

Original article

Understanding of Vietnamese shipping companies about accepting Maritime Letter of indemnity in the shipping industry ☆

Minh-Phuong NGUYEN

Faculty of Economic, Vietnam Maritime University, Vietnam, phuongnm@vamaru.edu.vn.

In shipping industry, the Letter of indemnity (LOI) is a common tool used by shipowners, ship operators, buyers, sellers and their bankers. Specifically, LOI is a document given by the party requesting some special requirement that deviates from a regulated practice to another to smooth their contractual obligations. However, there are still many doubts around using this document in the practice. This article aims to research the awareness of Vietnamese shipping firms while using this tool. A survey of Vietnamese shipping companies was conducted, then the collected data was analyzed related problems while applying LOI. The findings will not only enrich knowledge but also support Vietnamese shipping firms when using this useful shipping document in the international shipping.

Keywords: Letter of indemnity, Bill of Lading, Shipping companies.

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Peer review under responsibility of Korea Advanced Institute for International Association of e-Navigation and Ocean Economy

<https://doi.org/10.52820/j.enavi.2022.18.035>

1. Introduction

The use of LOI is closely connected to the use of Bill of lading (BL) which is a crucial document for the international trade and contract of carriage by sea. According to Anderson (2018), in the English law, Ocean Bill of Lading has three main functions. The first function is an evidence of the carriage contract. Secondly, BL is a receipt of goods by carriers that describing exactly the quality and quantity of goods received on board. Most importantly, BL is as a document of title that the rightful holder of BL has right to obtain possession of the cargo at port of destination. However, its functions sometimes cause difficulties for users including carriers, charterers, shippers, receivers and banks in the shipping practice (Arizon & David, 2014). Specifically, a growing number of cases that the original bill of lading (OBL) can not reach the consignees at discharging port to receive cargo on time. Therefore, these related parties have to use alternative ways to implement their contractual obligations. As a result, LOI is used to solve BL's problems.

Letter of indemnity has been used for a long period of time in the shipping industry, especially, it has become more widespread nowadays. It has greatly smoothed flow of commercial activities and reduce considerably arising costs and disputes in the international trade (Arizon & David, 2014). However, the use of LOI has caused risks for users. From carrier's perspective, he could risk his insurance cover for any misdeed while accepting LOI. On the other hand, trader that is an indemnifier could also take his own risks when take responsibility for covering any claims arising (Shepherd, 2011).

Vietnam is a country with more than 3000 kilometers of coastline. Sea transportation economics has been invested and developed as the spearhead economic sector of Vietnam. According to statistics from the United Nations Conference on Trade and Development (UNCTAD), the ranks of Vietnamese fleet has been at the fourth in ASEAN and 30th in the world in terms of deadweight tonnage. The Viet Nam Maritime Administration identified that the structure

of Vietnam merchant fleet has been evolving towards specialization. In there, the shipping fleet serving for tramp shipping such as bulk carriers, general cargo carrier, tanker carrier occupied the main proportion. Especially, those shipping firms have operated their vessels worldwide for the international trade. Therefore, Vietnamese shipping companies need to raise the awareness of LOI's functions, risks and frequency of use to facilitate their business activities.

2. Literature review

2.1. Definition

According to Arizon & David (2014), Letter of indemnity is a contract that one party secures the other from loss. In the shipping industry, carriers normally are the LOI beneficiary. They are head owners and disponent owners who are charterer in the time charter contract and bareboat charter contract. Charterers such as shipper, consignee or trader are indemnifiers for any loss of owners when accepting charterers' requests.

This letter allows the beneficiary of LOI the right to avoid liabilities, losses incurring from the acceptance of LOI issuer's particular requirements.

2.2. Common scenarios and related risks for using Letter of indemnity

2.2.1. Release of cargo without production of Original Bill of Lading

In the practice, it is very popular in a lot of trade, especially dry bulk and oil, when ship arrives the port of discharge, the Original BL can not reach the consignee because cargo is still traded while being carried on board as well as the documentary chain's delay. For commercial reasons, charterers often require release cargo against a Letter of indemnity, this requirement is normally inserted into the charter parties. From the carriers' perspective, they normally consider to accept LOI from their charterer or consignee (Miller, 2017).

Although, there is no incident in many cases while applying this way. Using LOI still has existed some

associated risks. Firstly, carrier can release cargo to wrongful person. In the English law, the lawful holder of bill of lading has right to receive cargo but the evident is not available at discharging port. Absolutely the safest way to avoid mis-delivery is deny discharging cargo till to bill of lading is presented. However, carrier only has right hold cargo in case of no provisions inserted in charter parties. In that case, carrier should unload the cargo to a warehouse or holding area in port that is controlled by carrier till to the presentation of BL. Secondly, carrier can loss from insurance cover. Particularly, liabilities arising as a result of mis-delivery are not guaranteed under almost P&I Club rules unless all member agree. The final risk is about creditworthiness of the party giving the LOI. Any claim under an LOI is not secured by any right of lien over cargo (Miller, 2017). Simultaneously, carrier is not sure about financial ability of indemnifier to implement its indemnification obligations.

2.2.2. Release of cargo against lost original Bill of lading

In the shipping industry, the most crucial document Original Bill of Lading may be lost during the transferred process. To minimize damages for all related parties, carriers normally accept LOI.

If consignee has obligation to hand BL out to carrier right after receiving BL in the case of releasing cargo without BL, the misplacement of BL can cause more risk for both parties. The carrier often requests protection against any mis-delivery claim from both shipper and consignee. LOIs from both parties also guarantee that none party can actually possess OBL. The LOI in this scenario has functions for reissuing the lost OBL, releasing the cargo without presentation of OBL as well as written agreements about actions should be implemented (Ariet Haxhijaj, 2017)

2.2.3. Change destination than stated in the bill of lading

There are many cases that a cargo will be continuously sold on the route to the discharging port. In other circumstance, a sale contract may fail, the cargo has to be resold to other buyer who requires

delivery good at another port to the one named in the BL. Letters of indemnity, which is given by shipper and consignee, hands out to carrier for changing the port of destination after BL has already been issued in port of loading.

In such cases, carrier could be exposed to mis-delivery risks when charterer may intend to deceive the legal possessor of the original bill of lading. For instance, charterer may receive payment for shipment from the holder of Bills of lading under Letter of Credit payment term. On the other hand, charterer issue LOI to carrier requiring changing port of destination that aims to sell cargo to another buyer under payment term after receiving cargo. The original bills of lading possessor will claim to carrier for loss of cargo.

2.2.4. Issuing of Clean Bill of Lading

From shippers' perspective, they sometimes try to persuade carriers to issue clean BL that do not include correct information regarding the quantity and condition of cargo loaded by providing a LOI. In other case, shipper sometimes require carrier to show shipment on date different to the actual date cargo shipped on board for the payment purpose under the letter of credit system.

BL issued with wrong information such as shipment dates and cargo descriptions while the carrier knows are inaccurate, could be detected by the innocent third party consignee or transferee. P&I insurance for cargo claims will be prejudiced. LOI used in such cases will absolutely not be enforceable (Anderson, 2018).

2.2.5. Issuing of Switch Bill of Lading

As opinion of Anderson (2018), charterer sometimes order the master to switch the original BL set issued to another BL set with different terms in exchange for a LOI. Switch bills of lading may be requested for various reasons. Particularly, for commercial purposes, buyer want to hide sub-purchaser the identity of supplier. As a result, the buyer may wish to be named as shipper in Bill of lading. Other cases allow trader to revise or add an additional the discharging port.

Carrier should consider carefully to issue switch bill of lading because of potential risks as follows. This type of indemnity letter may affect carrier's right to sue the supplier in case of transporting dangerous cargo. On the other hand, if the original BLs are not collected and surrendered in new bills of lading, the existence of two sets bills of lading could cause conflict when releasing cargo. Particularly, this important document is considered as deceiving the holder of the new set BLs and prejudice the possessor of the original ones. Letters of indemnity generally is illegal in these cases. Hence, full set original BLs should be collected before accepting to issuing switch BLs (Mills, Roberts and The North of England P&I Association, 2017).

2.3. *The legal of Maritime Letter of indemnity*

According to The North of England P&I Association (2017), liabilities of carrier are generally guaranteed by P&I clubs. However, P&I Clubs do not cover risks arising in cases of mis-delivering cargo due to problems regardless not complying rules using original bills of lading. When LOI is requested, the carrier must consider carefully a commercial necessity before accepting. If any claim arises from such circumstances, the LOI effectively plays a role as carrier's P&I cover. Under the viewpoint of English law, a master is not obliged to release cargo under Letter of indemnity except for orders by the Court. He is authorized to insist on the presentation of original Bill of Lading. However, in terms of Charter parties, charterers may add terms requiring the Master to deliver cargo against LOI. As a result, owner has to accept LOI in such cases.

In shipping practice, LOI against issuing clean bill of lading that has become more widespread and generally accepted. As we know, bill of lading plays a very important role in shipping that banks and consignees or purchasers always trust. Therefore, it is significantly strict for carrier to issue clean bill of lading although he does not gain any direct economic profit. In the legal aspect, the law does not allow any promises in a business transaction while transaction intention is to deceive an innocent party. A

misleading aim exists not only in case that the deceiving party knows any evident such as documents with wrong information, but also right after parties start making those fraudulent documents (Mills, Roberts and The North of England P&I Association, 2017).

2.4 *Recommendations from P&I clubs to mitigate risks from using LOI*

Firstly, the value of any Letter of indemnity depends on the trustworthiness of the party giving it. Accepting a LOI from an unknown charterer might cause more risks for carrier. For this reason, P&I clubs wording provides that LOI guaranteed by a consignee, shipper or charterer should be countersigned by a bank, especially, first class bank is recommended for high reliability. However, in the shipping practice, charter party often states that the charterer shall be required to unload cargo against a LOI without any bank counter-signature. In such cases, carriers have to accept to implement as term negotiated in Charter party (Arizon & David, 2014).

Moreover, in case of getting a bank signature in LOI, there is no guarantee that the bank will comply with its obligations. For instance, in an Australian case, the disponent owners accepted an LOI for discharging cargo without representation of bills of lading from their sub-charterers. LOI was countersigned by department manager of the 1st class bank. When the vessel was arrested for a mis-delivery claim, the bank denied honoring the LOI. Because the bank had only confirmed the signature of sub-charterer, not signed as co-guarantor of LOI. Therefore, carrier should always be careful to accept LOI (Arizon & David, 2014).

In the viewpoint of The North of England P&I Association (2017), many practical cases reveal that it is unsafe for carrier when accepting LOI against lost bills of lading. This P&I club recommends shipowner to look for courts' guidance in the relevant jurisdiction. But if the carrier tends to accept a Letter of indemnity from a party having an interest on the cargo due to commercial reasons, there is no legal obstacle for related parties. P&I clubs do not

generally insure risks arising from not complying rules while using BL. However, the P&I clubs try to support their members and others in the shipping industry by providing standard forms of Letters of indemnity for particular circumstances. The involved parties using these letters of indemnity have been responsible for any claim occurring. LOIs cover risks instead of P&I insurance for risks incurring when using LOI.

3 .Research methodology

To identify issues in accepting and using the Letter of indemnity of Vietnamese shipping firms in the international shipping, the author implemented investigating through interviews by Google form via Emails and Skype.

The survey, which has eight questions, was sent to operational departments of nine Vietnamese shipping companies, especially Vinalines Shipping Company, HTK Shipping and Import Export Co., Ltd, Vietnam Ocean Shipping joint stock company, Tan Binh Shipping Company, etc; two international ship brokering and chartering firms as Nueva Seas, BRS brokers; and maritime economics division in Vietnam Maritime University. After period of one month for investigation, author received 25 fruitful responses from experienced experts who work for the international shipping industry for many years. More particularly, 7 ship operators managers and 11 experienced ship operators, 5 ship brokers and 2 professors in maritime aspect revealed information about problems related to LOI in the practice and the overview about awareness of Vietnamese shipping firms in using this document. Their valuable responses will be discussed in more details in the following section.

4. Analysis of applying LOI in shipping practice of Vietnamese shipping firms.

4.1 The frequency of using LOIs in the shipping practice

Figure 2 revealed that the large proportion of

interviewees use LOIs frequently in many charter parties, around 65%. There is only 35% of opinions think that LOIs are used sometimes in their work because the most vital shipping document - Bill of lading is already used lawfully. Moreover, no idea showed that LOIs are used seldomly or never in the shipping practice in both the domestic shipping and the international shipping. In general, Vietnamese shipping firms are applying LOIs commonly in voyage chartering. Subsequently, the frequency of using LOIs is equal to the use of the Bill of Lading.

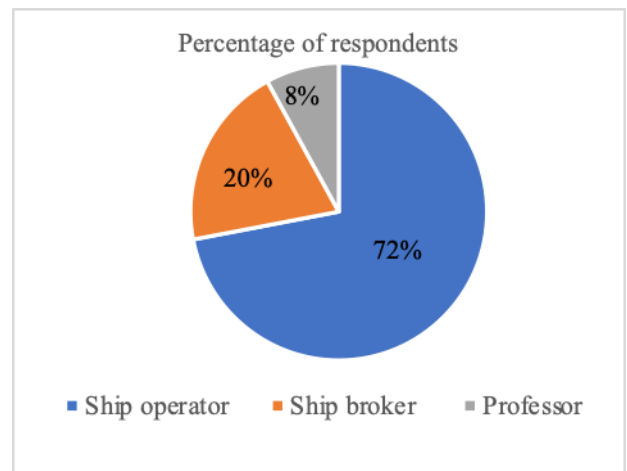


Figure 1: The percentage of the number of interviewees

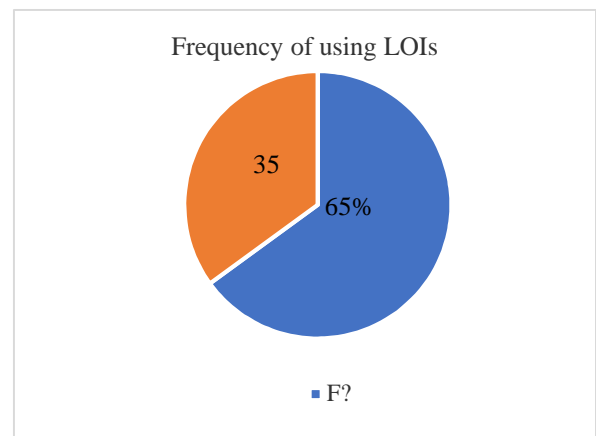


Figure 2: The frequency of using LOIs

4.2 Types of maritime Letter of indemnity used in the practical shipping.

Almost all interviewees revealed that they often accept maritime LOIs in various cases. The most common circumstance is using LOIs for releasing cargo without the original bills of lading. Followed by LOIs for changing port of destination, these scenarios

occur frequently when the cargo is continuously sold several times while carried on board. Subsequently, LOI for issuing clean Bill of Lading and switch Bill of Lading sometimes are applied in the practice. Besides, Vietnamese shipping companies occasionally accept LOIs for other purposes. More specifically, charterer requires to load and discharge cargo under rainy weather. In the practice, the application of LOI has been more widespread in diverse categories as well as the number of cases.

4.3 The required standard form of LOI

a. Do shipping firms require bank signature on LOIs?

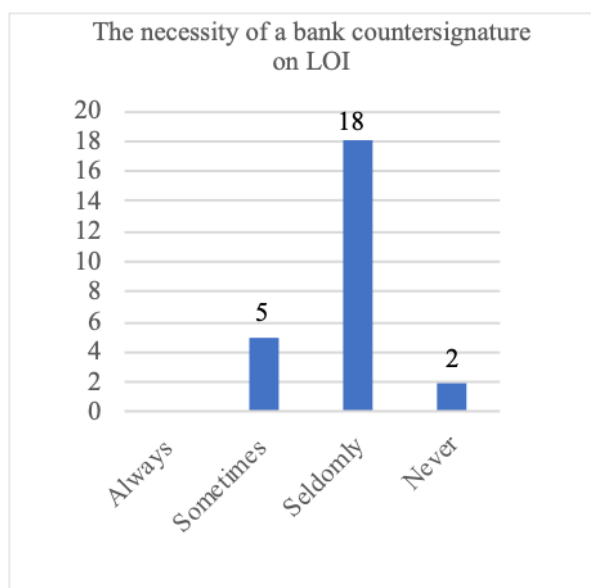


Figure 3: The necessity of a bank countersignature on LOIs

The result of surveys shows that LOIs without a bank countersignature are most commonly applied. Particularly, there are 18 opinions in the total 25 responses stated that LOIs are normally signed by indemnifier and shipping firms seldomly require LOIs countersigned by the reliable bank. Five experts stated that LOIs sometimes need a signature from the 1st class bank. Moreover, 2 responses asserted that their companies never require bank signature on LOIs. We can see a gap between the literature review and the practice about this issue. Shipping operators explained that charterparties generally include terms accepting LOIs without a signature from a bank, as a result, shipping companies have to accept using LOI

in these circumstances. Simultaneously, the delay for requiring the bank confirmation can cause more shipping cost and inconvenience for their customers.

b. Do shipping companies require P&I standard form for LOIs?

Almost responses agree that they commonly require different LOIs forms suggested by P&I clubs in various cases mentioned above.

4.4. The legal issues about using LOIs

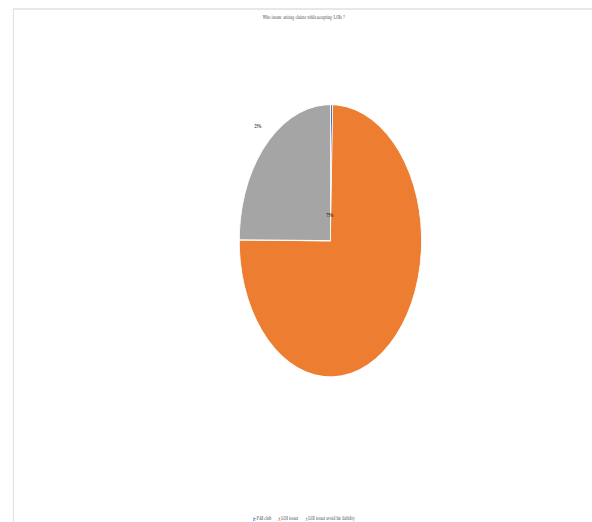


Figure 4: The parties insure arising claims while accepting LOIs

All respondents state that when LOIs are accepted, all responsibility toward the third parties are not insured by P&I Clubs anymore. The liability covering both claims and related cost are guaranteed by indemnifiers who issue Letter of indemnity. However, survey results reflected that the risks towards avoiding the responsibility of indemnifiers sometimes happen, occupies around 25%. As a result, carriers have to cope with disputes in the court and be suffered seriously in these scenarios.

4.5. Risks arising while using LOIs

According to answers from surveys, shipping firms sometimes may be claimed for mis-delivery cargo by the holder of original bills in case of delivery cargo without BLs, lost Bills of lading and changing port of discharging. Subsequently, carriers may occasionally cope with claims towards the shortage of cargo quantity and quality while issuing clean Bills of

lading. In summary, it depends on which types of LOIs used, there are always typical risks associated. The respondents stated that carriers are often exempt from liability towards risks caused directly by accepting LOIs. The indemnifiers issuing LOIs take responsibility for these claims. Any disputes are solved between claimant and indemnifier. On the other hand, in case of avoiding the responsibility of indemnifiers, carriers are not guaranteed by any insurance. They may be sued in the court and damaged significantly.

4.6. Alternative methods instead of accepting LOIs.

Almost all interviewees said that carriers accepting widely LOIs in many cases in the practice when all necessary conditions are satisfied. However, if carriers suspect parties who issue LOIs to have frauds, carrier will deny LOIs. Particularly, carrier may wait till to the appearance of bills of lading in case of no presence of bills of lading at the discharging port. Obviously, carrier may take a risk for demurrage, especially, when charterer delays in paying this money. In other scenario, carrier still issues claused Bill of lading although charterer insists on issuing Bill of lading.

5. Conclusion

The use of LOIs gradually become an important feature in the international trade. LOIs which are used properly can facilitate shipping process as well as save money for all related parties. However, the acceptance of LOIs also cause associated risks for carriers.

Generally, Vietnamese shipping firms understand somewhat about problems towards using LOIs. Currently, Vietnamese carriers accept LOIs widely in various circumstances. Their understanding about LOIs is largely based on practical experience, not based on theoretical basis. Sometimes, they also take risks seriously because of frauds. However, they all admit the undeniable benefit of LOIs.

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Appendix

Questionaries

I am looking forward to receiving your support for the research 'Understanding of Vietnamese shipping companies about using maritime letter of indemnity'.

- I. General information
 1. Full name:
 2. Company/ organization:
 3. Position
 4. Working experience
- II. Questionaries
 1. How frequency do shipping companies accept the letter of indemnity (LOI) in the shipping practice?
 - a. Frequently
 - b. Sometimes
 - c. Seldomly
 - d. Never
 2. How many types of maritime letter of indemnity are often used in fact?
 - a. 4
 - b. 5
 - c. 6
 - d. Others

3. Does your company use any alternative solution instead of using LOIs in those cases? What are these solutions?
-

4. Does your shipping company require a P&I standard form for LOIs?

- a. Yes
b. No

5. Does your shipping company require bank signature on LOIs?

- a. Always
b. Sometimes
c. Seldomly
d. Never

6. How many types of maritime letter of indemnity are often used in fact?

- e. 4
f. 5
g. 6
h. Others

7. Does your company use any alternative solution instead of using LOIs in those cases? What are these solutions?
-

8. Does your shipping company require a P&I standard form for LOIs?

- a. Yes
b. No

9. Does your shipping company require bank signature on LOIs?

- e. Always
f. Sometimes
g. Seldomly
h. Never

10. Which risks arise while accepting LOIs?
-

11. Are mis-delivery risks while accepting LOIs covered by P&I insurance?

- a. yes
b. no

12. When claims arise, do indemnifier cover risks stated on their LOIs?

- a. yes
b. No

Thank you!

Received 10 May 2021

Accepted 10 June 2021