PROCEDURES

LOIs AND RELEASING CARGO
- CONTRACTUAL ISSUES & INSURANCE COVER

Why are procedures around bills of lading and letters of indemnity so important?

An international team of reputable, dedicated and knowledgeable marine insurance professionals, proud of delivering high quality insurance products and advisory services to companies that charter vessels to carry cargo by sea.

Managed by the MECO group
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Complex trading and freight markets mean that charterers need insurance with 1st class security and the support of a global team of specialists.

With the creation of the Charterers P&I Club in London in 1986, we set up the first vehicle dedicated exclusively to charterers and rapidly established ourselves as a respected market leader. Since then we have consolidated this position and our international team of maritime professionals can offer clients unrivalled levels of expertise and experience in this specialised and technical field. This formidable resource is backed up by an insurance policy underwritten by one of the world’s largest insurance companies, with a market-leading financial rating.

Our comprehensive Charterers’ Liability cover and Freight Demurrage and Defence insurance are available to all charterers and traders. Currently, the Club insures over 360 charterers and 12,500 vessels. Our client pool includes clients from large shipping companies to cargo interests who might only have a few requirements for a handful of fixtures per annum.
LETTER OF INDENMITY

A contractual document that guarantees certain provisions will be met, between two parties.

An indemnity between two parties; one party agrees to perform a certain action and the other party gives guarantees in relation to the consequences of that action.
INTRODUCTION

In the last decade there has been a small shift to using electronic bills of lading but the vast majority of cargoes that are shipped are done so against an original paper bill of lading and these documents remain an integral part of the movement of goods by sea.

BILL OF LADING

The most significant aspect of the bill of lading is that it represents physical and legal ownership (title) to the goods in transit. These documents of title are frequently negotiable and goods in transit are bought and sold by transferring the original documents from seller to buyer (often in a chain of transactions).

The format and production of the bill of lading will often be specified within any contact of sale that accompanies cargo as well as being referenced within any charterparty that applies to that cargo movement; to add to the complexity the international banking system will require the originals to deal with payment.

Entire books have been written on the complexity of the bill of lading, we are concentrating on the specific issue of what happens when the bill of lading is not available at the place where cargo is to be delivered.

In these circumstances the request is made by the charterer, to the owner, that the cargo is released without production of the original bill of lading against a Letter of Indemnity (LoI) given by the charterer in favour of the owner.

The bill of lading can look deceptively simple but in fact it’s a complex document. It must adequately describe:

01. Who is shipping and receiving the cargo.
02. The condition and quantity of the cargo being shipped.
03. The Carriers’ responsibility, basic protections and claims.
04. The voyage charterparty terms that may be incorporated into the bill of lading.
05. Who has legal title to the cargo when the vessel arrives at the discharge port.
CONTRACTUAL ISSUES

The charterparty will contain several clauses that are relevant to the bill of lading, the following are examples:

01 Owners will issue, or allow to be issued, bills of lading following a standard format, such as the CONGEN bill format.

02 That, if the original bill of lading is not available at the discharge port, then owners will allow for cargo to be released against a LoI (from the charterer to the shipowner) as opposed to the production of an original bill of lading.

The LoI that charterers must give is “recommended” by the Owners P&I Club and standard in format. Don’t mistake recommended and standard for low risk, it’s an onerous document.

In particular:

1. The LoI is unlimited in value and time, it extends to the full loss of the cargo and any/all other expenses losses the owner incur;

2. If there is an issue with the shipment, which often occurs many months after discharge, we have seen security demands that include the full value of the cargo plus all expenses. USD 15 000 000 demands are not uncommon;

3. The LoI extends to losses and expenses the carrier (owner) incur, so if the vessel was arrested and could not trade for 6 months the loss of trade could be claimed under the LoI;

4. Owners and charterers who issue or accept LoI’s do not have insurance that will cover liabilities incurred under the LoI for defence costs or the claim made under the LoI;

5. LoI’s can be difficult to extinguish; often the only mechanism for killing the LoI is if the original bills are returned to the party requiring the LoI (the owners); but how do charterers (who have provided the LoI) know that this has occurred?
Release of cargo in this manner can be controversial as neither the owners nor the party requesting release most frequently, the charterers, have the benefit of P&I Cover.

The act of releasing cargo in this way puts them outside the scope of insurance cover as the cargo is not being delivered in accordance with the bill of lading contract (and contravenes applicable Maritime Law).

Great care must be taken when exercising this option under a Charterparty.
WHY IS THERE NO INSURANCE COVER?

Indemnity covers such as P&I, provide liability insurance for owners and charterers for legal liability following unexpected loss, e.g. a grounding, a collision, cargo damage following a storm or a fire on board.

Use of LoIs can open the door to fraudulent activity and is frequently contrary to the law.

In circumventing the legal documents required to release cargo there is the possibility of delivering the cargo to the wrong party; subsequently the correct party could ask for delivery under the bill of lading of the cargo and if there is no cargo to give then the holder of the bill is entitled to compensation from the carrier.

Whilst the possibility of fraud against the bill of lading issuer and the party that gives the LoI exists, instances are rare when compared to the amount of paper bills in circulation. This risk would however increase exponentially if insurers routinely provided cover for release of cargo against an LoI.

In circumventing the legal documents required to release cargo there is the possibility of delivering the cargo to the wrong person.
SECURITY

Whilst there is risk involved in the process, most shipments that are released against an LoI are uneventful.

However we see a handful of cases each year where cargo is either misdelivered or a fraud occurs and in due course the eventual bill of lading holder (or the bank or party who has financed the letter of credit) will seek to enforce their contractual right to receive the cargo.

These situations often result in arrest of an asset, typically the carrying ship and then the arguments over security for release and legal fees ensue. It’s very easy to build a large legal bill as well as having to compensate an owner for detention of their asset and their legal costs in dealing with the arrest.

There is also the not so small issue of providing valuable security to the owner to satisfy the demand under the LoI; this can be millions of dollars which the party who provided the LoI has to give.
ENFORCEMENT

If you are in the middle of a contractual chain there is a need to ensure that any party that you receive an LoI from is capable of securing your claim and costs. Should you need to enforce an LoI you need to ensure that the party you are enforcing against has assets.

TERMINATION

It’s good practice to ensure that the bills of lading are collected from the receiver and returned to the party that you gave the LoI to. This is the only way of terminating the LoI; perhaps consider changing the sales contract to make this a contractual provision.
SUMMARY

The scope for things to go wrong increases when bills are negotiable. If waybills are used it is much simpler. There should only be one receiver and it is simply a matter of the receiver proving their identity (not proving their title to the goods) in the absence of the original documentation at the discharge port.

01 COMMERCIAL DECISION

It is a commercial decision for charterers to decide if they grant an LoI (many charterers have a company policy of refusing to do so due to the risks).

02 OWNERS REFUSE LOI’S

Where the owners refuse to use LoI’s (and you know 100% who the ultimate buyer is) you could ask the owners to accept your amended LoI but only for delivery to a named person who presents proof of identity as per photographic example (copy of passport etc) you provide to them. The LoI can then only be called upon by the owner if they deliver cargo to that person and it transpires such person is not entitled to the cargo.

03 AMENABLE BUYER

The ultimate buyer would have to be amenable and assist you in these arrangements with the owners. The buyer should also provide you with counter security/LoI in the event your LoI is called upon by the owners. You should have confidence that you can enforce your LoI against the buyer (frequently difficult).
CONCLUSION

Practices and procedures around LoIs and Bills of Lading are important, care must be taken when either giving or accepting a LoI as the consequences can be extremely expensive to unravel.

Careful alignment of LoI clauses in the bill of lading, charterparty and contract of sale/purchase with appropriate security measures (including bank guarantees, if required) will assist in traversing the ‘LoI Swamp’. 
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VESSEL INSURANCE COST ENQUIRY

If you are interested in receiving an indication of the cost of insuring vessels with The Charterers P&I Club please complete our Proposal Form.