

Assessment of Principal Risks Related to the Acceptance of Letters of Indemnity in Oil Trading.

**Bachelor Project submitted for the obtention of the Bachelor of Science HES in
Business Administration with a major in International Management**

by

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Declaration

This Bachelor Project is submitted as part of the final examination requirements of the Geneva School of Business Administration, for obtaining the Bachelor of Science HES-SO in Business Administration, with major in International Management.

The student accepts the terms of the confidentiality agreement if one has been signed. The use of any conclusions or recommendations made in the Bachelor Project, with no prejudice to their value, engages neither the responsibility of the author, nor the adviser to the Bachelor Project, nor the jury members nor the HEG.

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Executive Summary

As oil became a globally traded product traders learnt to maximize their profits by moving energy commodities around the globe. Globalisation and technological development, besides having a durable positive effect on international maritime trade often triggers enormous risks. As much as financial institutions and big trading companies are trying to reconcile national differences between sourcing and consumption countries by minimising political risks, these transactions are never entirely risk free. Traders, ship-owners and bankers often ignore the implications that could stem from their engagements in profitable but not always straightforward obligations.

Oil trading is very complex business. Usually, trading volumes are very high and require substantial financial resources and a strong logistic system that could manage potential risks. A chain of participants involved in execution of one sale contract includes numerous parties such as ship-owners, brokers, insurers, inspection specialists, port agents, financial institutions and experienced support staff.

As a result, there are a number of risks that do not appear on the surface of transactions and arise as a consequence of negligence of contractual details or general misinterpretation. Often, these errors are caused due to mismatches between multiple contracts, Charterparties, letters of credits or, simply, a result of dishonest behaviour of partners.

Traders do not work in ideal world where contract executions follow their exact mechanism, there are no last minute changes and documents always arrive on time to the discharge ports. That's why the Letters of Indemnity are a great instrument that can remove a lot of barriers on the way of the traders. They facilitate timely delivery of cargoes to their receivers, reduce operational costs and as result, increase profit margins of traders. Hence, a Letter of Indemnity creates liabilities that fall beyond the framework of the sale contract and beyond the standard insurance coverage for ship-owners. Often, Letters of Indemnity generate liabilities under parties who might not have had an original unilateral contract. The biggest issues arise when the Letter of Indemnity is being called upon, and traders have to secure the claim of the carrier.

Yet, they are used by traders on every day basis as market dynamics imposes its own rules on the entire industry.

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List of International Conventions

Hague and Hague Visby Rules (1968)

Hamburg Rules (1978)

Rotterdam Rules (2008)

Uniform Customs and Practices 600 for Documentary Credits (2007)

List of Abbreviations and Acronyms

B/L-Bill of Lading

B/Ls-Bills of lading (plural)

BIMCO-Baltic International Maritime Conference

CIF-Cost Insurance Freight

C&F-Cost & Freight

Dwt-Dead weight tonnage

FOB-Free on Board

INCOTERMS-International Commercial Terms

ICC-International Chamber of Commerce

L/C-Letter of credit

LOI -Letter of Indemnity

LOIs -Letters of Indemnity (plural)

MT-metric tons

P&I clubs-Protection and Indemnity Clubs

1. Introduction

1.1 Oil industry overview

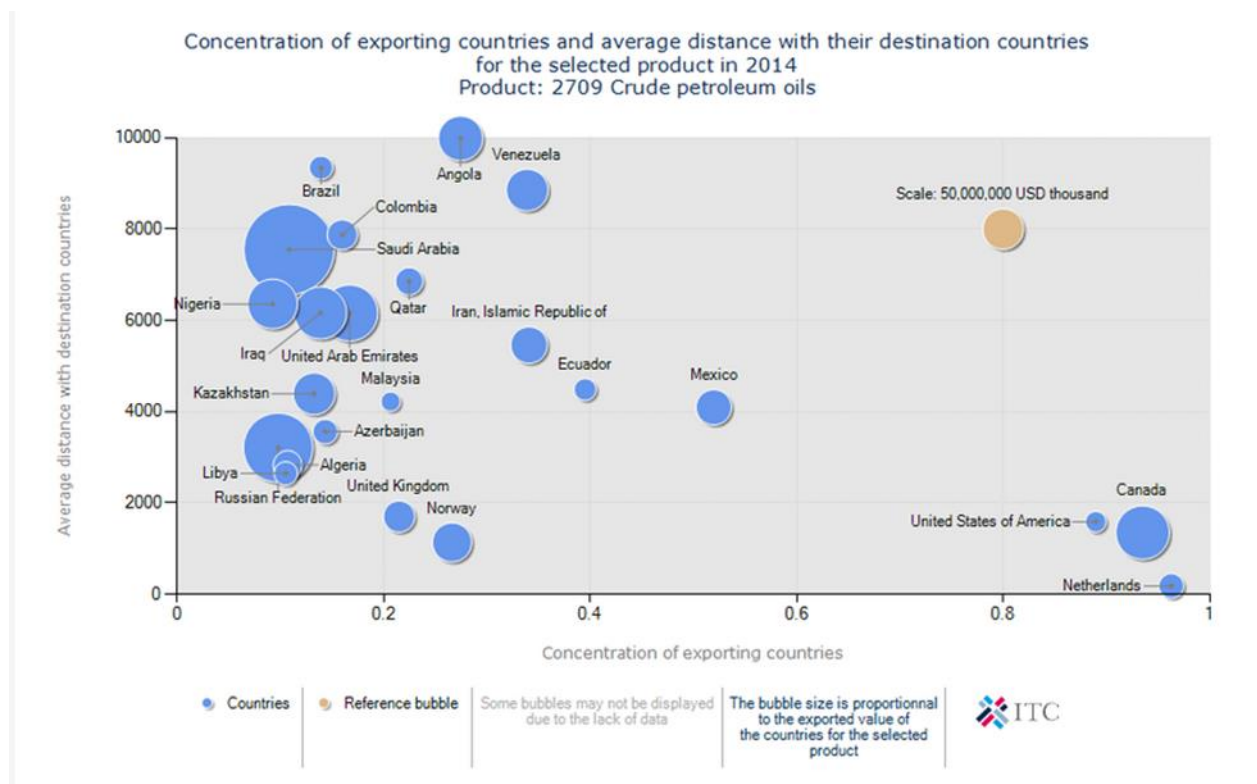
Multiple numbers of vessels loaded with merchandises and cargoes of commodities cross the oceans every day. Crude oil is a strategic commodity that is used as energy source as well as raw material for various manufactured goods. As supply and demand of oil are located in different geographic locations, trading companies are major actors moving oil from sourcing countries to consumption countries. Oil carried on the board of tankers accounts for nearly one third of global maritime trade. (Transporting Oil by Sea, 2015)

The oil industry is oftentimes referred to as an oligopoly with concentration of demand, supply and control in one specific region (Transporting Oil by Sea, 2015).

Middle Eastern counties: Iran, Iraq, Saudi Arabia and Kuwait have been among major suppliers of oil starting from the end of World War II. Today, Saudi Arabia is the biggest oil producer in the world with proven reserves of 260 million barrels (Royal Embassy of Saudi Arabia, 2015), which accounts for 18% of global reserves (OPEC, 2014). The OPEC's production, besides being flat since 2003, still covered 41% of the whole crude oil market in 2014 (BP, 2014). Other emerging countries such as Russia have joined the world oil industry in 1960s with exports and later on with gas in the 1970s. Further, the collapse of the USSR forced Russia to participate the international oil trade market as a competitive player. As evidence, Russia's exports of crude oil to China have doubled since 2010. In 2015 Russia outpaced Saudi Arabia as the first supplier of crude oil until May with exports exceeding 930,000 barrels per day (bbl. /day). After the month of May, Saudi Arabia lost the top spot and fell behind to third world exporter (the second largest supplier is Angola) with imports plummeting to 722,000 bbl. /day, which is 43% less compared to previous months. (Raval, 2015)

However, we have to discount the fact that sanctions imposed on Russia by European countries as a result of political events in Crimea in 2014 are forcing the country to look for alternative exporting markets.

Figure 1: Top 25 Crude Oil Exporting Countries and average distance to destination countries

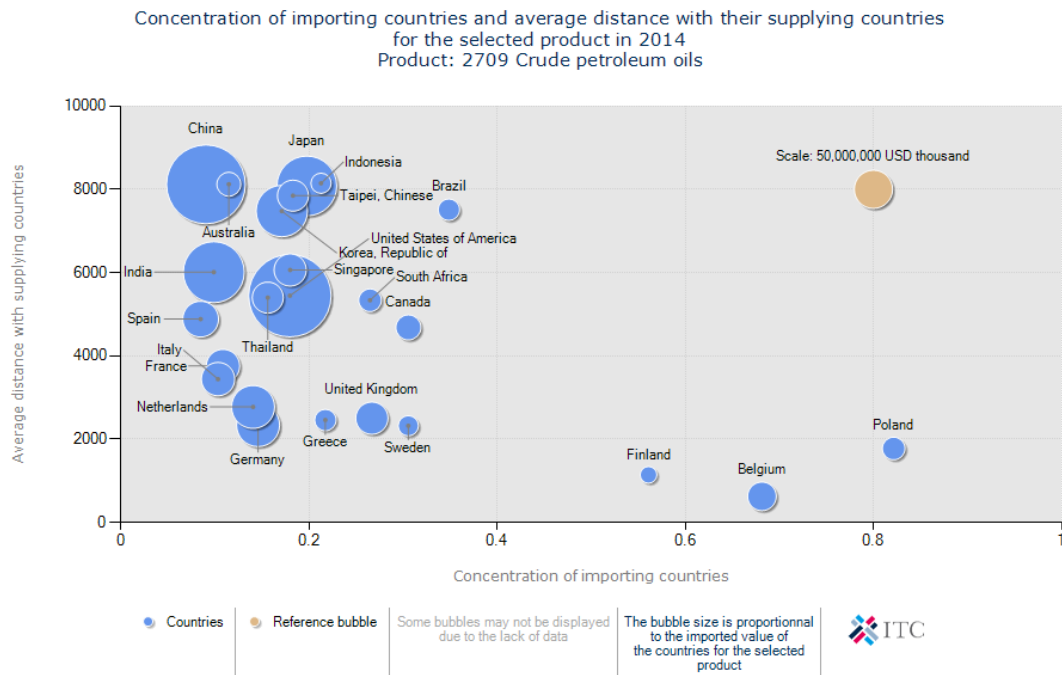


Source: (ITC Trade Map, 2014)

The bubble table above illustrates the largest net exporters of crude oil for 2014. As previously stated, Saudi Arabian exports were valued at USD 263,628,237,000 (350,864,917 tons) followed by the Russian Federation with exports estimated at USD 152,586,049,000 (220,694,082 tons). The total value of world exports for crude oil reached USD 1,459,090,604,000 which estimated to be equivalent of 1,857,477,366 tons. (ITC Trade Map, 2014)

This table also illustrates the average distance from exporting countries to consumption countries. For instance, the average distance from Saudi Arabia to the markets it delivers crude oil is 5'475 km. Angola and Venezuela export their crude to the furthest markets with average distance of 9'989 km and 8'856 km respectively. On the contrary, Canada is one the countries that mainly exports its crude to its neighbouring countries covering the average distance of 1'350 km (ITC Trade Map, 2014).

Figure 2: Top 25 Crude oil Importing Countries and average distance with their supplying countries



Source: (ITC, 2014)

Almost 90 million barrels of oil are consumed daily in the world (American Petroleum Institute, 2014). Demand for crude oil comes mainly from industrialized economies, the United States of America are on top of the list with imports and many countries, such as China, are in the process of development and have imported USD 228,234,984,000 (308,367,038 tons). India is located as one of the top three net importing countries with imports valued at USD 135,826,203,000 or 189,407,403 tons or (ITC, 2014)). We can also observe that China's sourcing markets are located the farthest (over 8'000 km). In comparison with Belgium whose sourcing market is the closest among top 25 importing countries with average distance to sourcing country 635 km. (ITC, 2014). The USA consumes 21% of total daily production of crude oil. China's consumption grew from previous 7% in 2003 to 10% in 2013 (API, 2014). Thus, imbalances arising from these regional supply and demand shortages are managed by traders on a daily basis, through international trade. Seaborne international trade is mainly applicable to countries which do not share inland common borders. The latest data from the report of the International Energy Agency, shows that the average demand for crude oil and other liquid fuels will reach 93 million barrels per day worldwide (IEA, 2015).

1.2 Importance of international seaborne trade

The first historical sea routes were laid out by explorers from Portugal during the Middle Ages, and were then followed by other major European countries. These populations started their sea voyages with the hope of finding an ultimate sea route to Asia for precious spices. Medieval ships sailing off from European countries (mainly France, England, and Portugal) were carrying wine, salt, timber, wool, olive oil and bringing back silk, fruit and other goods.

Since the Middle Ages, ocean trade has experienced great changes and increases in volume, speed and types of goods transported by sea. Growth of world trade was triggered by several historical events such as the liberalization of China, growth of Asian markets such as India and the dissolution of the Soviet Union in 1989. These events all heavily increased the flow of goods and commodities through venues that had not been previously exploited. Seaborne trade became a strategic tool for countries with access to the sea. As proof, the 10 biggest container ports out of the 50 worldwide are located in Asian countries (World Shipping Council, 2015).

According to website Clarksons Research (Clarksons Research, 2015), the global seaborne trade grew faster than the global economy. The agency discovered that global trade grew by 3.7% in average per annum, whereas, seaborne trade grew by 4.7%. Trade volumes have also been increased by nineteen fold since 1950. Seaborne trade is responsible for the 11 billion tons of goods transported each year, which could be distributed at 1.5 tons per person in the world.

Besides transportation of merchandises or containerized trade, energy trading has a central place in ocean trading. Oil is the most strategic resource for both developing and developed countries. For example, China's imports of crude oil that mainly arrive by sea from the Middle East reached 7.2 million barrels per day, and have outpaced imports of the United States by 0.2 million barrels per day for the month of April 2015 (Gronholt-Pedersen, 2015). Therefore, a disruption of oil supply in a country, which may be triggered by various factors, can cause a lot of damage to the country's economy. This is especially relevant for countries with growing industrial infrastructure, construction and transport needs, such as China and India.

The geopolitical location of certain countries like Saudi Arabia, Iran and other Gulf countries whose economies are established on the proceeds from oil trade can disrupt global oil supply when certain political events occur. One of these conflicts is the Iran-Iraq war (1981-1987). According to the policy research project "Strait of Hormuz" of the

University of Texas at Austin, Iranian reliance on trade from oil revenue is estimated to be close to 85%. Over 90% of Iranian exports cross the Hormuz Strait, the narrowest sea passage from the Persian Gulf to the Indian Ocean. This passage is responsible for 20% to 30% of global consumption with oil tankers shipping approximately 17 million barrels of oil per day. When in 1981 Iraq announced that ships leaving Iran through the Northern part of the Persian Gulf would be attacked by air strikes, it started “The Tanker War”, an infamous naval conflict. Iraq was trying to squeeze the Iranian economy by depriving it from the funds received by the oil trade. In turn, Iran also attacked tankers of partners of Iraq. As a result, 61% of attacked ships were oil tankers, but the number of sunken oil tankers was relatively low. Only 23% (55 tankers) out of 239 tankers were actually sunk. The conflict was resolved with the involvement of the United States in response to Kuwait’s message for help (Robert S Strauss Centre for International Law and Security, 2008). However, this conflict did not cause much disruption on world crude oil prices, instead, it substantially increased insurance risk premiums for vessels travelling through the Persian Gulf and into Iran. This said, Iranian exports were reduced by half, and the shipping flow in the Persian Gulf was decreased by 25% (Global Security Org, 2011).

This is an example of how regional conflicts can disturb the balance of global trade balance.

1.3 Evolution of transportation of seaborne crude oil.

As whale oil became notoriously known for its properties, and mainly used in fueling engines, it was also considered as a renewable source of energy. It was assumed that whales would reproduce in accordance with the natural rebirth cycle. The usage of whale oil was very widespread, and went from machine engines to household lamps. However, over 10 000 whales were massacred in the sea in the year of 1851. The price of whale oil at the same time climbed and USD 1,200 per barrel (Chancellor, 2008).

Whale oil was very scarce and an expensive resource, which enriched a lot of whale catchers, but simultaneously was a very risky business which had a high toll on the lives of many people. There was an urgent need to develop new source of energy compatible with whale oil

The first drill well was built in 1859 in Pennsylvania, by Colonel Edwin Drake who had been working on this project for several years after having been abandoned by Seneca

Oil, his main sponsor. Persistence and efforts paid off when he discovered oil at the depth of around 21 meters. At that time the production capacity of the well was around 20 to 40 barrels of oil per day (Dav, 2008).

Drake's invention marked the beginning of the industrial oil drilling age in the USA. In the meantime, a need for the development of commercial ties and secure ships for crude oil transportation has been growing with the expansion of oil production.

By 1876, the Nobel brothers had built a tanker called Zoroaster, which was operating in the Caspian Sea and along the Volga River. The vessel was connected to the pump of kerosene oil through a 12 km pipe that was linked to the site of production. The oil from the production site was not carried in casks but pumped to the vessel directly. This invention allowed saving space and time on transportation, as well as, improving the security of production sites and ports. Zoroaster was able to carry about 240 tons of kerosene in 21 tanks (Insight Marine, 2012).

The first fully-fledged specialized steam oil tanker was built in Britain, but was commissioned by Germany in 1886; it was called Gluckauf. The vessel was an ocean going vessel, quite opposite of the Zoroaster, which was used only at sea and for shorter voyages on rivers (Vassiliou, 2009 p. 550). The vessel contained separate tanks where oil could pump directly. This method was more expensive but also more secure because it gave more stability to the vessel. Gluckauf's tanks could hold 4000 barrels of oil in its 7 to 9 tanks, (Global Security Org., 2007) and its length was of 300 feet or the equivalent of 91 meters. Unfortunately, it sank after catching a gale on a way to New York from Germany (Davis Park Association, 2007).

By 1891, there were 70 steam ships tank which belonged to the Standard Oil Company (Vassiliou, 2009 p. 411). They were making trips from England to the New York in 11 days and carrying up to 4000 tons of oil (Global Security Org., 2007). Bulk transportation of oil allowed to cut costs of shipping and simultaneously increased volumes carried aboard tankers.

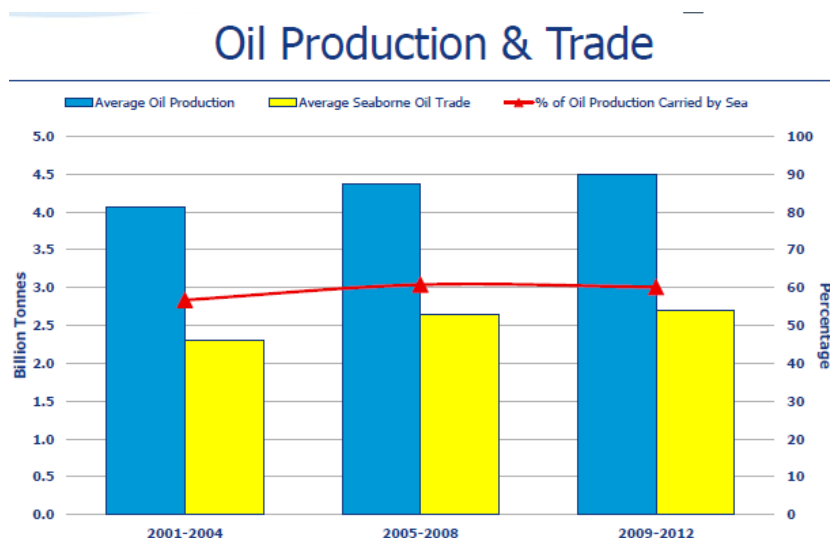
A diesel engine was invented in 1897 which facilitated and speed up the growth of the industry. During World War I and the World War II, the oil tanker technology became more sophisticated; the ships were larger and were able to carry bigger loads of oil. However, the vessels were mainly designed to carry petroleum products and not adapted for transport of crude oil, which required a different tank design. The US Navy used these oil tankers for military purposes to mainly refuel other military battleships

while on sea. Most of the tankers were resold after the war but stayed operational until the late 1960s.

1.4 Shipping of crude oil and petroleum products today

From the end of 1960s the shipping industry went through major changes. The communication systems have been improved and the infrastructure of ports and ships has also been modernized. Today, crude oil and petroleum products are transported on large tankers crossing the major trading routes. **APPENDIX 1.** Almost half of produced crude oil is transported from the country of origin to buyers' refineries: The table below shows the increase of quantities of oil transported by sea from 2001 to 2012, marking an increase of around 10% in average production and about 5% in average seaborne trade. (Yan, 2013).

Figure 3: World Oil Production & Trade



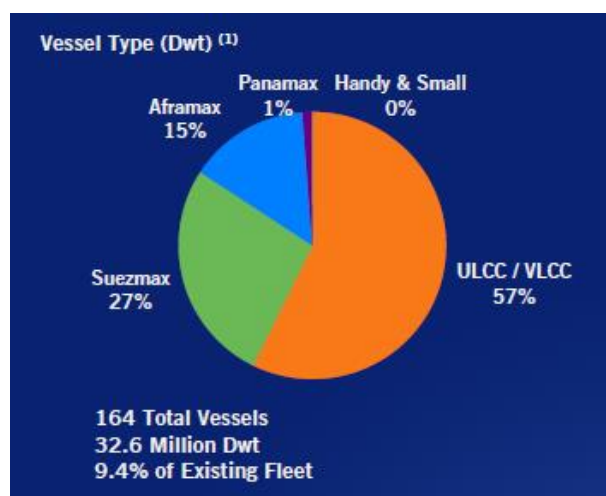
Source: (Jefferies, 2013)

The biggest share of shipping falls within dry bulk cargoes that include iron ore, coal and grains. According to the UNCTAD, total shipments of crude oil for 2013 have reached 1.8 billion tons, which is a slight increase from 2012, when the quantities of crude oil carried by sea were 1.78 billion tons.

According to UNCTAD's Maritime Transport Review, the total world tanker fleet accounted for 28.5% of overall world fleet including dry and container fleet. It showed a decline in 2014, since 2012 marked the end of the shipbuilding era (UNCTAD, 2014). Tanker fleet is dominated by VLCCs (very large crude carriers with deadweight tonnage of over 200,000 dwt); they constitute 57% of total global fleet (*est. 2013*).

These tankers carry crude oil from long distances originating from the Arabian Gulf and West Africa to Asia, Europe and the USA. Suezmax crude tanker has deadweight of 120,000 to 200,000 tons, and it accounts for 27% of global fleet of crude tankers. Suezmax is built principally to fit the Suez Canal. They are medium haul tankers that travel from West Africa to the United States. Aframax has a deadweight capacity of 80,000-119,000 tons and covers medium distances carrying crude oil between Europe and the United States. Aframax vessels used to dominate the tanker fleet to their flexibility in weight range but later on were upgraded to Large and Very Large Vessels. (EIA, 2014). Nowadays over 57% of world crude tanker fleet is appropriated to the ULLCC/VLCCs. Panamax is the short haul tanker which is able to carry between 60,000 -79,000 tons of crude oil, it is destined for short term distances (Jefferies, 2013). The total global fleet of crude oil tankers reached 32,6 million tons of deadweight among 164 vessels in total, as illustrated in Figure 4.

Figure 4: World Crude Tanker Fleet



Source: (Jefferies, 2013)

Product tankers are also called clean tankers (Handy size) they are traditionally smaller with deadweight of 5,000 tons to 80,000 tons. They cover a traditional arbitrage route of gasoline from Rotterdam to New York harbor. (Jefferies, 2013).

1.5 Structure of Brent Market: from forward to spot

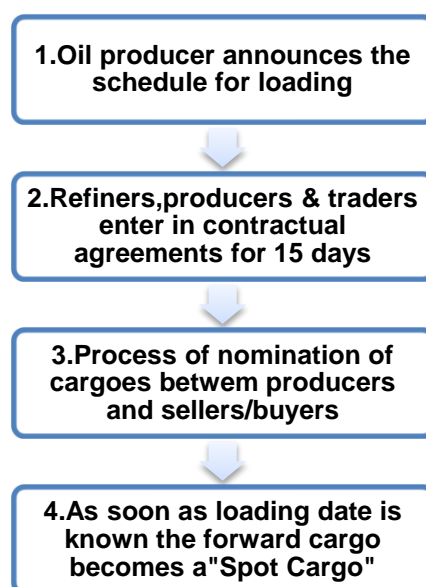
Physical oil is traded on forward and spot markets. Brent market is a physical over-the-counter (OTC) market, meaning that the deals between producers, traders and refineries are carried out over the phone and the transactions are not transparent to the general public. This practice is opposite to the practices on the exchange market, where the parties are cleared through a Clearing House and the sellers and buyers do not know one another but the transactions are published on Commodity Derivative Exchange sites. The prices of Brent oil are monitored by Reporting Agencies such as “Argos Petroleum”, “Reuters” and “Platt’s” who follow up on the transactions carried out by the end of the day and publish official prices of the Dated Brent. Over 50% of global crude is benchmarked on the basis of Brent (Barret, 2012).

The physical Brent market is dominated by forward contracts. As the Dated Brent is a global benchmark for pricing oil, other traders price their oil by adding or subtracting differentials based on the quality of the underlying oil. Brent forward’s underlying cargo are the cargoes of Forties, Oseberg or Ekofisk of 600,000 B/L of crude per cargo (Barret, 2012). Forties, Oseberg and Ekofisk are the major oil fields in the North Sea.

Forward means an obligation of a seller to make a cargo available for a non-specific date in the forward month in favour of the buyer. These contracts are called forward contracts due to the uncertainty of a precise loading date in the future. Historically, before 1985 the forward Brent required a 15 business day 5 pm London time notice (Long, Supplement 1998). From the seller to the buyer advising the loading date of the contractual cargo (Barret, 2012). After 1985 the notice period was changed to 21 days and to 25 days from 2007. Therefore, if the loading is scheduled from 1st, May to 3rd, May; the seller has to notify the buyer at least on March 31st, about the loading dates. The 15-day forward Brent had a tolerance of 5 to 10% at sellers’ option, which was later reduced to 1% tolerance on weight. This created a substantial risk exposure to traders due to the uncertainty in the volumes of the cargo they had ordered. These measures, of 21 days, were taken to protect the market from the price squeezes resulting from the shrinking volumes of oil drilled in the North Sea.

After the nomination of the cargo, i.e. loading date, “paper barrels” become “wet barrels” or a physical cargo. Being known as “daisy chains”, “multiple sales”, this process is also used as hedging tool along with speculative purposes by the agents on the market. (Reuteurs, 2015).

Figure 5: Transferring from forward to physical market



1. Oil producers issue a finalized schedule for all available cargoes 15 days prior to the loading date. Until then, traders or anyone else do not know about the precise loading dates.
2. Traders have a choice of keeping the cargo or passing the cargo down the chain to another buyer as long as the nomination prior of 15 days is respected. In their turn, the buyers have to accept the cargo.
3. Once, the deadline of 15 days expires prior to loading, the cargo will turn into wet/physical spot cargo (Dated Brent). From now on, it will have an assigned loading date.
4. As soon as the loading dates become available the cargo shifts to the Spot market or Dated Brent market. Dated Brent market gives the prices for the Brent, Forties, Oseberg and Ekofisk (Brent complex BFOE). The prices will be used as references for the coming 10-25 days. This pricing is used as assessment price for cargoes loading around these dates (Barret, 2012).

2. Analysis

2.1 Issue

As markets dictate their rules, traders are obliged to adapt in order to maximize their profit margins by leveraging available market opportunities. The foundation of international trade is focused on moving goods over the distances, connecting buyers and sellers while complying with national regulations and contractual obligations of parties. As shipping goods is a contractual obligation which requires formalized undertakings of parties, it requires production of various documents related to the transaction. Technological advancements in the maritime shipping related to speed, communications, port infrastructure and many others help to speed up the trade but the late arrival of documents to the destination ports which is required to take the delivery of the cargo leads to delays and additional risks.

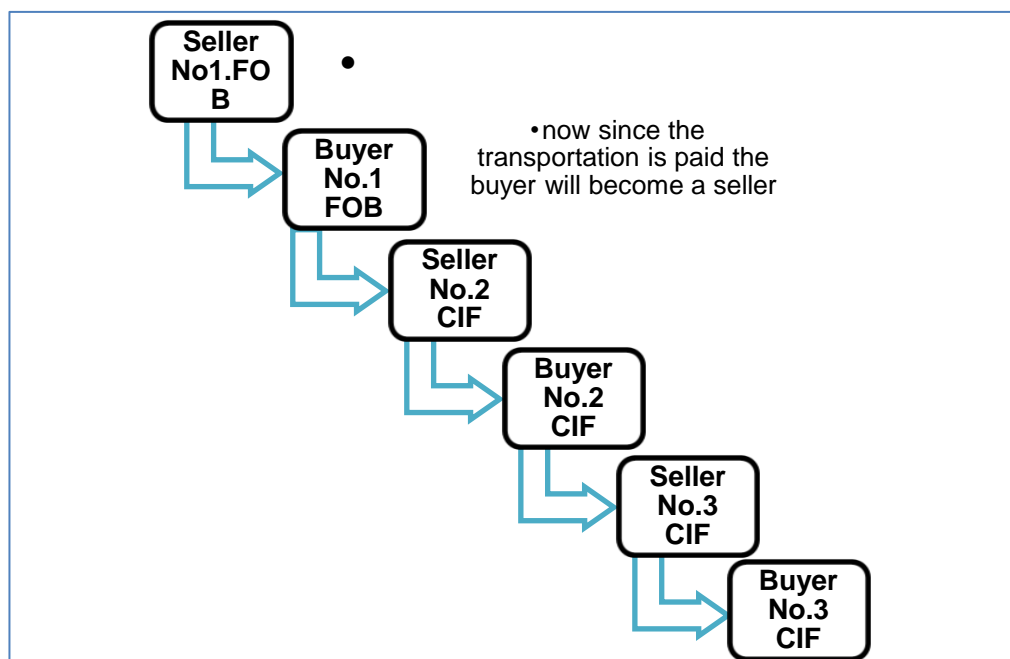
The fact that oil cargoes are resold multiple times while still on sea transit raises many issues in respect of the parties concerned. This phenomenon is also known as string trading, which is characterized by several parties dealing with the same cargo of oil. It is a type of deal where only an original shipper and the final receiver deal with the physical aspect of the cargo. A shipper at the port of shipping and the receiver at the port of destination are the only parties that will perform the loading and take the delivery of a cargo. Traders in the string chain will deal only with shipping documents and sales contracts. For example, Michael G. Bridge states that one cargo on FOB on the Brent market can be assigned up to nine times (Bridge, 2003). One of interviewees for this paper, confirmed that he had an experience of selling one cargo of oil on FOB terms to four buyers while goods were not yet loaded on the board of the vessel. In this case the B/L is "Made to the Order" with blanc space in the place of the shipper. Financing banks have a great interest in these kind of transactions because they require opening of multiple letters of credit and earning a commission. Therefore, the name of the shipper would be the name of the last seller who would load the goods on board.

Paul Todd in "Bills of Lading and Bankers Documentary credits" mentions that: "the oil cargoes may be negotiated up to 100 times and more" (Todd, 1990 p. 236).

Besides having multiple sale contracts and multiple Letters of Credits (LC), the shipping documents will be issued in one original set and will move along the chain on the sale. The interviewed bankers pointed out that the sometimes the Bill of Lading

have no space to put a bank's chop. For instance, when the cargo is sold and the trader has to nominate a final port of destination but they are not always ready to commit to specific delivery destination at the loading time because they might resell the cargo during the transit. Otherwise, a bulk cargo initially sold on CIF Rotterdam terms will be discharged at other destination than the initial Rotterdam port (Bridge, 2003). Figure 6 explains the formation of string sale contracts with the same cargo of oil. Multiple sale contracts will produce a multitude of transactions but the shipping documents, insurance certificate and contract of carriage will be the same. As soon as a shipper delivers the cargo on board of the vessel under FOB, the receiver/carrier can resell it to someone else on CIF terms since he has paid for the freight. The cargo is passed further down the chain of traders, who have their own commercial interests. By reselling cargoes traders are securing their profit margins, which are usually very low in oil trading.

Figure 6: Formation of string trading



Source: (Zieger, 2013)

Simultaneously, as it has been mentioned earlier, tankers are taking much less time to deliver cargoes, sea trips are becoming shorter due to increased speed and progress in communication. A common tool that is used in such situation is a Letter of Indemnity (LOI), which is given to the carrier as a promise of indemnifying him against all possible claims in case such claims might arise.

In turn, if the carrier agrees to the terms of LOI, it will follow the instructions of the charterer. The charterer is identified with the help of underlying sales contract and INCOTERM terms. In addition, LOIs are powerful tools in preventing excessive unnecessary fees occurring as a result of late arrival of Bills of Lading at discharging ports.

Although as practice shows, traders in a pursuit of saving money on demurrage costs or avoid ship retentions use this instrument without full knowledge of consecutive risks. Moreover, the charterers who are issuing such documents are risking that LOI will be called on by the ship-owners. Carriers and ship-owners are also incurring multiple risks, for delivery against an LOI, which can be in certain cases interpreted as mis delivery or a delivery to a wrong person.

When the deals are financed under documentary letters of credit, which call for presentation of shipping documents, the documents have to go through the hands of all concerned banks and down to the receivers, which in practice takes many days. By the time the shipping documents reach the receiver, the latter would have time to sell the cargo to someone else or to send to the refinery.

In practice, the documents are dispatched with priority courier services, and are tracked by the bank. Therefore, even if the bank receives the documents the trader/receiver will not be physically present at the port of discharge. As the trader/receiver works through his appointed agents, delivering documents to the port will not always match with the arrival time of the vessel. In addition, in accordance with UPC 600, financing bank is allowed to take up to five days for examining the strict conformity of documents with the clauses of the letter of credit. Many have criticized reliance of financing banks on strict compliance of documents with Letters of document which is a very impractical solution for the oil trade. In particular, B/LS in oil trade are rarely used as title document and the industry recurs to the practice of using LOIs. (Zieger, 2013).

2.2 Research Question and Methodology

Despite being a strong solution to modern international trade, LOIs can be non-enforceable in certain circumstances. Generally, LOIs imply an undertaking of an issuer of the document to indemnify the carrier and the (ship-owner), his servants and his agents to hold them harmless of any liability, loss or damage.¹

Although, the practice shows that this tool can provoke situations where the party having accepted the LOI stays non-indemnified or suffers other losses in connection to the requests under an LOI. Since the LOIs are not considered as documents that provide a legal title to the cargo, the status of ownership of contractual commodity can be also uncertain.

The main objective of this research paper is to understand the consequences of using Letters of Indemnity in oil trading. Since, the LOIs are frequently used in oil trading, this research will attempt to highlight underlying risks in respect of Maritime LOIs issued in the absence of B/L's at the discharge ports. Simultaneously, a short overview of other types of LOIs used in oil trading will be also explained as a comparison to the LOIs for discharge.

Consequently, the principal research question that is investigated in this paper is stated as follows: *What are the legal and financial consequences for parties accepting LOIs for discharge of goods in the absence of Bills of Lading at the destination ports?*

In connection with the main research question, special attention will be given to the position of the financing bank through documentary letters of credit, especially, related to deals requiring countersigning of LOIs by financing banks. Consecutive risks of the ship-owners accepting LOIs will be illustrated through the analysis of legal case studies. In addition, risks related to the sellers and buyers issuing LOIs will also be included in this paper.

The scope of this work will discuss legal cases that arose in respect of the use of LOIs in international trading. Considering that there are a multitude of different LOIs, this work will mainly discuss LOIs issued to the ship-owners in the absence of B/L at the destination port. A special attention will be paid to B/Ls and their connection to LOIs. Furthermore, legal status of LOIs in different jurisdictions, in countries following Common Law doctrine and in countries following Civil Law doctrine, will also be portrayed. Simultaneously, we will look into the status of various LOIs in the

¹ Please refer to APPENDIX 4 for text of discharge LOI.

international conventions such as the Hague-Hague Visby, the Hamburg and the Rotterdam Rules.

The primary data will be collected through interviews with professionals working in the field of commodity trading, shipping and banking. This will bring to the research a more practical application compared to that of the legal dispositions and texts.

And the secondary data on related risks will be analyzed through a documentary research and case study analysis. An examination of several case studies that arose after issuance of LOIs related to specific LOIs for discharge of goods without production of B/L at the destination port will be carried out at the final discussion part of the research. Moreover, case studies including involvement of financing banks and owners' claims will contribute to the discussion part of the research.

Regarding the methodology, the first part of this report will provide an overview of the oil industry and seaborne trade in the international market. Further in the text the evolution of oil transportation in the current market situation will be explained. The legal status of LOI in accordance with international conventions and regulations will also be integrated in this paper.

A general overview of different types of LOIs frequently used in oil trading will be given in the second part of this paper. Although, the core of this research will be focused on the risks of each party accepting a LOI for discharge of goods in the absence of Bs/L at the destination port.

Finally we will compare all the risks and will provide with some practical solutions that are used by various actors to secure their financial exposure and risks in deals involving LOIs.

2.3 Bills of Lading

Any commercial transactions, especially ones that related to the sourcing of commodities in large quantities, involve multiple key documents. Aside from signing sales contracts and executing payments, traders must ship the commodity from the point A to point B. The shipping documents are a crucial part of any physical transaction due to the rights and obligations they allocate to the participants of the contract. Consistent shipping documents ensure that vessels carrying cargoes to and from different countries, legislations and contractual parties can rely on standardized documents during international transactions.

B/Ls are the oldest documents used in international trade. They date back to medieval times when they were used by merchants as a receipt for the cargo. B/Ls started being used as a document of title in England in xvi century. The earliest copy comes from 1538 (Bennett, 1913 p. 9) In trade practice the B/Ls are issued by the Master of the vessel to the shipper. Once the cargo is loaded on board of the vessel the B/Ls can be delivered to the shipper.

These documents are signed by a Master with indications of a consignee who is an owner of goods until the delivery is completed and the title has been passed to the legal owner. Conditions of the transfer of the title are regulated in the sales contract and may be conditioned by the payment for the underlying cargo. Once the goods are shipped they remain in the custody of the carrier or Master who is contractually obliged to deliver them in sound condition, based on the principal charter party agreement

Under English Law, Bills of Lading has three main functions: r

- Receipt of goods
- Contract of carriage (evidence of the contract carriage between the shipper and carrier for transportation of goods)
- Document of title.

The receipt for shipped goods: As soon as the goods are loaded on board, they are under the custody of the carrier who is obliged to deliver them to the lawful holder of the B/L or persons who are entitled to the cargo. Under Hague-Visby Rules, Art. 3.3., the shipper will issue B/Ls stating the weight, quantity or number of bags, and the condition of the bags. The B/Ls must also indicate that the goods are shipped in “apparent order and good condition”. In the event that the goods are not in the condition stated in the Bs/L, or in the condition as they were received by the carrier

upon arrival to the port of discharge, the carrier will be liable for damage or deterioration of goods.

This function “of receipt of goods” requires more attention when the cargo is financed through a documentary letter of credit against a symbolic delivery, through endorsement of B/Ls to the bank. The B/Ls are pledged to the bank. If the bank discovers discrepancies between the stated contractual specifications and the text in the letter of credit, the bank will have the right to reject the Bs/L. It will also refuse to make any payment against the shipping documents (Wilson, 2010). Therefore, the shipper and the carrier both have to be diligent while entering the information related to the condition, quality and weight/quantity of goods.

The contract of carriage: This document is evidence that there is a contract of carriage for the underlying cargo. Usually, the contract of carriage between the shipper and the carrier has to be agreed before the signing of the B/L.

The contract of carriage has to be agreed upon terms and the shipper and carrier have to be aware of those terms. However, the shipper is entitled to change the terms of the contract if he does not agree with them, since the B/L serves as evidence of a contract rather than a contract of carriage itself 16 (Wilson, 2010 p. 130).

Charterparty B/L incorporates the terms of the Charterparty agreement made between the charterer of the vessel and the ship-owner. This kind of B/L is very common under FOB and CIF sales (Todd, 1990 p. 85). For instance, the B/L will indicate details about the Charterparty, such as: FREIGHT PAYABLE AS PER CHARTERPARTY, CHARTERPARTY BILL OF LADING.

It is important to distinguish between the parties to the sales contract and the parties to the Charterparty. Under CIF sales contract the party chartering the vessel would be the original party under the time or voyage Charterparty. The charterer/shipper will still need to have a B/L as acknowledgement of quantity and quantity of goods aboard. (Wilson, 2010 p. 6).

The seller will have a separate agreement with the carrier in the form of a Charterparty and the buyer will be able to use the B/L as evidence of the contract to deliver the goods (Baatz Yvonne, 2014 p. 97). In case if the goods are damaged in transit the buyer will have a right of suit against the carrier based on the B/L.

Under the FOB sales contract, when the goods are loaded free on board of the vessel, the buyer will be responsible for chartering the vessel. As a result, he will have a

Charterparty agreement with the carrier. The original contractual obligations of the buyer will be registered in the Charterparty regardless of the B/L (Baatz Yvonne, 2014 p. 97).

Document of title: A person who holds a B/L is entitled to the possession of cargo, because a B/L can be transferred during transit. For example, a voyage of a tanker from Rotterdam to Los Angeles typically takes 23 plus days. During this time, the cargo on board can be resold and the B/L has to be transferred to the new receiver (California Energy Commission, 2002). Therefore, the B/L is a negotiable and transferrable document that allows for the transfer of ownership rights for the cargo.

Wilson, In Carriage of Goods by Sea, describes that a B/L obtains the status of a contract of sale when it becomes a transferable document with wording “Made to order”. In order to qualify for a resale, it is necessary that the goods are still in transit, and not yet delivered to the buyer. The person who is indorsing the B/L should have ownership rights for the goods or to have a good title. Finally, when the indorsement is accomplished, the owner should have an intention to transfer the ownership of goods. (Wilson, 2010 p. 134).

A party holding documents of title under the Common Law has a right for a constructive possession over the underlying goods. When B/Ls are transferred from the pledger to the pledgee, a pledge of goods is created. The possession of the goods will pass with the transfer of B/Ls. As a custom, the supplier or the party selling the goods (pledger) is the one who will be responsible for pledging the goods to the confirming bank under the documentary letter of credit. The buyer won’t have a right to property over the goods before the payment is done. It is important that the B/Ls be made out to the order of the confirming bank, so that if the issuing bank does not reimburse the confirming bank for the value of the goods, the confirming bank can resell the goods. (Todd, 1990 p. 153)

In contrast to negotiable B/L, a “straight B/L” will indicate a name of designated person who will be taking a delivery of cargo. In this case, the B/L will not have a transferable feature and it will not be usable for financing of the underlying cargo.

2.4 Letters of Indemnity (LOIs).

The use of LOIs in modern maritime trade has become a common practice. LOIs are intended to facilitate operations. They are specifically applicable to oil trading due to the increased number of cargoes being transported by sea. Shipping documents such as B/Ls are issued in one original. Original B/Ls are often trapped in the contractual chain of buyers and financing banks.

In a nutshell, *“a LOI is contract between one party to keep the others harmless against loss”*. (Arizon, 2014 pp. location 677-679)

In the most cases neither traders nor ship-owners are willing to wait at the destination port for the arrival of the original Bs/L. Waiting time implies additional unnecessary costs such as demurrage. Waiting might also cause congestion at ports and disturb the commitments of ship-owners to other lined up contracts. So far, LOIs are the only practical solution to this problem. A LOI is considered as a request that is beyond the contractual obligation between parties. This means that the charterer will ask the carrier to perform an action that falls out of the framework of the contract of carriage. In practice, LOIs are issued in favor of a carrier by a shipper or a receiver of goods, depending who would be a charter of the vessel.

There are several types of LOI used in international maritime shipping “LOI against clean Bills of Lading” were common practice in the past.. Nowadays courts have established that issuing clean B/Ls might be classified as fraud.

The other four types of LOIs are very common for oil trading. Among them we distinguish maritime LOIs such as: “LOI against change of destination of a cargo”, “LOIs for discharge without a production of Bills of Lading”, “LOIs for comingling or blending cargo on the board of vessel”.

LOIs in oil shipping are much more straight forward. They are less formal and often made through emails. In return, LOIs for soft commodities require a formal letter written on the letterhead with the stamp from the management and relevant signatures. Several bankers have confirmed that most of their communication is based on email conversations, nowadays.

LOI for payment is a type of warranty used by traders; it is delivered by a seller in favor of the buyer in order to make a payment. This type of LOI involves the bank, contractual parties and does not include a carrier.

The terms of LOI are generally fixed by the P&I Clubs (Protection and Indemnity Insurance Clubs) and neither shippers nor receivers have the right to change them. All the claims against third parties should be settled via providing a carrier with financial support to defend the claim against other parties. (Shepherd, 2011). In other words, the claim to a third person will be settled by carrier who will be provided sufficient financial resources to respond to such a claim. P&I clubs play an important role in the shipping industry. They have the right to impose certain rules on their clients in order to protect their members. The main goal of such clubs is to “pool and share the risks” (Baatz Yvonne, 2014 p. 460).

These clubs are mainly controlled by ship owners, and were created as an instrument to make up for the shortages of the British marine insurance system. P&I clubs cover the liabilities of ship-owners towards third parties. In general terms, protection coverage is mainly provided for liabilities to the personnel and damage to the property. In cases where the personnel have been injured, needs to be repatriated or dead. The indemnity clauses cover the liabilities towards the owners of the cargo which are fixed through a contract of carriage (Baatz Yvonne, 2014 p. 458). Such liabilities might include damage to the cargo during the sea voyage, loading, carrying or handling process. Although, the risks covered by clubs vary based on their internal rules, the standard coverage is established by the Board and can be easily accessible on the websites of the P&I clubs.

P&I clubs have been extremely careful in situations where they are requested to accept LOIs. This is because they are excluded from the standard insurance coverage agreed by the Board of by P&I clubs. These rules include specific risk exceptions under LOIs. For instance, no right to recovery for any costs for:

- issuing a B/L with an incorrect description/quantity of goods;
- issuing anti dated or post-dated B/L;
- delivery of the cargo without production of B/L;
- delivery to the other party than the one identified in the non-negotiable transport document; (The Standard, P&I Club, 2015 p. 9)

2.4.1. LOIs against Clean Bills of Lading

According to maritime practice, B/L are issued once the commodity passes under the responsibility of a carrier. This means that the delivery has been completed and the goods are ready to be shipped in apparent condition and order.

A B/L, in principle should reflect the condition, the quantity and the nature of cargo that is loaded on board of the vessel. If Master is asked to sign a clean B/L knowing that the

goods are damaged, he has committed fraud. One of the conditions of obtaining a payment for goods from the bank is presenting a clean shipped B/L. The charterer will issue a LOI to the owner in return for issuing a clean B/L.

This type of LOI involves an arrangement between a charterer and the ship. Under CIF terms they should have a formalized contractual relationship through a Charterparty agreement. When the Master signs a clean B/L the shipper will eliminate a risk of discrepancies of representations of B/L to the financing bank. Thus, he can promptly receive his payment under a documentary letter of credit. As result, this transaction opens doors too many other risks that might appear if the cargo is not compliant with the contractual specifications, i.e. is damaged or contaminated.

Under the CIF terms, the cost, insurance and freight are paid by the shipper of the goods. The shipper will have a Charterparty agreement for chartering a vessel with the ship owner. Therefore, the shipper/charterer will be the party issuing a LOI for Clean B/L in the favor of the ship-owner. As the receiver has no contractual relationship with the ship-owner/carrier he will be excluded from the transaction and will not be aware of such arrangements between the Master and the shipper. This is especially true when the goods are loaded in non-apparent good condition.

When LOI against Clean B/L is issued, the buyer will not be able to claim liability for damaged goods from the shipper since the B/L would not be claused and the goods will be considered as shipped clean on board. All the parties involved in a string trade will find themselves in the situation with goods in non-compliant condition. Also the buyer will not be aware of the arrangement between the shipmaster and the seller, therefore he will have no rights to suit against the carrier since the B/L were issued for clean shipped cargo.

2.4.2. LOIs against change of destination of cargo.

Since the B/L is an evidence of contract of carriage, the carrier is obliged to deliver the goods to the port that is stated in the B/L (Arizon, 2014). The oil cargos might be resold multiple times in transit. Once the oil is loaded and the B/Ls are issued it might happen that the charterer will request a change of port of destination from the Master. Such situations are frequent in voyage Charterparties where the carrier will or will not accept to deliver cargo to a new port. Such cases require a special attention from carriers because the original set of B/Ls would have been already sent to initial port of destination, or to the initial buyer in the string of contract. The carrier will be exposed to

the risk that the original parties who will receive original B/Ls could claim the cargo from the carrier. Therefore, if the original B/Ls are not returned to the carrier, the carrier is risking reimbursing the value of the cargo and other related claims to the original holders of the Bs/L. Subsequently, he will make a call under LOI given to him by the charterer. So, the charterer will become liable under his LOI.

By changing the original destination of the cargo, the carrier will be in the breach of contract of carriage. Since the destination port is printed on the face of the B/L, the change of destination is considered as a breach of contract by the Master. As result, parties having title to the cargo can lawfully claim it at the new port of discharge.

LOIs for changes of destination of cargo are often used with LOIs for discharge of cargo without the presentation of the original B/L

2.4.3. LOIs for adding additive to the cargo/Blending cargoes.

Blending is a common practice in oil trading that allows obtaining a new product by adding additive to the cargo, or by modifying the existing cargo. This helps match a product to the market requirements and can be done on short notice on board the vessel. The reasons behind the blending could be different. One of these reasons includes the legal requirement for specific cargoes to comply with regulations of the countries or the buyer. (Skeet, 2011). In string trading traders might like to modify the existing cargo to sell it to another buyer with new contractual specifications. However, this requires substantial infrastructure on the shore such as blending and storage equipment that cannot be available to small suppliers. Blending on board of the vessel saves time for the trader if he needs to produce a specific blend. Instead of sourcing for two products from the same destination, he will be able to load one product, acquire another one from different destination and to blend them together aboard. Thus, he saves time and cost of the freight because the operation can be done while vessel is on the way to the buyer. It also optimizes the storage options because by blending, traders create only a required quantity of a specific cargo which will be shortly resold.

Physical blending of cargo on the board of the vessel happens with the help of pumps and pipes and the sea movement to blend the cargo. (Guard, 2014). Although, the physical blending of cargoes during the sea is prohibited in order to preserve the marine life due to the insecurity of the operation, the blending within the limits of ports can be authorized. The P&I covers do not have coverage in case of any claims from the shipper or the receiver. (Guard, 2014).

Usually, the blending will not be allowed if it has not been previously agreed in the Charterparty. All the blending costs are done on the account of the charterer.

There are several possible operational risks and legal risks that might occur while blending cargoes on board of the vessel. For instance, B/L at loading will contain contractual specifications of the cargo, as the blending relies on the motion of the vessel and the ships pumps, it could occur that once the cargo arrives at the destination port, it might not be compliant with contract specifications. For example, it might not have blended well and could turn out non-homogeneous. In this case, the seller will not be able to obtain the payment and the cargo will be rejected by the buyer and the financing bank. (Skeet, 2011). Another problem that might arise, is that since the cargoes are sourced from different destinations there could be a problem with dates of shipping on the Bs/L. Shipping dates on the B/Ls are crucial element for pricing of oil, as the price is usually calculated on the basis of B/L dates.

Sometimes the blending onboard of the vessel may be agreed in the sales contract between the buyer and the seller. (Skeet, 2011). This puts extra risks on the seller/charter under the CIF/CFR because he will be obliged to incur all of the risk and costs for the product that is tailor made to a specific customer. In case the seller doesn't manage to obtain a contractual product from the blending, he will be in the breach of contractual obligation himself. It is important to obtain some type of written guarantee from a buyer, stating that he will indemnify the seller against the discrepancies in the B/L with a physical product (Skeet, 2011). Carriers and ship-owners also get LOIs from the seller, which state that in case of unsuccessful blending the seller will indemnify them against any claims and costs that will arise in connection to this cargo. However, a LOI from a buyer doesn't protect a seller if the buyer becomes insolvent. The shipper will have to incur all the costs for blending and maybe sell his cargo at discounted price.

2.4.4. LOIs for payment.

It is important to point out that the LOI for payment is not a maritime LOI. It is tool that facilitates the payment in case the B/Ls are not available at the bank and the payment to the seller is due. The main difference of such LOI from the rest described above is that this LOI is issued by a seller in favor of buyer and not in favor of the ship-owner. In such cases payments are executed by the bank against the seller's commercial invoice and the LOI for payment, on behalf of the seller. The text of documentary letter of credit

has to include a provision for such LOI. It is important to note that such document would not replace a B/L and would not serve as collateral for the bank, either.

This is a relatively new instrument and it is extensively used by all commodity trading banks in Geneva. Being delivered to the buyer, the text of LOI for payment states that the seller has *“a marketable title free and clear of any lien or encumbrance to the oil”*. When the B/Ls become available, the seller has an obligation to surrender the original B/Ls to the buyer as soon as possible. Bankers consider this LOI as relatively safe instrument for payment, especially in deals concluded under the FOB terms when the cargo has been under the control of the buyer on the vessel chartered by him for several days. It gives the bank more security that the cargo will not be delivered to the wrong person. In such cases the LOI for payment is a secure instrument of payment. The text of LOI for payment can be found in the **APPENDIX 3**.

The topic of risks stemming from accepting LOI for payment under letters of credit could be another research topic, but to review the complexity of such transactions please refer to the legal case in the last part of the project: “Trafigura v Kookmin Bank”

2.4.5. LOIs for discharge without presentation of original Bill of Lading at the discharge port

LOIs issued for discharge of cargoes without presentation of original B/L are the most widespread documents in the oil trading. For this reason, this project will concentrate on the analysis of this type of indemnity. As it has been mentioned earlier, one of the principal features of B/L, is that it is a document of title that should be transferred to the lawful holder of the good. The Master, therefore, is obliged to deliver the goods to the holder of B/L. Although, when the B/Ls are not in the possession of the person taking a delivery of goods, the traders often arrange with a carrier to accept a LOI to allow the discharge of goods to the receiver at the destination port. Depending on the terms of the sales contract either a shipper or a final receiver will emit a LOI to the carrier. The carrier will agree to accept the LOI and allow a discharge of the cargo. In case if the cargo was delivered to the wrong party, the original holder of B/Ls will have a legitimate claim against the carrier under the Common Law. Then, the carrier will make a call under charterer's LOI.

Discharge of cargo without presentation of B/L, in the first place concerns the problem of ownership for the underlying cargo. By issuing a LOI traders, in principle, override the presentation rule under the document of title.

Risks: It is generally suggested that before issuing any LOI a trader has to be confident that he will be paid. There were situations where the bank found discrepancies in documents which prevented effecting a payment. (Shepherd, 2011). In this situation, the seller will have to look for another buyer while incurring additional costs or selling the cargo for a lower price. When the cargo is financed by a documentary letter of credit, the bank will have an interest in securing its financial exposure. LOIs do not have attributes of a B/L as of document of title. In fact, they are not considered as document of title and not accepted by banks as collateral. The buyer in turn might have other contractual obligations for the cargo, such as agreements with refineries, or selling it further down to another country which is not accessible by sea.

When B/Ls are pledged as collateral under the documentary letter of credit, a bank has the right to retain them if it finds out that its clients is not able to reimburse the credit for the underlying transaction. Since the cargo perhaps was already resold by the receiver, the bank will not be physically able to seize the cargo. In this case, the bank has a right to go to claim a delivery under the B/L from the ship-owner. Besides, having received a payment for the cargo, the seller will be accountable for entering in separate agreement with the carrier under LOI: (Shepherd, 2011).

As INCOTERMS regulate the terms of sales contracts, the FOB and CIF contracts have different contractual instructions for each party.

CIF terms foresee the payment of cost insurance and freight by the shipper who, simultaneously will be the charterer of the vessel. The LOI will be delivered to the ship-owner with instructions to discharge the cargo to the designated receiver by the charterer in the text of the LOI.

Regarding the FOB contracts, the shipper will release the goods free on board of the vessel. Under these terms the buyer of the cargo will contract the vessel on his charge. His contractual relation will be formally identified in a Charterparty. In FOB contracts the buyer will be the one issuing and delivering an LOI to the Master of the vessel. The seller will have no role in this transaction. In this case issuing LOI by a receiver would be considered less risky because the goods would be already under the control of the receiver or his agents. The risk of misdelivery of the cargo will be minimized.

2.5 Legal status and enforceability of LOIs

2.6.1. Common Law

Countries following doctrine of Common Law, such as Great Britain and its former colonies, are known for having based their legal systems on uncoded legislative decisions, known as precedents. In recent years, the England and Wales High Court have heard a variety of cases related to the enforceability and effects of LOIs. England's and Wales High Commercial Court Decisions Database "Baillii" returns over 500 search results of judicial cases containing key words "Letter of Indemnity". Several of the cases will be analyzed in the "Discussion" part of the project.

Often, LOIs at discharge are called "letters of guarantee" (Tetley, 2004) but English courts refer to such letters as to "Letters of Indemnity". The format of LOIs is standardized, and they usually contain a provision under which they will be governed and constructed under English Law.

The term of "Contract of Indemnity" in English law is seen as:

"A primary obligation of one party is to make good for loss suffered by another party. That obligation may not be the consequence of a contract at all, but may instead be based on some other legal principle and arise by operation of law. For these purposes, a contract of indemnity is a contract between a promisor (the indemnifier) and a creditor who is owed money by a third party (the principal debtor)". (Bamford, 2015 pp. 6962-6963)

The LOIs are issued as a promise to indemnify the creditor, in the contrary to the contracts of guarantee, which are the contracts that promise the creditor to be responsible for the future performance of the principal debtor (Bamford, 2015 pp. 6981-6984).

As it has been mentioned earlier, the delivery of cargo without a presentation of B/Ls is considered as a breach of contract under the English law based on "Bill of Lading Act 1855" which was later replaced by "Carriage of Goods by Sea Act 1924":

"The master is justified in delivering the goods to the consignee named in the bill of lading on production of it, or to the first person who presents a properly indorsed bill of lading, provided the master has no notice of dealings with other sets" (Ivamy, 1989 p. 164)

Regarding enforceability of LOI under the English Law, it is clearly stated that that if the Master is asked to sign a B/L which represents different statements then the actual description of the condition of cargo, this situation would be considered as third party

fraud. When a Master has a slight suspicion that the goods are not in the required condition he should restrain from accepting a LOI from the charterer.

The most famous case of non-enforceability of LOI was a case of “*Brown Jenkinson and Co Limited v Percy Dalton (London) Limited*”; CA 1957. A clean B/L was issued by a Master in exchange for a LOI from the charterer. Defendants, as charterers and shippers sold 100 barrels of orange juice which was carried on board of the vessel belonging to Brown Jenkinson (owners). At the time of loading agents of Brown Jenkinson noticed that the barrels in which the orange juice was carried were damaged and old. However, the shippers convinced the Master to sign a clean B/L, stating that the goods were shipped in apparent good order and condition, in return for a LOI. When the vessel arrived to a destination port in Hamburg, the buyers claimed the damages for the cargo which were settled by the owners. (Dockray, 2004 p. 97). The defendants claimed that the basis of the claim under LOI was illegal because the owners knew that the goods were damaged. The appeal case was rejected and the LOI was found to be non-enforceable. According to Arizon and Semark, this court decision influenced a perception among ship-owners that the LOI are not enforceable in majority of cases. This resulted in condoning of LOIs and imposing stricter terms on the traders. It increased the in confusion between the enforceability and unenforceability of LOIs in the industry. (Arizon, 2014 p. location 707). Up to now, the English court decisions on the status of enforceability of LOIs were largely based on the circumstances of each case.

2.6.2. Civil Law

In countries where the Civil Law dominates the legal system, the law has established various legal texts regulating the liabilities of ship-owners and other parties under LOIs which in French legislature referred as to letters of guarantee (Tetley, 2004 p. 24).

In France, the Law No. 66-420² entered in force in June 18, 1966 describes several situations related to LOI. It is a separate and individual contract from the contract of carriage. In cases where the ship-owners deliver the goods without the B/L and in exchange for a LOI, they will be liable against other holders of original B/L. According to the Article 20 the LOI's issued by the shipper to the carrier who has accepted to deliver the goods without a B/L will be considered null and void in case if the third party claims arise. This means the carrier will be the only one liable against third parties

² Loi n° 66-420 du 18 juin 1966 sur les contrats d'affrètement et de transport maritimes

(such as endorsees, financing banks, or cargo underwriters). Nevertheless, the carrier might have a claim against a shipper who issued a LOI. (Tetley, 2004 p. 24)

Chinese jurisdiction: As China is a home for major container ports in the world, the cases arising from the delivery of goods without the presentation of B/L are very frequent. Over 90% of cases that were heard before the Shanghai Maritime Court in the year 2000 concerned the delivery of goods without original Bs/L. The Chinese judicial system has not explained its position regarding the delivery of goods without a B/L (Han, 2008).

It is customary to follow the principle that the under the contract of carriage goods have to be released to the lawful holder of original B/L. In practice, the goods are released with presentation of one original of B/L. In a case of a claim, in order to prove its title to the goods the claimant has to present a full set of original B/L in the court. (Tong, 2008). Not all the cases in China involve issuance of LOIs', sometimes the seller and buyer override the presentation rule in the sales contract. However, the judges have not come to a common conclusion regarding the effects of LOI and often refrain from enforcing their effects. As LOIs do not undermine liabilities of a carrier to deliver the goods to the lawful holder. (Zou, 2005).

2.6.3. Hague Rules and Hague Visby Rules

The Hague Rules were originally adopted in Brussels in 1924 during the "International Convention for Unification of Certain Rules Relating to Bills of Lading". This convention was the first international convention regulating terms of Bs/L. The Hague Rules were conceived to force ship-owners to take some sort of liability for the cargoes they were transporting. For instance, even a negligence clause was excluded from the liability of the ship-owner under the English Law those days. (Reynolds, 1990). At that time, the B/Ls did not have an unified form and it was difficult to deal with multitude of various versions of B/Ls for financing banks or for parties making claims under them. By the adoption of Hague Rules the risk allocation between ship-owner and the cargo owners became better distributed. The owners were prescribed to provide sea worthiness of the vessel and due diligence and care for the cargo.

The Hague Rules were later amended by new rules to curb defects to become Hague Visby Rules in 1968. The Hague Visby Rules were ratified by over than 80 countries.

The geographical scope of Hague Visby Rules includes the application of B/Ls to a contacting state. In order to be governed by Hague Visby Rules, either the B/L should

be issued from the contracting state or the port of loading should be located in the contracting state. Consequently, it excludes shipments from the loading ports of non-contracting states to contracting states' discharge ports. (A Comparative Analysis of the Hague Visby Rule, the Hambourg Rules and Rotterdam Rules, 2009 p. 46).

Regarding the documents of transport, under the Hague Visby Rules the carrier must issue a B/L as a document of title. Hague Visby Rules exclude Charterparties as contracts of carriage. The only contract of carriage covered under these rules is a B/L. There is no mention of the effect of LOI as of document of title in the Hague Visby Rules. However, the Article No.3 rule 5 stipulates:

“Shipper shall be deemed to have guaranteed the carrier the accuracy at the time of shipment of marks, number quantity and weight, as furnished by him, and the shipper will indemnify the carrier against all loss, damages and expenses arising or resulting from inaccuracies in such particulars. The rights of the carrier to such indemnity shall in no way limit his responsibility and liability under the contract of carriage to any person other than the shipper “.

The carrier will have a right for indemnity from the shipper if the information provided by the shipper was inaccurate and if the carrier had to succumb to damages, or financial loss as result of these errors. As we can observe this provision does not mention statements about the condition of the cargo and the carrier. Additionally, there is no mention of indemnity related to the B/L as to the title document.

2.6.4. Hamburg Rules

The Hamburg rules were adopted during the United Nations Organizations conference on the carriage of goods in Hamburg in 1978. So far they have not been adopted by major maritime countries. Countries, having ratified the Hamburg Rules (34 countries) represent 5% of all world trade. Hamburg Rules face strong opposition from ship-owners clubs and are therefore are not fully integrated in the International trade system (Wilson, 2010 p. 227). The Hamburg Rules have a wider scope of application; they apply to cargoes during the whole period from the loading, carriage and discharge.

In terms of geographical scope, either the discharge or loading ports should be located in contracting state, the B/L is issued in contracting state (Berlingieri 2009). Although, they do not regulate any Charterparty agreements like Hague Visby rules.

Hamburg Rules have the same provision for letters of guarantee or LOIs in the Article No.17, rule 2, as in Hague Visby Rules.

“Any letter of guarantee or agreement by which the shipper undertakes to indemnify the carrier against loss resulting from the issuance of the bill of lading by the carrier, or by a person acting on his behalf, without entering a reservation relating to particulars furnished by the shipper for insertion in the bill of lading, or to the apparent condition of the goods, is void and of no effect as against any third party, including a consignee, to whom the bill of lading has been transferred.”

The meaning of article gives rise the issuance of clean B/L under which the shipper undertakes to indemnify the carrier for any insertion made in the B/L. The carrier will not be able to make a call under this LOI in case if he issued a clean B/L to defraud a third party, i.e. receiver. (Wilson, 2010 p. 223).Article No.17 rule 3 states that, *“although the LOI against the shipper will be valid if it is signed in case if the clean B/L was issued in faith that the goods were in prescribed condition “.*

As we can observe the Article 18, reflects the position on the function of B/L as of document confirming apparent good condition of goods Hamburg rules also do not mention any other transport document that can be replaced or substituted for the document of title.

2.6.5. Rotterdam Rules

Rotterdam Rules are the modern solution to the issues resulting from the international maritime trade. Rotterdam rules have a contractual approach since international trade today has to cover the entire contract of carriage on door -to -door basis. (Zieger, 2013).Rotterdam rules were elaborated by the United Nations in collaboration with *Comité International Maritime*. Other international organizations such as BIMCO; ICC and have also taken part in drawing of rules. Signing for this Convention has been open from 2009 in New York in Headquarters of the United Nations Organization. The door-to-door basis is explained as a final place of delivery of goods. (Bonner,Patrick and others, n/a).

The innovational aspect of Rotterdam Rules related to the fact that they are dealing with the delivery of goods at the destination port. (Ziegler, 2013).Another novelty introduced in this Convention is the inclusion of electronic bills of lading as negotiable documents.

The convention foresees occasions where the B/Ls are not available at the discharge port. The, Article 47, rule 2 deals with a delivery when negotiable documents or electronic records are not available at the destination port and the transport document

expressly states that the goods maybe delivered without the surrender of the negotiable document there are two conditions that have to be met.

Besides being highly controversial the Article 47, rule 2, causes a lot of debates in the industry. Its sense is unclear and the language is permissive. Although, according to Yvonne Baatz, the holder of negotiable document should, firstly, possess the right to negotiable bill and should present it for the delivery to the carrier. Secondly, the holder is also has an obligation of identifying himself as a holder of negotiable bill. Therefore, the negotiable shipping documents have to be only presented but not surrendered to the carrier. *"Thus interpreted Article 47(2) would present little challenge to English lawyers: they would need to be presented but not surrendered"* (Baatz, 2013 p. 146).

Other authors argue that this article should be removed from the Rotterdam Rules due to controversies in its construction.

3. Discussion: Practical solutions for risk mitigation under discharge LOIs

3.1 Owners' position regarding LOIs

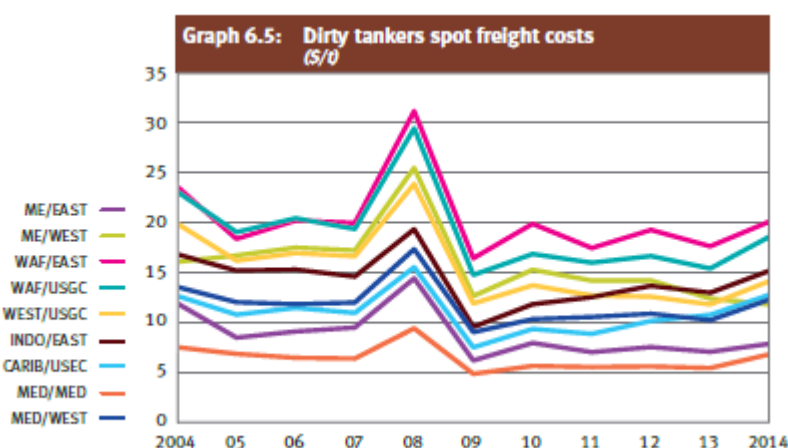
3.1.1. Protection and Indemnity clubs position regarding LOIs.

In case of a breaching a contract of carriage the losing parties are most often the carrier and ship-owners. In order to protect parties most vulnerable to breach ship-owners often take part of Protection and Indemnity Clubs (P&I) – created to defend interests of ship-owners. P&I Clubs strongly recommend their members to avoid making a delivery without a B/L whenever possible. – As a rule, LOIs are not covered by P&I clubs' insurance policies. As result, if a LOI is not enforceable - carriers who discharge cargoes without proper presentation of a B/L may be forced to reimburse the value of a cargo to the claimants. Standard practice is for P&I clubs to ask the ship-owners when delivering without a B/L to obtain a standardized LOI. In most cases, the wording of a LOIs is non-negotiable and the terms are unalterable. The party issuing the LOI will be determined under the contractual relationship with the owner. The party chartering the vessel will have the right to issue a LOI in the favor of the ship-owner. Such party shall undertake to make good against any claims from the third-parties (receivers, consignees, and financing banks). Additionally, the LOI has to clearly identify the party to whom the goods should be delivered. The scope of LOI should also be as large as possible, in order to cover from any possible claims and to protect from unexpected situations.

Oftentimes, ship-owners request the charterers to countersign their LOIs by first-class banks. In order to increase security coverage to owners, over time P&I clubs have developed multiple guidelines reigning LOIs. More recently, the countersignature of the LOIs by banks is becoming less common- the majority of traders prefer to bypass banks and to deal directly with the carrier. Further explanation and detail on the countersigned guarantees will be covered in “Banks perspectives on LOIs for discharge”.

Most importantly, the P&I clubs advise their members to pay attention to the terms of LOI, *“to the party who is making this request and if the party who is making this request has an authority to signor of the LOI and enforceability of the LOI”* (Souli, 2014).

Figure 7: Dirty Tankers Spot Freight Cost in \$/T



Source: (OPEC, 2015 p. 71)

As the shipping rates are relatively low in most cases ship-owners do not have a negotiating power to insist on banks to countersign the LOIs.

In cases where a claim under an LOI presents itself, the owners will fix an amount of the claim, having justified it by supporting documents and official statements of evaluation of damages confirmed by experts.

Charterparty clauses providing for LOI. As traders adapt to an evolving market place, some Charterparties have provisions foreseeing the discharge of good without presentation of B/L (Arizon, 2014 p. location 692). Charterparty and the LOI terms can differ depending on the transaction increasing the risks and potentially liabilities for ship-owners. If the Charterparty has a clause of LOI then the Master will be obliged to accept an LOI and comply with the instructions of the charterer. The Master must then discharge the goods without the presentation of B/Ls to the persons indicated in the LOI

3.1.2. Case study: Farenco Shipping Co. Ltd. v Daebo Shipping Co. Ltd. (Bremen Max) –Baillii [2008] EWHC 2755

The Farenco v Daebo Shipping Co. case demonstrates the types of complications arising from delivery of goods against a LOI issued in the chain of sub-charterers. It is a case where the Charterparty had a clause permitting LOI under which the Master was obliged to deliver the goods. Besides having been issued in accordance with the guidance of P&I clubs the LOI's construction was not able to provide the owners with

sufficient coverage. Therefore, the court found that the charterers were not liable under their LOI since the owners delivered the cargo to the wrong party.

Cargo: 70'888 metric tons of Brazilian origin Sinter Feed

Loading port: Tubarao, Brazil

Discharge port: Bourgas, Bulgaria.

Notify party: G an M-5 (agents) and Kremikovtzi AD Sofia, Botunetz.

Consigned bank: to the order of HSH Nordbank AG London.

Vessel: Bremen Max bulk carrier of 73,500 dwt.

Claimants: Farenco Shipping Co. Ltd

Defendants: Daebo Shipping Co. Ltd.

Shipper: Companhia Vale do Rio Doce

Facts: The owners of the vessel Bremen Max are Pavey Services Ltd. The vessel was chartered by its owners first to COSCO Bulk Carrier Co. Ltd and then sub-chartered on back-to-back charters to Farenco Shipping Co. Ltd (the claimants under this case). Norden and Deilemar Shipping are respectively the third and the fourth parties to this case. Dieulemar was the last charterer under CIF sale contract who issued a final LOI for delivery to Kremikovtzi

The case revolves around the B/Ls which were not available at the port of discharge by the time the vessel "Bremen Max" arrived from Brazil to Bourgas in late March 2008. The cargo was discharged under the charterers' LOI at Bourgas and afterwards it was discovered that the cargo was not delivered to the party indicated in the LOI Kremikovtzi. The whereabouts of that cargo were unknown at the time of the hearing.

The case is complicated by the fact that there were several Charterparties due to multiple number of sub-charters, each sub-charterer had its disponent owner at the time. The chain of sub-charterers presented itself as following: Pavey Service (owners) → Cosco (disponent owner of Farenco) → Farenco (disponent owner of Daebo) → Daebo (disponent owner of Norden) → Norden (disponent owner of Daelium) → Daelium (final charterer).

Each Charterparty had a clause regarding the release of goods against Charterers' LOI according to wording of the Owner's P&I club's recommendations. The wording contained the following:

"In case original Bills of Lading are not available at discharge port(s), Master/Owners to allow discharge and release the cargo on board against Charterers single Letter of Indemnity signed by Charterers only with wording as per Owners' Protection and Indemnity Club recommendation" (BAILII:[2008] EWHC 2755, 2008 p. [4])

Consequently, each charterer provided a LOI to his disponent owner. Farenco were delivering the LOI to their disponent owner Cosco.

Stemcor UK Ltd was most likely one of the string buyers, who reappeared in July 29th 2008, declaring that they were the holders of original B/Ls and asked for the delivery of the cargo from the owners. The Owners (Pavey Services Ltd) made a call under the LOI issued by Cosco who were the first sub-charterers in line, and the other sub-charterers were informed about this issue and asked to arrange for a security deposit for the vessel. Owners asked Cosco to put in security guarantee in the favour of owners in the framework of its LOI. However, when Bremen Max arrived in Australia on of August 20th 2008, the vessel got arrested by Stemcor, due to the fact that there was no security provided either by Cosco or other sub charterers to the owners account. None of the charterers honoured their liabilities under their LOIs. In order to release the vessel the owners Pavey Services arranged for a guarantee of USD 11 mio. In return, the owners obtained a "Rule B Maritime "3 allowing owners to seize USD 11 mio from Cosco's account.

Farenco, one of the sub-charters was aware that it would be impossible to recover financially if Cosco managed to obtain the same ruling on their accounts, so they managed to obtain cash for the amount of USD 11 mio in favour of Stemcor and USD 500'000 in the favour of the owners. The cash was secured under escrow account with HFW solicitors.

As a result Farenco who was the second charterer (and a disponent owner of Daebo) in the line, started the judicial proceeding against the Daebo (the third sub-charterer). Daebo in turn started the same process against Norden (the fourth sub-charterer).

Issue: Overall, there were three issues that were evoked during the proceeding but we will analyse the "Issue No. 3" that is specifically related to the delivery of goods without production of Bs/L. The issue is formulated as following:

"Whether the undertakings provided are conditional upon delivery to Kremikovitzi?"

³ Rule B Maritime Attachment is a claim that may be obtained directly from the debtor and against the ship or cargo. It is especially valid when the debtor is nonresident in the country by obtaining "Rule B the claimant is ensuring that the debtor will participate in judicial proceedings. It is used to seize funds on bank accounts of the debtor (Steamship Mutual , 201)

Farenco did not have a case directly against Daelium and had already deposited cash at escrow account, it attacked the sub-charterer Daebo. Farenco had signed a prior Charterparty agreement with Daelium which facilitated the case.

Farenco argued that its responsibility as disponent owner to release the cargo to its sub-charterers and in turn the sub-charterer would deliver it to the receiver at Kremikovtzi. The judge hearing the case rejected the charge countering that “*delivery is done by the ship-owner who has the cargo in his possession. Discharge is a different concept, which means a movement of the cargo from the ship ashore.*” (BAILII:[2008] EWHC 2755, 2008 pp. [32]-[33])

Judgement: The judge upheld that it was the owner’s obligation to deliver the goods to the named party in the LOI, as Dalieum (the shipper/charterer) had clearly named Kremikovtzi as the receiver. It is the owner’s responsibility to know that delivery of goods is made to the correct party (as per instruction of charterer). In summary, the judge ruled that their disponent owner didn’t follow the instructions of the charterer, and the “issue No.3” was resolved in the favour of Dalieum. The charterer’s LOI was non-enforceable, as the cargo was delivered to the wrong party.

3.1.3. Case Study: Projector SA v Marubeni International Petroleum (S) Pte. Ltd (No 3) [2005] SGSA 5,2005

The given case is an Appeal Case from Projector SA to the decision of High Court of Singapore claiming to:

“to lift unconditionally an ex parte interim mandatory injunction (“IMI”) granted against the appellant; and to order an inquiry as to damages suffered by the appellant on account of the grant of the IMI. (COMMONLII:[2005] SGCA 5, 2005 p. [1])

Projector SA as an issuer of charterer’s LOI for discharge without Bs/L, failed to comply with its liabilities which resulted in arrest of the owner’s vessel. The court dismissed the appeal and ordered that the Projector SA had to honour its obligations under its LOI.

Appellant: Projector SA(Belize) & Singapore

Respondent: Marubeni International Petroleum (Japan)

Owners: Mitsui OSK Lines Ltd

Cargo: Gas oil

Loading port: Taiwan

Discharge port: Kunsu, South Korea

Vessel: Dynamic Express

Receivers: Petaco Petroleum

Facts: Projector sub-chartered the vessel from Marubeni under the voyage Charterparty, Marubeni, in turn chartered the Dynamic Express from owner Mitsui OSK Lines Ltd (Mitsui) under the time charter. The Charterparty foresaw a clause for non-availability of B/Ls at the port of destination of the cargo. It stipulated that the cargo had to be released against Charterer's LOI. Therefore, Projector delivered a LOI to his disponent owner (Marubeni).

The argument brought up by the Projector's disponent owners, stated that the Projector failed to secure the bail to prevent the arrest of the vessel. In accordance with the Clauses 4 and 5 of the LOI, Projector had to:

"to provide bail or security that may be required to prevent such arrest or detention or to secure the release of such arrest or detention whether or not the same may be justified" (COMMONLII:[2005] SGCA 5, 2005 p. [4])

Sale contract was most likely concluded on C&F terms, due to the fact that Projector was the charterer of the vessel. Consequently, 4 original B/Ls were issued upon the completion of loading and their whereabouts were not known to the charterer.

On November 24th, 2003, the bank arrested the vessel based on the claim that they were holders of two sets of original Bs/L. As, there were no indications about the role of this banks in the transaction, they were, presumably, the financing bank of the receiver.

Owners obtained an ex parte ⁴ interim mandatory injunction (IMI) against Projector to pay a sum of USD 1,125,981.32 and USD 1,509,011.67 to the South Korean court in order to allow the release of vessel.

Marubeni's lawyers argued that Projector, regardless of knowing about upcoming arrest of the vessel and their obligations under their LOI, had not taken any action to prevent the retention of vessel by the bank.

In the meantime, on November 4th, 2003, the receiver of the cargo (Petaco Petroleum) was declared insolvent and the Shin Han Bank announced that it was the holder of B/Ls and demanded the delivery of cargo or a payment. (COMMONLII:[2005] SGCA 5, 2005 p. [16]). Assuming that the receivers, perhaps, have not reimbursed their credit to the financing banks, the bank had the right to arrest the cargo as legitimate holder of Bs/L.

⁴ In the presence of one party," is used to refer to motions for orders that can be granted without waiting for a response from the other side" (Cornell, n/a)

Projector insisted that it had honored its obligations under its LOI by putting up the security to Korean Bank. It pointed out that the cash deposit was made under its liability stemming from LOI, in no means against the injunction obtained by the owners for the retention of the vessel. Projector was also claiming restitution for damages suffered in connection to the injunction. (COMMONLII:[2005] SGCA 5, 2005 p. [13])

Judgement: The judge dismissed the appeal by ruling that Projector entirely overlooked the object of LOI. Projector had to suffer all accrued costs resulting from the retention of the ship and court injunction.

As there is no mention of back to back LOI, issued by the receiver, the charterer was the only party, who exposed itself without taking into consideration the possible default on payment from his buyer. Although, having obtained a back to back LOI would not have improved the situation of the charterer, as the receivers clearly did not have any funds to honor their contractual obligations. Therefore, the Projector was obliged to assume all financial costs related to the retention of the vessel. It was unknown, if the Projector had received a payment from the receiver's bank under presumed letter of credit. Otherwise, Projector would have to suffer the loss of the value cargo, as well.

To summarize the present case, Projector SA was one of the big oil trading companies founded in 1992 in Belize, by Jonathan Kollek former executive employee of Marc Rich & Co. (Blas, 2010). However, Projector went through liquidation in 2008. In December, 2008 High Court of Singapore ruled on another case in relation to Projector SA (Re Projector SA - [2008] SGHC 234, 12nd, December 2008). ING Belgium and ING Geneva, submitted a claim for winding up of Projector SA which was registered as foreign company in Singapore. The claim was opposed by two Projector SA, "creditors", Mitsui group (same owner as in previous case) and Samsung Total Petrochemical Co Ltd. Who had time-chartered three vessel and one of them Morning Express, being retained by ING.

Interestingly enough, that the origin of this court case rests with a LOI that was delivered to the owner of Morning Express, Mitsui by Projector SA. The terms of the LOI were exactly the same as in previous case, i.e. the carriers were obliged to put up a security for the release of cargo. Projector's transaction for the sale of gas oil and naphtha was financed by ING bank and its subsidiary, who turned to be holders of original Bs/L. Since, Projector did not pay under its letter of credit, the vessel was arrested by the bank on the 30th May, 2008. By the time of the court hearing, the amount requested for the release of the vessel reached USD 69 mio. with interests.

Projector, revoking serious financial problems was not able to provide such security for owners. Nevertheless, ING insisted on dissolution of the company, in a hope of benefiting from the proceeds of liquidation as a lawful creditor. Mitsui and Samsung opposed the dissolution, perhaps due to the fact that a LOI would not give them same property rights, as those vested in the ING as in the holders of Bs/L. Owners were referred to as “unsecured creditors” :*An unsecured creditor of an insolvent company should not be allowed to retain the benefit of a garnishee order*” (CommonLii., 2008 p. [46]). As result, the court ordered the dissolution of the Projector on 12th December, 2008. The liquidation procedures were to be supervised by appointed liquidators, in accordance with the legislature of Singapore and to the benefit of general body of creditors (CommonLii., 2008 p. [45]) .

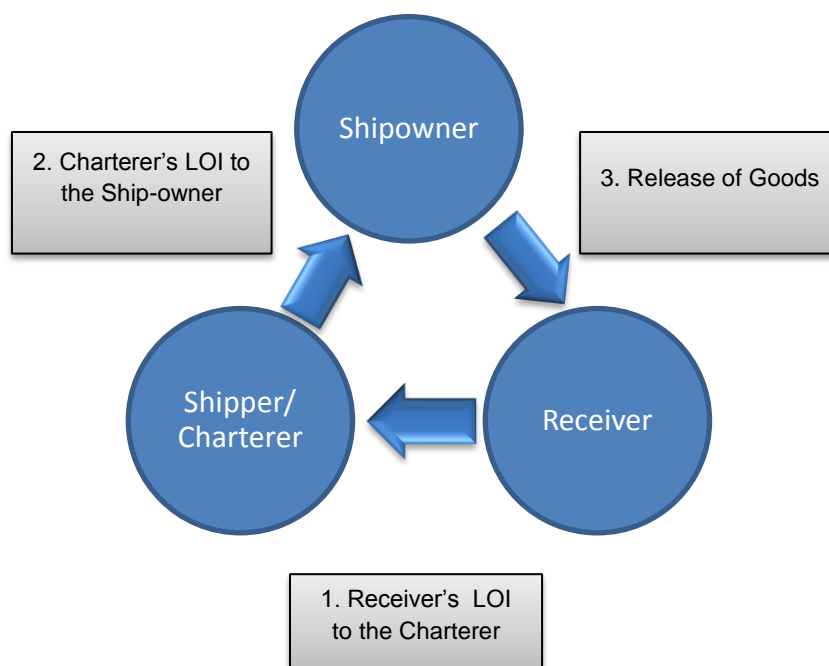
It is important to notice that the events under this case, took place during the financial crisis of 2008, where the freight costs were at their peak (Figure 7). This general situation could have been a reason for the elevated security bail of USD 69 mio. The oil market prices were extremely volatile striking from USD 150 in June and going down to USD 45 in early December (Sentence, 2012). This general context could have contributed to the dissolution of the company.

3.2 Charterer's and Receiver's Risk Mitigation

3.2.1. Back to Back LOIs.

Back to back LOIs were created to protect the charterers from the potential risks arising from LOI issuances. In such a scenario, each party involved in the transaction under the LOI will be covered from claims by the LOI from its counterparty.

Figure 8: Back to Back LOI under CIF Terms



Interviews conducted throughout the scope of this paper have confirmed that both small and large trading companies such as Cargill require their partners to issue an LOI in their favor before issuing an LOI in the favor of the ship-owner.

Issuing back to back LOIs has become common practice among traders. It is a simple mechanism that protects all parties involved in the deal against risks and liabilities that will stem from delivering the cargo without Bs/L. If the charterer takes the risk of delivering the cargo without B/Ls and doesn't ask for a LOI in return from his receiver- he might run the risk of never receiving payment for his cargo. As the practice demonstrates, contractual obligation are broken rather frequently, a company may default on payment or may simply be declared insolvent. In such a case the trader who

releases the cargo without a backup of a LOI from the receiver could lose the value of the cargo plus freight costs and other operational expenses related to the cargo.

Big trading companies such as Cargill in practice first request an LOI from their receiver and only then give an LOI to the ship-owners with instructions for delivery to the person named in the LOI. In order to mitigate risk of non-payment of the cargo, no LOI is given to the owner of the cargo hasn't been yet paid. Depending on the reputation and relationship with the client, the company can offer a credit facility which has to be previously agreed with the top management. In addition, depending on the conditions of underlying letter of credit, the company might ask to receive a payment guarantee before allowing a discharge.

With the evolution of technology large trading companies are opting for developing in-house systems, for example, Cargill-Sellers/ Cargill-Buyers based on electronic B/Ls to foresee situations when B/Ls do not reach the destination port on time. In such situations, an electronically updated record with clear indication of who is the final receiver of the goods will be available upon arrival at the discharge port.

Also large companies have a more powerful position in negotiating terms of LOIs directly with the ship-owners and most likely are not asked to countersign their LOIs by banks. It is likely, that ship-owners will be reluctant to lose their key clients and will agree to amend their LOIs. In some cases large companies have their own fleet and the Master in such cases will comply with the instructions of the charterer.

This practice is tougher for smaller trading companies that have to hire their vessels through brokers. In the industry it is common to hire a vessel through a sub-charterer. Such situations will require more care with regards to the content of the text of LOI. Most of the time smaller companies prefer issuing LOIs directly to the ship-owners thus avoiding involvement of the financing bank. Smaller companies usually have less funds available as collateral in case if the bank debits company's account for the value of the cargo that was misdelivered. Generally, banks are not aware of existence of LOIs between the charterers and the ship-owners.

Smaller ship-owners tend not to ask the charterers LOIs to be countersigned by the banks either. Also the value of the countersigned LOI will be different depending on the bank countersigning the LOI. For example, a LOI countersigned by BNP will have more value than a LOI countersigned by a smaller less-known bank.

3.2.2. Case Study: Laemthong International Lines Company Ltd v Abdullah Mohammed Fahem & Co. [2005] EWCA Civ 519

A receiver's' LOI was issued in the favor of the charterer but the owners were able to obtain an indemnity due to the construction of the text of the LOI.

Claimants: Laemthong International Lines (Owner)

Defendants: Abdullah Mohammed Fahem & Co

Cargo: 14'000 metric tons of crystal sugar

Loading port: Santos, Brazil

Discharge port: Hodeidah or Aden in Yemen at charterer's option.

Consigned bank: to the order of Yemen Kuwait bank for trade Investment

Advising bank: Credit Agricole Indosuez Suisse SA.

Shipper: Cargill Agricola SA

Charterer: Artis

Facts: The first defendant is Artis the first charterer and the second defendant is the receiver (Abdullah Mohammed Fahem). The goods were shipped by Cargill Agricola SA on FOB terms and the cargo was sold on C&F terms to receiver by charterers in seven shipments on January 30th, 2003. The contract of carriage was governed by a Charterparty between the owner (Laemthong Int. Co) and the charterer. "El Mokha Shipping and Trading Co Ltd" was nominated as the owner's agent at the port of destination *"to attend agency of the vessel/owners"* (BAILII:[2005] EWCA Civ.519, 2005 p. [8]) by receivers in accordance with provisions of sales contract. Additionally the Charterparty had a clause 42 *"for release of cargo to the receivers on receipt of faxed LOI from the Charterers, in case if the B/Ls were not available at the discharge ports."* The B/Ls and other documents were sent by Credit Agricole to Yemen bank. Yemen bank was receiver's issuing bank for a documentary credit.

On February 22nd, 2004 the receivers asked the charterers to arrange to deliver a LOI to the Master instructing him to allow the discharge of the vessel at the arrival port. In turn the charterer Artis, asked for the same LOI from the receiver in order to have some guarantee in case of possible claims, as it was discovered there were some disputes between the parties regarding the sale-back option of the contract. In order to obtain the delivery, the receiver requested a LOI and faxed it to the charterers.

The parties to charterer's LOI were the charterer and the ship-owner. The parties to the receiver's LOI were the charterer and receiver constructed on the basis of their sales contract. Both charterer's LOI and receiver's LOI contained exact same terms.

It is unknown why receivers didn't have the original Bs/L, nevertheless, it was known that the issuing bank, Bank of Yemen remitted the payment to the charterer but the bank never received a payment from its receivers afterwards.

El Mokha and the Master of the vessel received both LOIs (the receiver's and the charterer's) and discharged the cargo on February 26th, 2004. On March 10th, 2004 the vessel was arrested by Yemen Bank who claimed to have original B/Ls and was claiming USD 3 mio to release the cargo.

The owner made a call under both receiver and charterer's LOI asking to put a security bail to arrange the release of the vessel. As the owner was not party to the receiver's LOI it based its claim on "The Rights of Third Parties Act 1999."

The Act prescribes that the *"third party can be entitled to enforce a provision in a contract in his name a) if a contract expressly provides that he may or where the contract purports to confer the benefit to a third party"* (Wilson, 2010 p. 153). This claim was accepted by the judge.

The owner argued that it was the agent of the charterer and could benefit from the receiver's LOI. As the receivers' LOI was sent to the charterer and not to the owner directly- the owner fell into the category of "agent" in accordance with the text of LOI issued by receivers. Also in case of arrest of the vessel the owner would be required to provide funds to release the vessel.

"The owners were according the agents of the charterers for the purpose of complying with the receivers' request in the receivers' LOI, namely to deliver the cargo to them under receivers' LOI and were thus properly be regarded as falling with the category of "agents" whom the receivers' promised to indemnify in the clause 1 of the LOI" (Baillii:[2005] EWCA Civ.519, 2005 p. [27])

Receivers claimed that if the owners were the agents of the charterers, their agency came to the end when the charterers paid by receivers. But the owners replied that there was no evidence that charterers were actually paid (Baillii:[2005] EWCA Civ.519, 2005 p. [25]).

Judgement: The construction of the receiver's LOI stipulated that the *"charterers and their agents"* and as the owners were the agents of charterers they were entitled to indemnity under the given LOI. The judge declared that the receivers' LOI was enforceable against the receivers and the judge held *"that the primary party to whom this clause was intended to refer to agents must be the owners."* (Baillii:[2005] EWCA

Civ.519, 2005 p. [30]), therefore the owners had a right to obtain a security of USD 3 mio related to the retention of the vessel by the Bank of Yemen.

3.2.3. Case study: Great Eastern Shipping v Far East Chartering Ltd [2011] EWHC 1372

The current case is similar to the case “Laemthong International Lines Company Ltd v Abdullah Mohammed Fahem”. It also evolves around receiver’s LOI which was found to be enforceable due to its construction. Owners based argument of one the issues on the Rights of Third Parties Act.

Claimants: Great Eastern Shipping Company (Owners)

Defendant No.1: Far East Chartering Limited (FEC, the Chartering arm of the Intermediary)

Defendant No 2: Binani Cement Ltd. (Final receiver)

Cargo: 44’104 mt of coal

Loading port: Indonesia

Discharge port: Navlakhi, India

Shipper: PT Harkat Utama Mulia Mandiri (Indonesia)

Vessel: Jag Ravi

Facts: A sale contract between the shippers: Harkat Utama Mulia and the Swiss Company Visa Comtrade AG (VICAG) was settled on the FOB basis. The title to goods had to pass upon reception of payment from VICAG. The contract was afterwards amended to change payment terms and that the originals B/Ls had to be released by the agents of vessel directly to VICAG (BAILII:[2011]EWHC 1372, 2011). This is surprising since usually when the transaction is financed under L/C the shippers have to tender documents to the advising bank in order to obtain payment.

Later on VICAG sold the same cargo on CIF terms to Binani, who is a second defendant under this case. So, there was a chain of contracts sale contract on FOB terms and on-sale contract on CIF terms. The contract of VICAG with Binani contained provisions under which it stipulated if the B/Ls do not arrive to the discharge port the cargo will be discharged against Buyers’ LOI upon prior arrangements of the seller with owners. It is a fact, that the owners didn’t have knowledge of existence of this LOI before they started proceedings in India.

The Charterparty also contained a Clause permitting delivery of cargo without production of B/Ls in case of fast-arrived ship, owners agreed to discharge the cargo

against the LOI delivered by the Charterer along with a copy of B/L in the format of P&I club of the owner

There is nothing said about FEC, except that is a chartering arm of VICAG, but since FEC went into liquidation it didn't contribute to the hearing. Nevertheless, it is known that the FEC chartered a vessel on December 10th, 2008. Upon loading of the vessel, owners issued five B/Ls which were later found in the hands of shippers. The vessel arrived in India on 12th October, and the cargo was discharged on anchored barges. As B/Ls were not available in India, owners instructed the Port Authority to issue a delivery order in favor of Binani. It is known Binani on the request of FEC issued a LOI (receiver's) emailed to FEC on the 6th of October. In turn, charterers were supposed to issue the same LOI to the owners. Upon the inspection at discharge port it was reported that the cargo's specifications were below the specifications required by on-sale contract. As a result Binani rejected the cargo, but it had already removed a part of the cargo on to the barges (7400mt).

Lawyers, representing the shippers PT Harkat Utama Mulia Mandriri contacted the owners by threatening them with claim for misdelivery on 12th of November. Owners tried to recall the delivery order from the Port authority but the demand didn't succeed. Subsequently, after negotiations, Binani accepted to pay discounted price of USD 3.79 mio from previously agreed USD 6.8mio from VICAG on the 17th of January.

The totality of cargo was removed on the 13 of May 2009, the delay occurred due the owners continuous effort in attempt of obtaining an injunction against Binani and the Port in India. In turn, Binani retained USD 1.72 mio from USD 3.79 mio for B/Ls which were never supplied.

In the meantime VICAG was also found insolvent. On the 4th of June the sister vessel of Jag Ravi was arrested by the shippers PT Harkat Utama Mulia Mandriri. We can hypothesize that VICAG has never paid the shippers under its sale contract and the shippers retained original B/Ls in their possession. Furthermore Owners had to secure the release of cargo by providing a deposit of USD 2'040'410.

Judgment: The problem with Binani's LOI was in its construction, even if it was faxed to the charterers it was still addressed to the Owners/Charterers/and their agents. We do not know if this omission was done by negligence or for any other reason. The judge upheld that the LOI was addressed to the charterers and the owners simultaneously, so owners had a direct right to enforce the present LOI.

Additionally, Binani contended that the delivery under LOI was not considered as accomplished, since the cargo was delivered to the Port Authority, which would not amount to true delivery. The court decided that the cargo was delivered to the Port Authority which received it not as Binani's agent but as bailee for owners (BAILII:[2011]EWHC 1372, 2011 p. [27]). And the cargo was presumably discharged on barges by receivers' agents, since neither, VICAG, FER nor owners had an obligation to pay or arrange for discharge on barges.

In the context of the LOI, and in any ordinary use of the English language, a cargo which has reached a port, been discharged and collected by the receiver has been delivered. (BAILII:[2011]EWHC 1372, 2011 p. [30]).The judge awarded the owners' claim and since the goods were delivered the owners could enforce the LOI.

3.3 Bank's Perspective for discharge of goods without Bills of Lading

Documentary letters of credits have been used in international trade for over 150 years (UNCTAD, n/a). Financing with documentary letters of credit is a mechanism that allows transferring goods through connecting suppliers and buyers by minimizing political, performance, and counterparty risks. The principal objectives of documentary credits are to: ensure that both parties respect their financial obligations, ensure that the seller receives payment, and ensure the buyer will reimburse his loan to the bank. (Letter of Credit: The Banks' Position in Determining Documentary Compliance-A Comparative Evolution under U.S Swiss and German Law, 1995 p. 86).

The B/L is a crucial because it can be used to sell or pledge goods while they are in the transit in the sea (Todd, 1990 p. 7). The use of B/L as document of title and instrument of transfer of constructive possession over the goods has been going on for decades.

The seller under documentary credit demands payment against a “clean⁵” shipped B/L, and retains it as a pledge on the goods against the nonpayment. If buyer defaults the seller keeps his right to possession because these goods would not count towards the assets of the defaulted buyer (Todd, 1990 p. 7).

The financing bank retains the B/L as a security until it gets paid bank from its client/ the buyer. If the deal is not successful the bank can always claim the goods. In turn, the bank will be able to collect some of the value of the cargo in case of the nonpayment from the client. In the event of buyer bankruptcy the bank will have a right to demand the cargo at the discharge ports in relation to the B/L as of document of title and it might claim goods in virtue of “obtaining a special property as pledgee” (Todd, 1990 p. 10).

According the practice of UCP 600, a bank has five working days to inspect transport documents including the B/L before emitting payment in the honor of the seller. The strict compliance of goods to the specification mentioned in the sales contract is crucial in obtaining a payment, as the bank may reject documents for discrepancies with the documentary letter of credit.

In practice, in cases where the traders are confident about their counterparties they prefer not to include contractual specifications to the text of documentary credits, thus avoiding the rejection of documents by the financing bank (Geneva, 2015).

⁵ Not cloused B/L

As the documentary letters of credits are separate contracts from the sales contract, they have a status of autonomy. The sales contracts are regulated under the English Law and the Contracts of Credit fall under the provision of Uniform Customs and Practices for Documentary Credits, first published in 1933 by the International Chamber of Commerce. UPC provisions apply to all documentary credits and to the extent of Standby Letters of Credit. They will also be incorporated in each documentary credit issued under the UPC practice, according to the Article 1 of UPC 600. UCP 600 is a set of rules that is aimed at regulating legislature on credits in related countries but offered as guidelines (Jack, 1991 p. 10). Documentary credits are thus treated as separate transactions, per Article 3 of UCP, and deal only with documents and not with goods. When the documents are accurate the bank will honor its payment obligations (Jack, 1991 p. 17).

3.3.1. LOIs countersigned by banks

In some rare cases banks financing commodities under documentary credits may be required to be countersigned. The rationale behind this requirement is that when owners accept an LOI from the charterer only, they are not aware about the charterers' financial solvency. Owners would like to protect themselves from counter-party risk and so often ask a financing bank to countersign such LOI for the client. As discovered through interviews with major financing banks in Geneva, often big players have dropped the practice of countersigning LOIs' over the past couple of years. Several bankers working in Trade Finance in crude oil trading had no experience of using LOIs for discharge of cargoes without original B/Ls at all.

The bank becomes financially and legally liable only when it countersigns such LOI. It's involvement of financing bank can extend to the values larger than the B/L value of the cargo. Moreover, the duration of LOI under English law extends to at least five years, meaning that the claim under LOI can be made during that period.

In general banks will countersign such LOIs only for selected key clients. Obtaining such countersigned guarantees is much easier for major trading companies. The creditworthiness of the client will play a major role for consideration for the signature of LOI.

In accordance with the logic of Incoterms, most of the countersigned LOI's are issued under FOB sales (the buyer is a charterer of the vessel). In practice, banks do not

countersign LOIs without seeing at least a copy of B/L for import transactions. Other banks countersign guarantees only when they receive the B/L at their desk.

It has also become a common practice to agree on the presentation of B/L in advance before the end of the loading process. Timing of presentation of B/L is especially relevant to shipping in big tankers where multiple cargoes from various shippers must to be pumped into the vessel. Blending cargoes takes longer time and the shippers who loaded their cargo first have to wait for other shippers to finish. Once the presentations of B/L are agreed between the Master and the shipper the B/L will be issued promptly thereafter as soon as loading of the tanker completes.

The amount of the commission the bank charges for countersigning such an LOI depends on the security of underlying transaction and on the creditworthiness of the client. In general, the value of LOI should be estimated at 110% to 150% of the value of the cargo on a CIF basis, according to the responses given during interviews. Considering that the commission charged for LOI will be relatively low, total cost for the trader amounts to around 5'000-6'000 CHF.

According to Mr. Nicolas Gay-Crosier from UBS, commodity finance procedures have evolved greatly over the past ten years. Currently banks are rarely countersign LOIs but oftentimes accept LOI for payment which is integrated in the text of the LC. This type of LOIs was briefly explained in the Chapter 2.4.5, however its analysis will require further development outside of the scope of this work.

As it was pointed out by several trade financiers in Geneva, in the case where the bank is not sure about the solvency of its client/buyer (when B/L pledged to the bank), the bank will request the Master to discharge the cargo in a specific storage point at the port. The warehouse receipts, once the cargo is discharged will be made to "the Order of the financing bank". Then they wait for the arrival of original B/L which might take several months. Although not the most secure option, storage is considered to be less expensive than demurrage fees. Such practice is common in the petrochemicals trading business.

3.3.2. Case study: Pacific Carriers v BNP Paribas [2004] HCA 35, 218 CLR 451. High Court of Australia.

A legal case that involves a Trade Finance Department of BNP Singapore Branch whose manager countersigned the LOI of a charterer. The Court found Charterer's LOI countersigned by BNP to be enforceable by the owners.

Appellant: Pacific Carriers Ltd (time charterers)

Respondent: BNP Paribas

Cargo: 10'000 metric tons chickpeas and 10'000 metric tons of dun peas

Loading port: Santos, Brazil

Discharge port: Calcutta, India

Shipper/Supplier: New England Agricultural Traders Pty (NEAT)

Receiver: Royal Trading Company (India)

Financier of Receiver-Swiss Singapore Overseas Enterprises Pte Ltd (SSOE)

Vessel: MV Nelson

Owners: Bolton Navigation SA

Advising bank: BNP in Sydney

Facts: The NEAT sold to the Indian company a cargo of chickpeas.. On its way to India, there was general confusion about letters of credit and bills of lading, which were later split. Due to some complications it was clear the originals B/Ls would not arrive on time at time of discharge to the destination port. It is clear that the sales contract was concluded under C&F terms, because the shipper NEAT was chartering MV Nelson on the basis of voyage Charterparty from Pacific Carriers; who in turn sub-chartered the vessel from Bolton Navigation SA.

Upon arrival in India, operational problems delayed discharge and delivery. Additionally, the receiver (Royal), refused to pay the contractual price because during transit the market price for legumes had decreased substantially (Austlii:[2005] HCATrans 850 , 2004 p. [3]).

When the vessel arrived in Calcutta on January 29th, 1999, NEAT asked the Royal to issue a LOI, in the favor of NEAT (Receiver's LOI) and to countersign it by Royal's bank. Royal sent a LOI to NEAT with the bank's endorsement, but the bank's signature didn't take on any liability and only verified the signature of Royal. This LOI was rejected by the carriers. NEAT was trying to obtain a back-to-back LOI from the receiver.

On January 28th, 2009 NEAT faxed a text of LOI to BNP Paribas, the bank which countersigned the LOI. The payment was to be settled through a letter of credit by a

bank deemed acceptable by BNP Paribas. The managers of NEAT reached an agreement with the Manager of Trade Finance Department Ms.Dhiri who countersigned and stamped the LOI of NEAT with BNP' s stamp at the space reserved for "Bank guarantee" and faxed it to the carrier (Pacific).

The second LOI was issued by Ms. Dhiri, Trade Finance Manager on February 18th due to continuing difficulties at the discharge port. The second LOI was sent to charterers (NEAT) who forwarded the LOI to the Pacific Carriers. On March 31st, the vessel was arrested by Royal's Financier (SSOE) who had previously arranged for a letter of credit, probably for not receiving payment from Royal.

Pacific Carriers assessed their loss with interest for amount of USD 4,237,207. In the meantime NEAT was found to insolvent and Pacific Carriers started proceedings against BNP as against a bank who cosigned to indemnify the carriers.

BNP argued that in their understanding they were signing those LOIs only to verify the authenticity of the NEAT signatories, and not in a capacity of taking any form of liability under the Charterer's LOI. Also it was argued that Ms. Dhiri had no authority to issue document binding the bank, since this type of documents should be processed by the guarantees department of the bank. Pacific argued that once BNP Paribas signed NEAT's LOI it was the banks liability to indemnify and settle the claims under that LOI. It was evident that the Bank didn't have a clear understanding of the impact of countersigning the LOI.

Judgement: It was held that the Pacific Carriers were entitled to the indemnity from BNP Paribas. Ms. Dhiri was authorized to sign documents verifying the authenticity of clients but not binding BNP Paribas into transactions where it would act as indemnifying party. Additionally, the bank had no internal procedures through which Ms. Dhiri could seek for assistance (Austlii:[2005] HCATrans 850 , 2004 p. [43]).

Nothing in construction of LOI made Pacific Carriers believe that they were certifying the NEAT's signature LOI and not countersigning it. In addition Pacific could not be aware about the authority of Ms. Dhiri to sign LOIs.

3.3.3. Case study: Trafigura Beheer B.V. v Kookmin Bank [2006]EWHC 1450

This case stems from the letter of credit of LOI for payment and LOI for discharge of goods against a LOI.

Claimants: Trafigura Beheer BV

Defendants: Kookmin Bank Co (Korean Bank)

Cargo: 200'000 barrels of decant oil

Loading port: Bolongan, Indonesia

Discharge port: Kunsan, South Korea

Receivers: Huron Co Ltd.

Charterer: Trafigura Pte Ltd

Vessel: Shanghai Bulker

Facts: A sales contract was concluded between the seller Trafigura and the buyer Huron Co. Ltd on October 28th, 2003 on CFR terms.

Trafigura was an intermediary buyer, having purchased the cargo from Indonesian Oil major Pertamina. Subsequently, the original shippers were Pertamina and Pertamina sold the cargo to Trafigura on FOB terms, then the cargo was resold to Huron on CFR terms.

The deal was financed by a letter of credit from Kookmin bank, which was issuing bank for Huron and under which Trafigura was a beneficiary. The value of L/C reached USD 5.9 mio. Trafigura's advising bank was ANZ London Branch. The payment had to be made in accordance with sales contract's Clause 8 and L/C's field 47 A , which stipulated "*that in the event documents were not available for payment, the payment will be effected against the Seller's invoice and the Seller's LOI*" (Baillii:[2006]EWCH 1450, 2006). The Text of LOI for payment can be found in

APPENDIX 3.

To reiterate, the particularity of LOI for payment is that it is issued in the favor of buyer from the seller who warrants that he has a marketable title over the goods.

The Vessel Shanghai was chartered by the Trafigura Pte Ltd (a sister company) with conclusion of Charterparty with the owners Morelia Overseas. It is known that the Charterparty had a clause No.36 for discharge of goods against the presentation of LOI from the Charterers.

On November 29th, 2003 Trafigura delivered a LOI in favor of the ship-owner, revoking a "clause No. 36" in the Charterparty and asking the owner to discharge the cargo to

Huron. The cargo was discharged by December 2nd but into a bonded warehouse (Baillii:[2006]EWCH 1450, 2006 p. [19])⁶.

When Trafigura had to present documents for the payment on December 12th, 2003 one of the employees noticed that there were discrepancies between the B/Ls and the text of the L/C related to the loading port and to the payment of freight. Trafigura was interested in obtaining the payment and agreeing on discrepancies with Huron would take time, they issued a LOI for payment along with the commercial invoice and presented it to ANZ bank in London. ANZ remitted a payment to Trafigura for the value of the cargo around December 31st, 2003. The goods were released from the warehouse upon the payment to Trafigura. Consequently, ANZ asked Kookmin bank to reimburse under the L/C. As Kookmin replied that they only had a LOI for payment and requested original shipping documents.

It turned out that original B/Ls were with the initial shippers of the cargo Pertamina who forwarded them the same day to Singapore office of Trafigura.

Since the original B/Ls had discrepancies with the text of the L/C the employee of Trafigura arranged for issuance of new 3 sets of B/Ls with the owners. 1/3 B/Ls was kept by the captain and other 2/3 and Mate's receipt were sent to shippers so they could forward them to the bank from Indonesia. Originals were received by Kookmin on the 4th of February.

As Huron went into liquidation on February 5th Kookmin bank was not able to obtain any payment from its client. Had Kookmin been in possession of the original B/Ls it could have arrested the vessel as a lawful holder of Bs/L, and could have resold the cargo obtaining some sort of restitution.

⁶ Bonded warehouses are used for goods that do not have to be cleared immediately by customs. Goods can be stored for undetermined period of time. (Holland International Distribution Council, n/a)

4. Conclusion

In conclusion, LOIs are very complex documents that have to be used with an extreme care, hence the industry is still struggling to come up with alternative solutions that could be equivalent to the value of B/L. LOIs are a temporarily solution, as mentioned by one of the interviewee's, they are a sort of bandage over the big problem which is ignored by everyone in the industry.

Most importantly, the industry has no clear idea about the status and effects of LOI as of legal documents. There has been no clear cut legal decision that could regulate the use of LOI within the shipping and banking community.

LOIs are usually drawn up under time pressure when the vessels are approaching the discharge ports. They are also often delivered in situations where the traders have good partnership relations with their counterparties. But the business relationships deteriorate and parties often become reluctant to honor their contractual obligations. In such situations, LOIs could serve as a last resort to recuperate financial losses. Nevertheless, their construction, wording and a scope of LOIs' seem to be raising many problems and can be enforced by parties who were not a party to a LOI in issuer's intention.

Therefore, they have to be drawn up with a very specific wording for each situation. The terms Charterparties and sale contracts should also be homogenous, in order to prevent misinterpretation. As larger trading companies have more power to negotiate with ship-owners on the terms of LOI, small companies do not have such opportunity and comply with ship-owners rules.

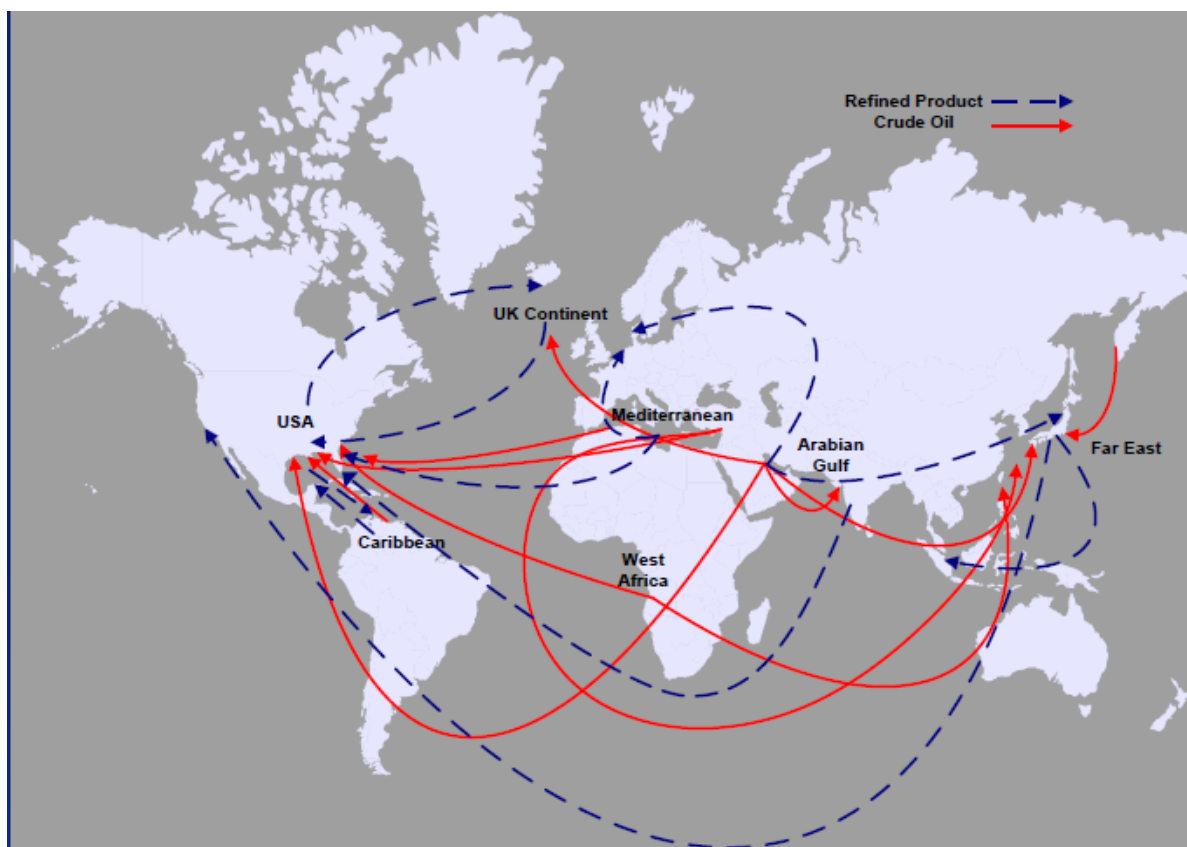
Back to Back LOIs, however, can give some space to negotiate as their terms are usually agreed between the Charterer and the receiver. Therefore, their terms and coverage should be identical and specific as possible, covering the value of underlying cargo. The party issuing a LOI and the party benefiting from the LOI have to be clearly identified in its text.

As we have learnt through the case studies, most of the risks that arise in relation to LOIs stem from operational and performance risks of the partners. Nevertheless, the risk of default of the client is one of the major issues, against which a LOI does not give any protection. Hence, to B/Ls as title documents, give special property over the goods and can help recovering the loss of the creditor in case of insolvency of a client. LOIs,

unfortunately, do not possess such property attributes. Therefore, the trust in creditworthiness of your partners remains as one of the main criteria to be considered when accepting or issuing a LOI.

On a personal note, the commodity trading industry, especially shipping and financing through negotiable documents, needs modernization. Traders, bankers and ship-owners should have a stronger instrument against the risks resulting from LOIs. Perhaps, this is one of the reasons, why financial institutions have abandoned the practice of countersigning LOIs. However, the future of B/Ls has been, already a subject of discussion of many international initiatives. The future of LOIs stays unclear but the introduction of electronic system of negotiable B/Ls such as Bolero which is being currently used by some majors can give more security to the participants of the international trade.

APPENDIX 1: Major Chokepoints in the world



Source: (JEFFERIES, 2013)

APPENDIX 2: Sample of LOI for Blending/Comingling Cargoes on board and substituting Bills of Lading.

Source: (GARD, 2003)

To:[insert name of shipowners]
The Owners of the [insert name of ship]
[insert address]

[insert date]

Dear Sirs,

Ship: [insert name of ship]
Voyage: [insert details]
Charterparty dated [insert date] between [insert name of parties]
Bills of Lading [insert identification numbers, dates and places of issue]

The above vessel has loaded the following cargo(es):

- a) at [place]...on [date]...m/t of [type of cargo]...
- b) at [place]...on [date]...m/t of [type of cargo]...

and bills of lading have been issued as follows:

Bills of lading [insert identification numbers, dates and places of issue]

Further to the above, the vessel is to load/ has loaded[delete as appropriate] the following cargo(es):

- c) at...on...m/t of...
- d) at...on...m/t of...

and bills of lading were to be/have been [delete as appropriate]issued accordingly.
Bills of lading [insert identification numbers, date and place of issue]

We, [insert name of requesting party], Charterers of the above vessel under the above charterparty, now wish the cargo(es) referred to in (...[a, b, c or d]) and (...[a,b, c or d]) above to be blended/commingled on board the vessel and hereby request you order the vessel to perform the said blending/commingling of the cargo(es).

We also request you to substitute the original bills of lading for the cargo(es) referred to in (...[a, b, cor d]) and (...[a, b, c or d]) above with new bills of lading for cargo(es) referred to in (...[a, b, c or d]) and(...[a, b, c or d]). The new bills of lading are to be issued in the same form and content as the substituted bills, except as follows:

(i) [insert details of changes, e.g., to issue date, shipper, consignee, etc.]

(ii) they will contain in description of the cargo the following statement: "...m/t of...blended/commingled onboard from ...m/t of...loaded at...on... and...m/t of ...loaded at...on..."

(iii) they will contain the following exclusion of carrier's liability: "the carrier shall not be

liable for any loss or damage to the cargo whatsoever and howsoever arising from the blending/commingling, whether or not arising from negligence on the part of the carrier, their servants or agents”

In consideration of your complying with our above request, we hereby agree as follows:

1. To indemnify you, your servants and agents and to hold all of you harmless in respect of any liability, loss, damage or expense of whatsoever nature and howsoever arising, including but not limited to any liability in connection with change of quantity, quality or pump ability and/or any damage to the vessel including tanks, pumps and lines, and which you may sustain by reason of blending/commingling cargo(es) on board and/or by issuing bills of lading in accordance with our request.

2. To accept full responsibility and risk for the successor otherwise of the blending/commingling operation and the consequences of any failure of whatsoever nature and how so ever arising from the operation, whether or not arising from your, your servants’ or your agents’ negligence.

3. To pay you on demand the amount of any loss, damage or expense of whatsoever nature and howsoever arising which you, your servants or agents may incur or be faced with incurring by reason of blending/commingling cargo(es) onboard and/or by issuing bills of lading in accordance with our request.

4. To treat all time used during or arising from blending/commingling cargo(es) on board and/or by issuing bills of lading as time on hire/laytime or time on demurrage [delete as appropriate].

5. To provide to your satisfaction, and as a pre-requisite to the commencement of any blending/commingling operation, the following:

(a) A letter of indemnity in these terms, with authorised signatures.

(b) Surrender of all of the original bills of lading for the cargo(es) referred to in (...[a, b, c or d]) and (...[a, b, c or d]) together with written confirmation from the holders/transferees of those bills of lading that they have lawful title to the cargo(es) and are authorized in their own right and by the owners of the cargo(es) to:

(i) Authorize the blending/commingling operation and substitution of those original bills of lading as requested herein.

(ii) Accept substitution of those bills of lading by new bills of lading in the terms stated above, such substitution taking effect at the time of issue of the new bills of lading.

6. In the event of any proceedings being commenced against you or any of your servants or agents in connection with blending/commingling cargo(es) on board and/or issuing bills of lading in accordance with our request, to provide you or them on demand with sufficient funds to defend the same.

7. If, in connection with blending/commingling cargo(es) on board and/or issuing bills of lading in accordance with our requests, the ship or any other ship or property in the same or associated ownership, management or control should be arrested or detained or should the arrest or detention thereof be threatened, or should there be any interference in the use or trading of the vessel (whether by virtue of a caveat being entered on the ship’s registry or otherwise), to provide on demand such bail or other security as maybe required to prevent such arrest or detention or to secrete the release of such ship or property or to remove such interference and to indemnify you in respect of any liability, loss, damage or expense caused by such arrest or detention or

threatened arrest or detention or such interference, whether or not such arrest or detention or threatened arrest or detention or interference may be justified.

8. The liability of each and every person under this indemnity shall be joint and several and shall not be conditional upon your proceeding first against any person, whether or not such person is party to or liable under this indemnity.

9. This indemnity shall be governed by and construed in accordance with English law and each and every person liable under this indemnity shall at your request submit to the jurisdiction of the High Court of Justice in London.

Yours faithfully,
For and on behalf of
[insert name of Requestor]
The Requestor

.....

For and on behalf of
[insert name of bank]
Bankers
.....

[insert full details of the office to which any demand or notice is to be addressed.]

APPENDIX 3: Sample of LOI submitted for payment under Letter of Credit.

**LOI for Payment extracted from Trafigura Beheer B.V. v Kookmin Bank [2006]
EWHC 1450 (BAILII:[2006]EWCH 1450, 2006 p. [8])**

Dear Sirs,

We refer to a cargo of [quantity] of [product] loaded on board vessel [] pursuant to Bills of Lading dated [].

Although we have agreed to sell the said cargo to yourselves, we have been unable to provide you with the full set of original 3/3 clean on board Bills of Lading (or 2/3 original Bills of Lading and master's receipt for 1/3 original Bill of Lading) and other original shipping documents covering the said sale.

In consideration of your paying the full purchase price of USD [] with value [], we hereby expressly warrant that we have marketable title to the goods, and that we have the full right and authority to transfer such title to you and to effect delivery of the said cargo.

We further agree to make all reasonable efforts to locate and surrender to you, as soon as possible, the full set of original Bills of Lading (or 2/3 Bills of Lading and master's receipt for 1.3 original Bill of Lading) and to protect, indemnify and hold you harmless from any and all damages, costs and expenses (including reasonable Attorney fees) which you may suffer by reason of the Bills of Lading and other shipping documents remaining outstanding, including but not limited to, any claims and demands which may be made by a holder or transferee of the original Bills of Lading and other original shipping documents or by any third party claiming an interest in the cargo or the proceeds thereof.

This Letter of Indemnity shall be governed by and construed in accordance with the laws of England and each party expressly submits to the exclusive jurisdiction of the English Courts in London.

This Letter of Indemnity shall expire 14 months after shipment or upon our tender of the shipping documents to you, whichever occurs first. We agree that we will make all reasonable efforts to obtain and surrender the shipping documents as soon as possible."

APPENDIX 4: Sample of LOI for discharge of goods in the absence of original Bills of Lading

STANDARD FORM LETTER OF INDEMNITY TO BE GIVEN IN RETURN FOR
DELIVERING CARGO WITHOUT PRODUCTION OF THE ORIGINAL BILL OF
LADING Source: SKULD 2015

To : [insert name of Owners] [insert date]

The Owners of the *[insert name of ship]*
[insert address]

Dear Sirs,

Ship: *[insert name of ship]*

Voyage: *[insert load and discharge ports as stated in the bill of lading]*

Cargo: *[insert description of cargo]*

Bill of lading: *[insert identification numbers, date and place of issue]*

The above cargo was shipped on the above ship by *[insert name of shipper]* and consigned to *[insert name of consignee or party to whose order the bill of lading is made out, as appropriate]* for delivery at the port of *[insert name of discharge port stated in the bill of lading]* but the bill of lading has not arrived and we, *[insert name of party requesting delivery]*, hereby request you to deliver the said cargo to "X *[name of the specific party]* or to such party as you believe to be or to represent X or to be acting on behalf of X" at *[insert place where delivery is to be made]* without production of the original bill of lading.

In consideration of your complying with our above request, we hereby agree as follows

1. To indemnify you, your servants and agents and to hold all of you harmless in respect of any liability, loss, damage or expense of whatsoever nature which you may sustain by reason of delivering the cargo in accordance with our request.

2. In the event of any proceedings being commenced against you or any of your servants or agents in connection with the delivery of the cargo as aforesaid, to provide you or them on demand with sufficient funds to defend the same.
3. If, in connection with the delivery of the cargo as aforesaid, the ship, or any other ship or property in the same or associated ownership, management or control, should be arrested or detained or should the arrest or detention thereof be threatened, or should there be any interference in the use or trading of the vessel (whether by virtue of a caveat being entered on the ship's registry or otherwise howsoever), to provide on demand such bail or other security as may be required to prevent such arrest or detention or to secure the release of such ship or property or to remove such interference and to indemnify you in respect of any liability, loss, damage or expense caused by such arrest or detention or threatened arrest or detention or such interference, whether or not such arrest or detention or threatened arrest or detention or such interference may be justified.
4. If the place at which we have asked you to make delivery is a bulk liquid or gas terminal or facility, or another ship, lighter or barge, then delivery to such terminal, facility, ship, lighter or barge shall be deemed to be delivery to the party to whom we have requested you to make such delivery.
5. As soon as all original bills of lading for the above cargo shall have come into our possession, to deliver the same to you, or otherwise to cause all original bills of lading to be delivered to you, whereupon our liability hereunder shall cease.
6. The liability of each and every person under this indemnity shall be joint and several and shall not be conditional upon your proceeding first against any person, whether or not such person is party to or liable under this indemnity.
7. This indemnity shall be governed by and construed in accordance with English law and each and every person liable under this indemnity shall at your request submit to the jurisdiction of the High Court of Justice of England.

Yours faithfully

For and on behalf of

[insert name of Requestor]

The Requestor

.....

Signature

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