

The P & I Letter of Undertaking: Difficult Situations

The significance and relevance of a P & I Club letter of undertaking (LOU) or letter of indemnity (LOI) in today's context is worth re-examining. It has been and always will be an essential commercial arrangement in international trade. Its use over the years and the impact it has had on industry practices in general has always been of interest to practitioners and players in the shipping industry. This paper seeks to examine, in the context highlighted above, the role the P & I LOU has played in the past years in Singapore.

1. This paper deals with firstly, the general role of a club letter of undertaking in international trade, and case law both in the Singaporean and English context that has addressed some of the pitfalls and difficulties arising from the provision of security by way of a club letter.
2. The writer addresses both the procedure of P & I club letters as well as the practical workings of the same followed by an analysis of the pitfalls and difficulties associated with it by reference to appropriate case law.

The P & I Club Letter

3. Parties in a dispute where the claim relates to a vessel have to find a way to secure the claim, either before or after the vessel is arrested. An action in rem against the vessel gives the claimant a powerful remedy and it is no exaggeration to say that the vessel owner's business grinds to a halt in the event his vessel is arrested. Vessels are encumbered with constant running costs of a significant nature as follows:-
 - 3.1 Bunkers for its operation;
 - 3.2 Crew wages;
 - 3.3 Upkeep of the vessel's machinery and equipment; and
 - 3.4 Port dues and charges [if the vessel is berthed].

4. The vessel is also likely to be on charter which penalises in demurrage costs any delay on the part of the vessel. Hence, upon arrest, these charges commence and mount in such a way that an owner's financial capability could be severely impinged. The shipment also will be affected, especially in the case of cargo that needs to be urgently delivered, such as

perishables and project cargo. If the vessel is kept under arrest for too long, chain contracts down the line may be cancelled resulting in huge losses.

5. Hence, there is truth in the statement that international trade will grind to a halt unless there is a swift mechanism of lifting the arrest and releasing the vessel.
6. As a matter of practice, when a vessel is arrested, the P & I club of the vessel will instruct solicitors to attend to its release. In most circumstances, the arresting party will formulate its best arguable case, quantum of security is agreed, and the club letter is sent to secure the release. This seems a simple enough machinery to deal with the situation. In several instances however, using the club letter has resulted in difficulties as will be discussed below.

Case Law Analysis

7. One local case that showed that the concept of the club letter definitely has

facilitated international shipping trade, and which at the same time arguably revealed its potential pitfalls, was **The Piya Bhum et al [1994] 1 SLR 564**. A club letter is of a superior status to that of a bail bond, as was established in The Piya Bhum. Here, there was a cargo claim and prior to any arrest, the Plaintiffs attempted to negotiate with the carrier's P & I Club with a view to establishing security for their claim.

8. The difficulty faced by most solicitors in agreeing the wording of a club letter, surfaced in The Piya Bhum.
9. In The Piya Bhum, upon being faced with this difficulty, the P & I Club did not negotiate further and instead took the step of posting a bail bond in Court. The Plaintiffs applied to have the bail bond set aside, failed at first instance, but succeeded on appeal. The Court held that the essence of a bail bond was that the surety would have to have assets within jurisdiction available for immediate execution if the terms of the bond were activated. A foreign P & I Club did not meet such a requirement.
10. One would see that the posting of a club letter is not always a

straightforward matter. Parties may be diametrically opposed on the wording to be adopted in the undertaking. P & I Clubs tend to have their standard letter and would usually instruct solicitors to push for its acceptance by the Plaintiffs/Claimants. However, the Plaintiffs/Claimants are not bound to accept the same; security in a form acceptable to them must be posted.

11. This would be well and fine in the case of The Piya Bhum where there was no arrest. If a vessel has been detained and charges are being incurred on a daily basis in terms of demurrage port charges, dues, etc, it is advisable that the P & I Club be more accommodating in the wording of the letter so as to facilitate a quick release of the vessel. The other step that is likely to be taken on urgent application to Court would be to fix the terms of the guarantee and/or quantum of security so that the vessel can be released. The Court's jurisdiction to determine whether the quantum demanded is reasonable was affirmed recently in the Malaysian decision of **Shell Refining Company (Federation of Malaya) Bhd v Neptune Associated Shipping Pte Ltd (Vincent Ng J) [2007] 5 MLJ 87.** The Court's power is summed up in the following dicta that "*.....the Court has inherent jurisdiction to prevent any abuse of the process of court or the use of*

court procedure in an oppressive way..... And that, while the court may not have jurisdiction to vary the method of giving security agreed to between the parties, the court's power to control the amount of security and actions in rem is not ousted by the mere fact that the amount of security had originally been agreed to by the parties outside and without court intervention. This is because all too often, the owners of a vessel that has been arrested have no choice but to furnish security to the plaintiffs' satisfaction if they want the vessel to be released promptly. In so acting perforce, the owners are often in no position to assess what the amount of security should be until sufficient information of the plaintiff's claim is furnished..... It is my considered opinion that it is incumbent upon the court to exercise its inherent jurisdiction to reduce security when the demand for security in an admiralty claim by the plaintiff is excessive – a fortiori, as demonstrated in the instant case by the plaintiff's own application to reduce the quantum of its claim and in abuse of process of court. This is in recognition of the drastic consequences of an arrest of a vessel, and the coercive effect of a threat of arrest of a vessel. In determining what amount may reasonably be demanded as security, the courts have held that the plaintiff is entitled to such quantum of security as could be based upon its reasonably arguable best case, in terms of its principal claim and its reasonably recoverable interest and cost.”

12. The rationale of this approach is plain to see. It is the very fact that P & I

LOUs serve such an important purpose in facilitating the workings of international trade that drives a Court of law to ensure claimants do not defeat its operation by stipulating unreasonable and unacceptable terms while holding the owner's vessel under arrest, and placing him under severe commercial pressure.

13. To conclude the issue on The Piya Bhum, the club letter has a potential pitfall of delay in detention of the vessel under arrest while parties remain at loggerheads over the wording. However, the bail bond posted by a P & I Club has no better standing. The pitfall is usually averted by the appropriate urgent application to Court, or by the operation of indirect pressure on owners faced with mounting charges of detention where such pressure would be felt by the club itself. However, as borne out by authority, security can be given "*under protest*" and an application be made to Court subsequently to fix security.

14. The P & I Club letter in a way also facilitates the resolution of jurisdictional issues. This was exhibited in the **The ICL Raja Mahendra [1999] 1 SLR 329**. The issue here was whether the letter of undertaking required by the

plaintiffs for the release of the vessel should be restricted to London and Singapore in terms of jurisdiction. The Court proceeded on the basis that since London and Singapore were selected as the fora for dispute resolution, this would bind the parties. This case is important in that it shows the Courts are astute to ensure Club letters are restricted to the jurisdiction selected by the parties via their contracts, in this case the jurisdiction clause of the bill of lading. The argument of the plaintiffs that the wording of the letter should read “*court of competent jurisdiction*” may have succeeded if there was no fixed jurisdiction selected by the parties.

15. Another example of the relevance of P & I Club letters on jurisdiction was seen in the **Vishva Apurva [1992] 2 SLR 175**, where the Court held that parties should be held to their selection of jurisdiction. The Court held that they should: -

“accord full recognition to exclusive jurisdiction clause which are freely negotiated between parties and which are unaffected by fraud, undue influence or overwhelming bargaining power, unless the plaintiff who seeks to break his contractual obligation can show that trial in the contractual forum will be so gravely difficult and inconvenient that he will, for all

practical purposes, be deprived of his day in court.”

16. In facilitating the decision, the P & I Club letter was relevant. The Court held that the presence of exchange control restrictions in India was not significant to deny its jurisdiction as any judgment would have been immediately enforceable against the P & I Club as guarantors under the letter of undertaking.

17. The difficulties which may arise in relation to club letters also pertain to the financial status of the club per se. This issue surfaced in the **The Arktis Fighter [2001] 3 SLR 394**. The Court held that the Plaintiffs were entitled to an undertaking that would be nearly as secure as the vessel they had arrested. The defendants’ P & I Club, Skuld, had at the time been given a ‘BB’ rating which meant that it had vulnerable characteristics and according to the Court, “could lead to insufficient ability to meet financial commitments”. As such the court decided that security could be provided by way of a letter of undertaking from Skuld, on the condition that the defendants substituted a local banker’s guarantee for it within a month. The writer is of the view that only cogent reasons should persuade a Court that a P & I LOU is unacceptable, and proper evidence instead of market₉

information should be the relevant factor.

18. The concern in the case of The Arktis Fighter was the continued detention of the vessel under arrest, not because parties were polarised on the wording of the club letter [that was a side issue at the hearing itself pertaining to the ambit of the club letter as discussed below] but because of the drop in the rating of Skuld Assuranceforeningen to BB by Standard and Poor. Therein lies another pitfall of the club letter. Members trade their vessels on the basis that the club would at any time resolve any indemnity claims and attend to arrest of their vessels. This machinery grinds to a halt somewhat when the club letter is no longer an effective security instrument. The evidence adduced at the hearing by Skuld included that of its assets, multi layer covers, ownership of its building in Oslo, etc. This was insufficient to sway the judge that the club letter need not be further securitised due to Standard and Poor's rating. The writer submits that it is a grey area as to what evidence is sufficient to establish acceptable security in a situation where an unfavourable Standard and Poor rating has been issued to the club.

19. It must be said that the Court was still astute to the situation at hand and to allow a release of the vessel against the club letter effective for a month save that a bankers guarantee had to be submitted in substitution, within a month. It is submitted that Courts do adopt a practical approach to any pitfalls that may arise from problems relating to the club letter. Also significantly, the Court dismissed the argument of the plaintiffs that security ought to cover the claim as formulated and not for unsubstantiated claims.

20. On the wording of the club letter, counsel for the club argued that the Skuld undertaking covered only the liability of the defendants but not their successors on the ground that P & I Club memberships and rights are not transferable. However the Court was not inclined to so restrict the wording, holding that the club's indemnity to a third party is not dependent on its private arrangements with its own members so far as that third party is concerned. This is a potential pitfall for the club in arranging security; it may be compelled to issue a club letter inconsistent with its own constitution.

21. Another difficulty with P & I Club letters arose in **The Evmar [1989] SLR**

474. Here, a writ in rem claiming for damages was issued and the ship was arrested pursuant to a High Court warrant issued on the same day. Prior to the arrest, the plaintiffs had asked agents of the defendants to furnish a guarantee from a P & I Club. The defendants agreed to furnish security for the plaintiffs' claim subject to certain reservations. These reservations were not accepted by the plaintiffs who proceeded to arrest the ship. On 14 March 1988, the defendants informed the plaintiffs that in order to mitigate their own losses, they would agree to the plaintiffs' demand for security, and a letter of undertaking was accordingly faxed to the defendants' solicitors. The plaintiffs however refused to release the ship but asked the defendants to file a bail bond to obtain the release of the ship. Subsequently, on the same day, the defendants applied to Court for an order inter alia, setting aside the warrant of arrest. The Court set aside the arrest and released the vessel on the ground that alternative security provided by the Defendants' P & I Club ought to have been accepted by the Plaintiffs and their continued arrest of the vessel constituted malicious negligence. Hence, the Courts are always concerned with cases where the club letter is given short shrift, and this case emphasizes the significance placed by the Court on the validity and reasonableness of such security.

22. In the case of **The Benja Bhum (1994) 1 SLR 88**, the Court was astute to protect the claimant's interests in the club letter. Courts are generally predisposed to facilitating as far as possible the application of the club letter as an instrument of security in favour of the claimant. The Court held that because the Plaintiffs had already arrested the vessel and had a security for their claim, they were entitled to insist that the letter of undertaking should contain terms which would give them adequate protection or security in replacement of the res they had arrested. The Defendants tried to suggest that security wording should make express reference to arbitration but the evidence did not support such a conclusion.
23. Finally, the writer will address the English decision of **Canmer International Inc. v UK Mutual Steamship Assurance Association [2005] 2 Lloyd's Rep. 479** where the wording of the club letter resulted in full blown litigation regarding its ambit. To summarise, Canmer had time chartered the vessel from the owners Seatex. Canmer then voyage chartered it to Conagra Canada and for a shipment to Conagra Naples, named as notify party in the bills of lading issued by Seatex. The cargo

was unloaded damaged, and Conagra Naples sued Seatex. Conagra Canada sued Canmer under the voyage charterparty and Canmer in turn sued Seatex under the time charterparty. Canmer also counterclaimed Conagra Canada for demurrage and freight. The arbitrators allowed all claims but Seatex did not pay Canmer. Conagra Naples also demanded payment from Seatex under the bills of lading award. The vessel was subsequently arrested by Canmer and the security by way of a club letter was provided to Canmer by the UK P & I club. The club paid Canmer the costs of the arbitration but paid the amount due to Conagra Naples directly. Canmer subsequently claimed from the UK P & I the sum awarded to them under the time charterparty reference.

24. Canmer acknowledged that Seatex had already paid the sum due to the consignee Conagra Naples for the cargo damage but wanted it paid a second time to Canmer under the strict wording of the undertaking to recover costs which it may be liable to under the voyage charter to Conagra Canada, and the demurrage award. UK P & I essentially argued their earlier payment of the principal to Conagra Naples had extinguished their liability under the undertaking. The Court held that the UK Club's

remittance to Conagra Naples under the bills of lading award did not discharge Canmer's separate liability to Conagra Canada under the voyage charter award. Conagra Naples had refused, and continued to refuse, to accept the sum remitted in respect of the bill of lading award on the terms upon which it was tendered. Payment was a consensual act and required the accord of both creditor and debtor. A creditor accepted payment either by expressly declaring its unconditional assent to the payment, or by acceptance or by treating the money as its own. That had not happened in the present case. Accordingly, no payment sufficient to discharge Seatex's liability under the bills of lading award had yet been made by the UK Club because its remittance had not been accepted by Conagra Naples. Therefore it could not be said that no sum was owing to Canmer from Seatex because Canmer would have no liability to Conagra Canada under the voyage charter award. In any event, even if payment under the bill of lading award had been made by Seatex to Conagra Naples, such payment could not discharge the liability of a third party (Canmer) under a separate award (the voyage charter award) in favour of a different claimant (Conagra Canada). The mutual rights and liabilities of Canmer and Seatex, Canmer and ConAgra Canada, and Seatex and

ConAgra Naples were governed by the time charter award, the voyage charter award and the bills of lading award, respectively. The three awards were separate and independent. The important principle of law to be noted is that the *liability under one award could not be discharged by satisfaction of a different award*. Each award replaced the underlying causes of action upon which it was based and created new rights between the parties thereto superseding their previous rights.

25. The above case highlights the importance of ensuring the correct intended wording of the undertaking is used in securing claims under a multi-party arbitration where back to back awards had been made. This is a pitfall for the club. In thinking that by making payment to the end consignee, its liability would be discharged for the principal claim sum, the club had made an error of judgment. The wording of the undertaking continued to render it liable under the time charterparty award in favour of Canmer. Clubs will be well advised to consider carefully how it wishes to issue security when such multiple claims arise.

CONCLUSION

26. Hence, the aforesaid analysis totally accords with the question posed in this paper. While ostensibly the arrest of a vessel can be adequately and swiftly dealt with by the issuance of a club letter, this is by no means a smooth and seamless machinery without its problems. However, it is gratifying that Courts have approached disputes on club letters in a practical manner to allow for the principal tenets of international shipping to remain unscathed. As long as arresting parties are reasonable in their quantum calculations and adhere to the jurisdictions they have chosen, the club letter would continue as a powerful security instrument in facilitating international trade. From the club's perspective, it is constantly necessary to watch their solvency ratings, and to ensure care in dealing with multi – party claims.