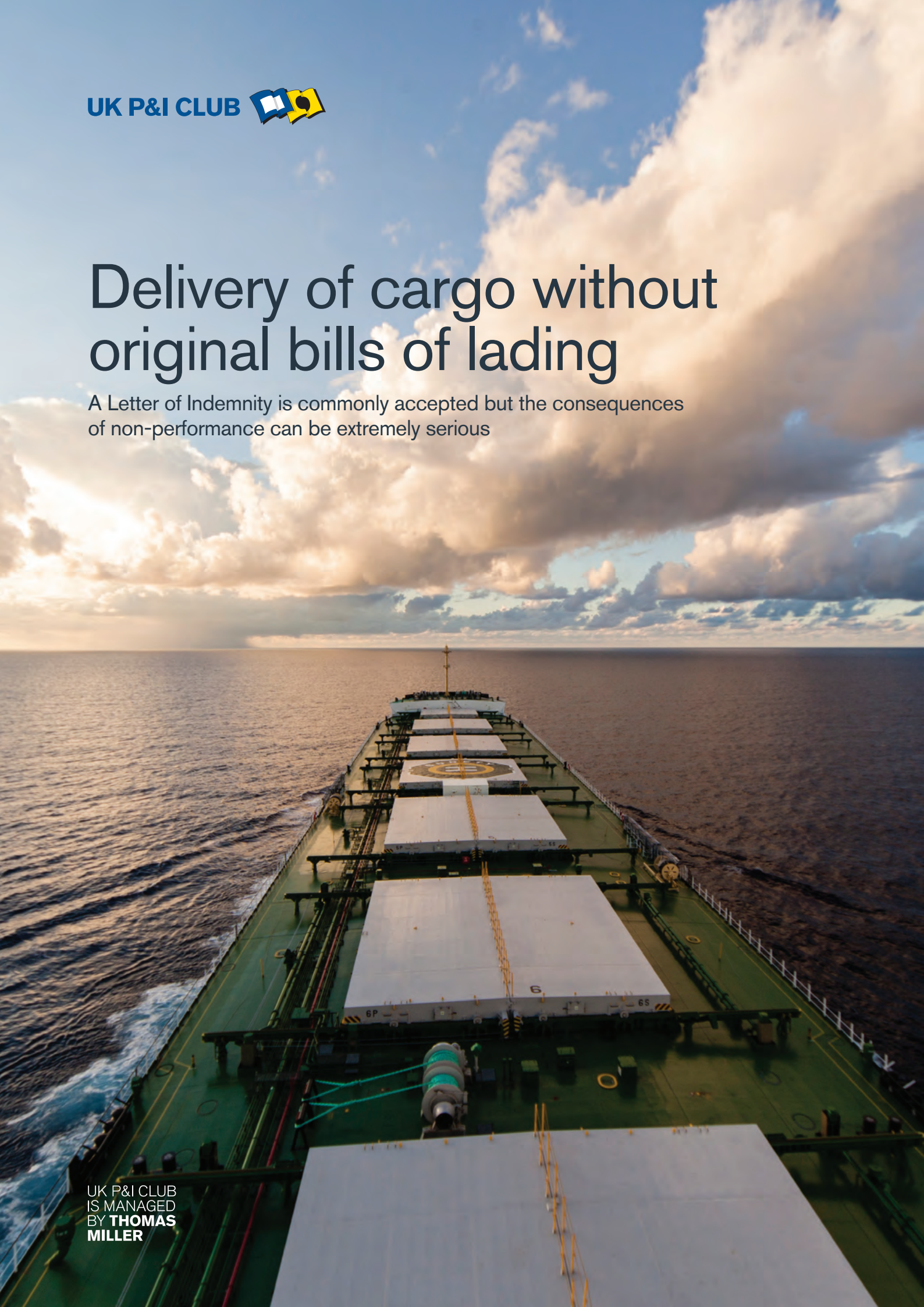
UK P&I CLUB

Delivery of cargo without original bills of lading

A Letter of Indemnity is commonly accepted but the consequences of non-performance can be extremely serious



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Key issues

- It is common in a lot of trades, whether bulk or oil, to accept a Letter of Indemnity ("LOI") for non-production of bills of lading. Although it is commonly accepted in many trades, the consequences of non-performance can be extremely serious for Members.
- P&I cover is prejudiced if cargo is delivered against an LOI and claims arise where the cargo is mis-delivered.
- It is absolutely essential that Members get the wording of the LOI right and ensure that proper procedures are in place to demonstrate compliance with the LOI.
- Members must also actively weigh up the counter party risk of accepting an LOI. An LOI is only as secure as the party providing it.
- The Zagora is the most recent English High Court case which considers the issues arising from the non production of an original bill of lading.

Introduction

Delivery of cargo without presentation of an original bill of lading, although not recommended, is a reality of international trade. Delays in the documentary chain, and onward sales of the cargo while it is in transit, often means that original bills are not available when the ship reaches the discharge port.

When this occurs, the carrier invariably agrees to deliver the cargo in consideration of receiving a Letter of Indemnity (LOI) from their charterer/ receiver. In many cases, a delivery of cargo in this way will proceed without incident. However, whilst the practice is familiar, familiarity can sometimes lead to complacency.

It is therefore important to remember the risks involved in such operations and to act cautiously in order to minimise risks to shipowning interests.

Risk Focus
There are four main risks associated with delivery of cargo without presentation of original bills of lading.

The first is a risk of mis-delivery of cargo. It is well understood a bill of lading, amongst other functions, acts as a "key" to the warehouse which, when available at the discharge port, is presented to the Master in order to release the cargo to the "bearer" of the bill of lading. Where such a "key" is not available at the discharge port, it must be remembered that an LOI will not absolve the carrier from liability if the cargo is delivered to the wrong party (commonly referred to as a "mis-delivery claim"). The lawful holder of the bill of lading can bring a mis-delivery claim against the shipowner, and this will most likely need to be dealt with by the Owner without support from their P&I Club (see below) as well as with the uncertainty as to whether the LOI provided will respond to protect the Owner.

Of course, the easiest way to avoid a mis-delivery claim in these circumstances is to refuse to discharge the cargo unless an original bill of lading is presented. Absent any clause in the charterparty, an Owner cannot be compelled to deliver cargo without presentation of an original bill of lading. However, commercial pressures often are brought to bear, and in many charters, an Owner will have already agreed to discharge against an LOI, where original bills are not available under a Bills of Lading / Letters of Indemnity Clause (or similar). If such a provision exists in the charterparty, an Owner cannot refuse to deliver without originals, no matter how uncomfortable they may feel, save if there is evidence to suggest that the person demanding delivery is not entitled to possesion of the cargo.

Regardless of the Owner's agreement to release cargo against an LOI, enquiries should always be made as to why an original bill of lading will not be presented at the discharge port. There may be perfectly legitimate reasons why an original might be delayed from arriving at the discharge port, such as banking delays. However, there may be another reason which might inform the shipowner of a risk of a mis-delivery claim. For example, the original bill of lading might be being held by the bank who has paid the seller under the letter of credit, but may not have cover from its customer (the Buyer) and thus retains the bill of lading.

Finally, a Master should still be vigilant and take care to verify the identity of the person (taking a record of their name and ID) attending the ship to take delivery, and to carefully confirm, so far as they are able, that the person corresponds to the person identified, either in the LOI or by the charterer (as provider of the LOI), as being or representing the party named in the LOI to whom cargo is to be delivered. Some prudent Owners will take a step further and try to obtain, in advance of arrival at the discharge port, the name and ID of the person who will attend the ship for delivery for the party named in the LOI. So far as Charterers are able to assist in this regard, this practice should be commended.

The second risk relates to insurance cover. It is well understood that liabilities arising as a consequence of mis-delivery are not covered under all P&I Club rules unless the Directors of the club in question otherwise agree (see, for example, Rule 2.17(c)(ii) of the UK P&I Club Rules). The LOI is designed to try to alleviate such risk, so far as it can, but it must be understood that an LOI effectively substitutes an Owner's P&I cover for mis-delivery claims (if there is no causal connection between delivery without an original bill and the subsequent claim, cover will remain in place: so, for instance, claims for loss or damage to cargo will still be covered).

The UK Club can arrange Extended Cargo Cover for certain types of vessels, if appropriate, including cover for delivery of cargo without production of the bill of lading or at a port other than that stated in the bill of lading.[1]

The third risk is whether the LOI will in fact respond in the event of a mis-delivery claim. The wording of the LOI is therefore critical. As previously mentioned, in the majority of charters an Owner has already agreed to accept an LOI under a Bills of Lading / Letters of Indemnity Clause (or similar). Quite often, charterers insist the standard IG LOI wording should be followed without any modification, but this may not take into account the facts on the ground at a particular port and at a particular time. Accordingly, care should be given to the wording of these clauses from the very outset to ensure that Owners are not placing too much risk on their shoulders. For example, often, Charterparty clauses are amended so that Owners "agree to discharge" cargo against an LOI as opposed to "agree to deliver" cargo against an LOI. Whilst this can be seen as desirable for the Owner so that the LOI applies from the moment of discharge, Owners are still required to "deliver" the cargo under the Bill of Lading. "Discharge" of the cargo and "delivery" of the cargo are two different concepts and therefore, unless the Owner retains possession or control of the discharged cargo (unlikely in most instances), they will be at risk of mis-delivery.

The BREMEN MAX[2] case also highlighted the critical importance of adhering to the LOI wording. In that case, based on the LOI being considered, the judge highlighted that a shipowner might prejudice his right to demand and receive security under the LOI if they provide security to the cargo claimant before making his own demand for security under the LOI. The charterers also raised an argument that the indemnity was conditional upon delivery of the cargo to the party named as receiver in the LOI. In October 2010, the IG Clubs issued a circular recommending changes to the standard LOI to address these two points.

It was the second of these points which was considered in the most recent LOI case, The ZAGORA[3]. In that case, the relevance of the LOI arose following a discharge which took place without production of an original bill of lading against the charterer's LOI. More than eight months after discharge, the vessel returned to the same discharge port and was placed under arrest at the suit of the Bank of China, who asserted that they were holders of the original bill of lading, that they had not been paid, and that the cargo had been wrongfully discharged (i.e. without production of the original bill of lading).

The Owners duly called upon the Head Charterers to obtain the release of the vessel pursuant to the LOI they had provided. The Head Charterers passed the demand down the charter chain but, despite sub-charterers obtaining an interim mandatory injunction to force the Buyer to honour the LOI and put up security, the Buyer refused to do so. After some delay, the Head Charterers were eventually obliged to provide security to obtain the release of the vessel, whilst reserving its right to argue the LOI had not been engaged.

The dispute was litigated in the English High Court and the judgment was handed down almost three years after discharge. The Head Charterers argued that an LOI for delivery to "Xiamen or such party as you believe to be or to represent Xiamen" was not engaged where the Owners had discharged the

[1] The UK P&I Club offers such cover – see https://www.ukpandi.com/fileadmin/uploads/uk-pi/Documents/Extended%20Cargo%20Cover%20brochure%20Oct%202008.pdf

[2] Farenco Shipping Co. Ltd v Daebo Shipping Co Ltd (The "Bremen Max") [2008] EWHC 2755 (Comm)

[3] Oldendorff GmbH & Co KG v Sea Powerful II Special Maritime Enterprises (The Zagora) [2016] EWHC 3212 (Comm)

cargo into the possession and control of shipping agents appointed by the ultimate Buyer of the cargo, and passed up the chain of charterparties. Rather, the Head Charterers argued, the shipping agents took custody of the cargo as agent for the Owners.

Ultimately, the English High Court upheld the LOI, finding that the shipping agent did represent "Xiamen" as the party to whom Owners were instructed to discharge and release the cargo. However, this was not before an intensely factual investigation into the chain of charterparties and sales contracts, the evidence relating to the formation of the LOI up and down the contractual chains as well as the circumstances of the discharge operations including correspondence passing between the parties. The ZAGORA highlights the inherent difficulties where a chain of LOIs has been provided.

The fourth and final risk concerns the creditworthiness of the party providing the LOI. This is well understood by shipowners but, it is worth highlighting that a claim under an LOI is not secured by any right of lien over cargo. Remember, the LOI may stand in place of P&I cover. It is also important to emphasise that the creditworthiness to pay hire and other incidentals under a charterparty is not the same as the creditworthiness of a company to meet a mis-delivery claim for the value of the cargo. Claims will come at a later time and may be significant. The ZAGORA demonstrates the creditworthiness point for a charterer in the middle of the chain. In that case, a sub-sub charterer made no appearance in the proceedings which came to court three years after discharge, leaving Charterers higher up the chain to deal with the consequences of the mis-delivery of cargo.

Will the use of E-bills help?

The use of electronic bills of lading has increased significantly over recent years. In contrast to paper bills of lading, the risk of an E-bill not being available at the discharge port to enable cargo discharge is, on the contrary, remote, and the parties who have embraced electronic bills have commented that as a consequence, the number of LOIs issued has dropped dramatically. This being the case, the risks of mis-delivery are greatly reduced. The "closed" nature of electronic bill of lading systems also assists in establishing the identity of a party taking delivery of the cargo.

Further information on e-bills can be found in the UK Club Legal Briefing on Electronic Bills of Lading.[4]

Conclusion

The practice of delivery of cargo without presentation of original bills of lading is very familiar, and so far as paper bills of lading are concerned, is here to stay. However, mis-delivery claims do arise which must be dealt with without support of insurance as well as with the uncertainty of whether an LOI will effectively protect the shipowner in the event of claim. It is therefore crucial that Owners remain vigilant with their procedures for delivery of cargo as well as with regards to Charterparty clauses and LOI wording. If in doubt, Members should seek advice from the Club.

[4] https://www.ukpandi.com/knowledge-publications/article/legal-briefing-electronic-bills-of-lading-138374/

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