

LOI, LOU and BLG – Confused?

Background

When dealing with liability claims in shipping one often come across terminology unfamiliar to those not working with claims on a regular basis.

The above abbreviations are typical examples often causing confusion and misunderstandings. They are often regarded as names for documents needed when things go wrong, but many have no idea what they contain or which effect they have. It is also often the case that the content of such documents can be legalistic and detailed.

This Circular explains what these documents are for and the kind of content they should contain in order to protect one's interests.

LOI – Letter of Indemnity

When one party wants the other to deviate from a normal or regulated practice, it may be necessary to give an indemnity. A Letter of Indemnity is a document which purports to give a party a right of recovery against the LOI issuer for any liabilities, losses, costs or expenses arising from following the specific requests/orders contained within the LOI.

A typical shipping example is a charterer's order to a carrier to discharge cargo at a discharge port without the receiver providing an original bill of lading in exchange for the goods being delivered to him. In these circumstances, the carrier's consequential liability for following such an order is excluded from its P&I insurance. The International Group of P&I Clubs has, however, drafted a standard form LOI, under which an indemnity is created in favour of the carrier. The issue of insurance cover remains unchanged but the LOI gives the carrier an express right of recourse against the charterer.

A Letter of Indemnity should normally include:

- reason for issue with a description of the circumstances,
- indemnity for a list of specific risks,
- agreement to provide funds to defend claims,
- agreement to provide security if vessel or assets are arrested,
- full list of parties jointly liable under the LOI,
- law and jurisdiction of the LOI.

It is important to remember that LOIs are not a fix-all solution for any kind of problem. Equally important, some LOIs are unenforceable at law, for example an LOI received in return for issuing a clean on board bill of lading despite the fact that the document was known to contain an incorrect description of the cargo or its quantity or its condition. Furthermore, any LOI is only as good as the party providing it. Hence, accepting an LOI does mean a risk of incurring an uninsured loss.

LOU – Letter of Undertaking

While the LOI is a document whereby the provider promises the receiver of it to reimburse his financial loss for carrying out certain actions, a Letter of Undertaking is a document whereby the provider promises the receiver of it to reimburse financial loss incurred as a result of a shipping incident.

For more information please contact Loss Prevention Manager Terje R. Paulsen, email terje.paulsen@gard.no or Loss Prevention Executive Marius Schønberg, email marius.schonberg@gard.no

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An LOU is a guarantee often issued by a P&I Club on behalf of its Member to a claimant who allegedly has suffered a loss for which the Member is liable and covered under its P&I insurance. In most cases, a Club LOU is issued on the threat of arrest or detention of a vessel. The terms of a Club LOU will include that, once accepted by the receiver as security for his claim, he must release the ship from arrest or detention and promise not to re-arrest the ship or take any action against other assets to obtain security for the same claim.

The main advantages of a Club LOU from the Member's and Club's perspective lie in its ease of issue and flexibility regarding content. Once a security demand is put forward, a Club LOU can be issued as soon its terms have been agreed, formulated and signed, then faxed or e-mailed around the globe in minutes. The main advantage of a Club LOU from the claimant's perspective is that he obtains a right to recover his claim directly from the Club. It is important that a Club LOU balances the respective interests, i.e. securing the claim without jeopardizing the defendant's rights and defences.

A Club LOU should normally include:

- identity of parties,
- details of the claim,
- reason for issue,
- reference to the contract or circumstances under which it is given,
- maximum amount of security,
- triggers for payment,
- provision preserving Member's rights and defences,
- law and jurisdiction for the claim and for any enforcement of the LOU.

Normally, the trigger for payment under a Club LOU is a settlement agreement between the parties or a final and enforceable court judgment or arbitration award.

Important limitations to keep in mind: P&I Clubs have no obligation to provide LOUs, they are purely discretionary; Club LOUs may not be accepted in some jurisdictions or by the claimant; and the claim may be outside P&I cover.

BLG – Bank Letter of Guarantee

Bank Guarantees have a long tradition for securing claims. As with any form of security, it is important that the terms included are in line with our recommendations for Club LOUs. Due to the costs and time involved in issuing Bank Guarantees, especially where more than one bank is involved, there are many advantages in having a Club LOU issued rather than a Bank Guarantee where possible. It should also be remembered that banks are not immune from financial failure and that a Bank Guarantee is not necessarily "better" security.

See Gard News issues [162](#) and [155](#) for further information.

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