Insurance Marine News

LOIs – worth more than the paper they're printed on?

By admin On September 28, 2021 In Insurance Marine News, Keep, Legal, Marine Liability

Zachary W Simon, Claims Executive, Lawyer, at marine insurer Skuld has written on reconsidering the risks and benefits of exchanging Letters of Indemnity (LOI) under standard and extraordinary vessel operations.

Simon said that Skuld had recognized a noticeable rise in the use of LOIs in day-to-day operations in the industry, and, consequently, had seen a great rise in the number of queries from mutual members and assureds seeking advice or assurances on the drafted language.

It has therefore provided some reminders, "hopefully far in advance of parties needing to resolve a commercial dispute at a final hour".

An LOI provides the very practical function of allowing one party on an ad hoc basis to take on specified risk(s) in performing a particular operation or set of operations involving risks that he or she may not otherwise be legally obligated to bear. The parties in the most ideal circumstances can continue to enjoy a cooperative commercial relationship with this promise of indemnity memorialized in a legally enforceable writing.

Following on from Skuld's October 2019 publication *Enforceability of LOIs – a practical guide*, provided by Skuld's Aislinn Fawcett, the insurer has highlighted concerns already addressed within this guide with respect to inherent risks with enforceability, and the potential conflict with traditional club cover.

Members as prospective recipients of an LOI

The risks undertaken pursuant to an LOI are traditionally those that lie outside of club cover, either as extraordinary risks explicitly excluded under conditions of cover or in some circumstances only available for cover subject to prior risk assessment and express confirmation by club management in writing.

Simon said that Skuld understood the commercial pressure that members and assureds faced when negotiating LOI terms, because the reassurance they stand to gain in accepting an LOI from their counterparty is effectively a substitute for

prejudiced or missing cover. By the same token, a breach of this promise could represent a great liability, not only for the underlying risk, but also legal defence, no matter whether any breach was committed deliberately and wrongfully or as a consequence of unfortunate circumstances.

Skuld noted that it was regularly notified of disputes where a promisor of indemnification was not willing or able to honour a promise made. Simon noted that "despite how advantageous its terms, an LOI's promise that cannot or will not be honoured in short course quickly becomes the focus of a costly, drawn-out legal dispute between not only the parties to this LOI, but also several other sets of counterparties in the contractual chain trying to enforce their own rights on back-to-back LOI terms".

As discussed in Skuld's October 2019 practical guide, common challenges to the validity of an LOI is the LOI's signatory valid authority and claims that the LOI cannot be enforced on the grounds that it promotes illegality.

Simon noted that Skuld always reminded members and assureds of their obligation to make commercial decisions as a "prudent uninsured," especially for risks that might not be covered. "Despite the ongoing obligation that members and assureds recognize and responsibly act against risk of extra liability exposure, due diligence is always required to assess the strength of the commercial relationship between the parties and the enforceability of promises exchanged between them", he wrote.

An LOI must also be practically enforceable. The promising party must be creditworthy or have enough assets to willingly – if not under force of law – honour this promised indemnity. A first-class bank's co-signature guaranteeing the credit of the indemnifying party is the "gold standard" for evaluating the promisor's creditworthiness. However, Simon accepted that obtaining such a guarantee would often not be feasible.

Members as prospective offerors of an LOI

Promising indemnification to another party for some extraordinary risk-taking operation outside of already approved terms nearly always corresponds to increased exposure to liability, often in contravention of the terms of club cover.

Simon said that this was especially common with respect to the carriage of cargo, for example where special risks to be undertaken would expose members or assureds to loss of special rights or defences under the Hague or Hague-Visby Rules, or similar rules of carriage. Skuld's terms of cover exclude risks for actions taken negligently or deliberately in breach of these rules.

Simon wrote that invalidly issuing clean bills of lading or issuing claused bills that otherwise did not accurately conform to the facts of the shipment were chief among the root of carriage-related disputes where club cover might be prejudiced.

Skuld was clear in stating that a member or assured promising indemnification for risks undertaken in contravention of Skuld rules or terms and conditions would not automatically be protected under Skuld cover by reason that it has received an LOI on back-to-back terms.

“[T]he LOI that a member or assured receives for a non-covered risk is effectively a substitute for prejudiced cover, and an LOI on back-to-back terms does not revive this cover”, said Simon.

Full details at:

https://www.skuld.com/topics/legal/pi-and-defence/lois---worth-more-than-the-paper-theyre-printed-on/