nature and value of such goods have been declared by the shipper before shipment and inserted in the bill of lading.

Art IV 5(e) of the HV Rules states : Neither the carrier nor the ship shall be entitled to the benefit of the limitation of liability provided for in this paragraph if it is proved that the damage resulted from an act or omission of the carrier done with intent to cause damage, or recklessly and with knowledge that damage would probably result.

Issues with LOI's

5. Insurance Cover?

6. Bank's Signature

- Pacific Carriers Ltd v BNP Paribas
- China Shipping Development Co Ltd v State Bank of Saurashtra

LOI Wordings

International Group Standard Letter of Indemnities

Int Group A

- wo production of OBL

Int Group B

- delivery to a port other than that ...

Int Group C

- delivery to a port other than that ... wo production of OBL

Int Group AA

- with bank

Int Group BB

- with bank

Int Group CC

- with bank

Insurance issues

- ❖ Rule 2 c of the UK P&I Club Rules – Discretionary cover (Omnibus Rule) - Delivery without B/L, Change of Destination
- ❖ Clause 13 (9) i on Limitation of Cover of Charterers P&I excludes cover for cargo without production of OBL or documents of title

Suggestions



Look at counter-party



Look at exposures including legal costs



Party in the chain – look to defend and attack and seek recovery of the costs in the indemnity



Seek Guarantee's (for instance from Bank)

Suggestions



Fraud unravels all – LOI's will not be valid when issued with intent to defraud



Wordings of LOI – wide / narrow depending on which side a party is in



Finally, commercial tool – handle with care

Solutions



Electronic Bills of Lading



Counterparty of the sale / BL / Bank advised prior to release



Commercial tool – be properly secured – no legal right to agree unless contractually bound

THANK YOU

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