

Pitfalls of Letters of Indemnity

The recent Australian case of *Pacific Carriers Limited v BNP Paribas (2004)* highlights the importance of the attention that should be paid to the exact wording of the LOI, explains Imad Elias, Managing Director, Elias Marine Consultants Ltd.

Anyone involved in commercial management of ships will at some stage encounter the use of Letters of Indemnity (LOI's). Such LOI's are normally offered by cargo interests (be it Charterers, Shippers or Receivers) in respect of various eventualities such as change of port of destination or for delivery of cargo without production of Bills of Lading (for a host of reasons the Bills of Lading may not be available at the port of discharge). The provision of an LOI may even be contemplated in advance as a term of the charterparty.

In general, a carrier who acts pursuant to an LOI will have no P&I cover for the consequences of doing so (even if the Clubs' recommended wording is used), making it crucial to ensure that the LOI offered provides adequate security. Hence, in such situations one normally finds that the carrier would insist on the LOI being signed not only by the cargo interest but also by a bank.

The recent Australian case of *Pacific Carriers Limited v BNP Paribas (2004)* highlights the importance of the attention that should be paid to the exact wording of the LOI. It is pleasing to note that the High Court of Australia decided to rule in favour of the carrier but it must be emphasised that the decision was based on both the wording and the surrounding factual circumstances of that case.

The proceedings arose out of the sale of 20,000 MT of legumes (chickpeas and dun peas) by New England Agricultural Traders (NEAT), an Australian grain trader, to Royal Trading Company (Royal) in India. BNP was NEAT's bank in Sydney. Pacific was the time charterer of M/V "Nelson" which it sub-chartered to NEAT for a voyage from Australia to India. The vessel loaded and sailed from Brisbane to Calcutta where she arrived on 24th January 1999. During the voyage there was a fall in the market for legumes and Royal delayed accepting the cargo and failed to pay the purchase price. Two LOI's signed by both NEAT and BNP were provided to Pacific and the cargo was delivered without production of the Bills of Lading. The vessel was then arrested by Swiss Singapore Overseas Enterprises (SSOE), Royal's financier. The matter went to arbitration but was finally settled by Pacific paying substantial damages to SSOE. NEAT became insolvent and Pacific sued BNP pursuant to the LOI's. BNP presented a two-pronged defence:

1. That on the true construction of the LOI's, BNP did not agree to indemnify Pacific but were simply verifying NEAT's signature (the construction issue).
2. That the LOI's were signed without BNP's authority and were, therefore, not binding on BNP (the authority issue).

At first instance the judge, Hunter J, decided in favour of Pacific on a ground that had not

been argued by Pacific, namely that BNP had negligently represented NEAT's financial capacity to honour its obligations under the LOI's. He consequently awarded substantial damages of USD 4,237,207.47 to Pacific.



The fact that a bank such as BNP chose to run such a defence to an indemnity on such legal arguments should ring alarm bells, cautions Imad Elias.

BNP appealed. The Court of Appeal reversed the judgement of Hunter J. Although the Court of Appeal accepted the construction of the LOI's for which Pacific contended, namely that BNP was acting as an indemnifier and not simply validating the signatures of NEAT, nevertheless they gave judgement in favour of BNP in holding that the bank officer who had signed the LOI's, Ms Dhiri, had neither actual nor ostensible (apparent) authority to bind the bank to an indemnity.

Pacific appealed to the High Court of Australia where the court unanimously held in favour of Pacific based not only on the wording of the LOI's but also the surrounding circumstances. The High Court noted that in September 1997, in relation to another voyage, BNP had joined in signing an LOI with NEAT and that LOI was also provided to Pacific. There was no reason to call for enforcement of the LOI in 1997.

In the present instance, initially on 28th January 1999 an LOI was sent to Pacific signed by Royal with an endorsement by a bank which disclaimed any liability on the part of the bank and merely confirmed Royal's signature. This LOI was rejected by Pacific. Subsequently, NEAT sent a "standard form of undertaking ... for receiving cargo without production of the Bills of Lading" to BNP and requested Ms Dhiri to sign it and send it to Pacific. Ms Dhiri signed it in the space reserved for "banker's signature"

and affixed the bank's stamp. The LOI was returned by Ms Dhiri to NEAT who then sent it by facsimile to Pacific. A second LOI was signed on 19th February 1999 in the same manner for a further parcel of the cargo.

The construction issue

According to BNP's defence, it was their understanding that all BNP was doing was authenticating NEAT's execution of the LOI's for verification of those signatures only. The High Court, however, held that Ms Dhiri's subjective intention as to what the LOI's were meant to convey was irrelevant. Rather the meaning of the LOI's had to be determined objectively by what a reasonable person in Pacific's position would have understood them to mean, based on their wording and the surrounding circumstances. Nothing in the LOI's indicated that BNP was merely authenticating NEAT's signature. Consequently, the High Court held that BNP was undertaking liability as an indemnifying party.

The authority issue

The bank's defence was that it was not bound by the indemnity since Ms Dhiri was not authorised to sign such an indemnity. Whilst Ms Dhiri, who signed the LOI's on behalf of BNP and affixed the bank's stamp, was Manager of the Documentary Credit Department, the issuing of indemnities and guarantees by BNP in Sydney was in fact the function of the Guarantee Loan Department.

In determining this issue the High Court took into account that in 1997 Ms Dhiri had herself signed together with another BNP officer, and stamped an LOI given by NEAT for delivery of cargo without Bills of Lading.

The High Court decided that although Ms Dhiri had no actual authority to sign such LOI's, there was nothing to put Pacific on notice or inquiry as to her lack of authority. Therefore, the court held that Ms Dhiri had apparent authority on which Pacific had reasonably relied to their detriment and, consequently, BNP was bound to honour the LOI's.

Conclusion

Although the ruling of the High Court of Australia was favourable to the interests of owners/ carriers accepting LOI's for delivery of cargo without Bills of Lading, the court examined the particular wording of the LOI in question and the surrounding circumstances. However, the fact that a bank such as BNP chose to run such a defence to an indemnity on such legal arguments should ring alarm bells. Furthermore, the fact that the case had to be appealed all the way to the High Court (with part of the bank's defence having succeeded before the Court of Appeal) should be enough to ensure that very close attention is paid to the wording and method of execution of such letters of indemnity before they are accepted.