JAPAN P&I NEWS

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To the Members

Dear Sirs,

China – Cargo Delivery Without Production of Original Bill of Lading

Please let us refer you to our circular No.10-016 dated 12 October 2010, "INTERNATIONAL GROUP STANDARD FORM LETTERS OF INDEMNITY Delivery of cargo without production of Bills of Lading". Please find attached circular from International Law Firm, Holman Fenwick Willan LLP (Shanghai Office) about "Cargo Delivery without Production of Original Bill of Lading".

Yours faithfully,

The Japan Ship Owners' Mutual Protection & Indemnity Association

Delivery of cargo without production of original bills of lading in China

It is well known that carriers are exposed to the risk of liability for misdelivery claims when cargo is delivered without production of original bills of lading ("OBLs"). For that reason, carriers usually only agree to follow instructions to deliver cargo without production of OBLs against letters of indemnity ("LOIs") from their charterers. However, a spate of recent misdelivery claims in China brought by holders of OBLs against carriers highlights – once again - that LOIs may not afford carriers and other parties involved adequate protection against the consequences of misdelivery claims. This article discusses the issues arising in relation to these misdelivery claims and the use of LOIs, with particular focus on such claims in China.

The use of LOIs

The aim of standard LOIs (usually based on the International Group's standard form wording) is to provide protection from the consequences of misdelivery claims. The standard LOI wording is intentionally drafted widely so that as long as the carrier (or beneficiary of the LOI) delivers the cargo to the party named, or claiming to be named, in the LOI, the beneficiary will have a good right of indemnity from the party requesting delivery without production of the OBLs for most of the conceivable consequences of a potential misdelivery claim. Thus, so long as the original instructions for delivery in the LOI are followed by the carrier (or beneficiary), English courts have sought to give effect to such LOIs.

For example, English courts generally do not accept arguments that losses flowing from misdelivery claims were due to reasons other than the underlying request to deliver the cargo without OBLs. The Courts also recognise that in misdelivery claims, the carrier's vessel is often arrested by the party holding the OBLs. They will therefore frequently grant mandatory injunctions ordering the party who provided the LOI and instructions to deliver without production of OBLs to take steps to procure the release of the vessel from arrest. Such mandatory injunctions may be obtained relatively quickly, perhaps within a matter of weeks.

Where, as is common, a chain of LOIs are provided on the standard P&I terms for delivery without production of OBLs, the carrier can also sue and apply for a

mandatory injunction under each and any of the LOIs in the chain as a beneficiary. This gives the carrier potential recourse against other parties in the contractual chain in the event the immediate provider of the LOI to the carrier is, for whatever reason, likely to ignore an English Court order, or insolvent.

With the legal protection that LOIs afford, bulk cargo carriers are now routinely obliged as owners under both time and voyage charterparties to deliver cargo without production of OBLs against provision by their charterers of LOIs. Indeed, in certain trades, for example for bulk mineral cargoes imported into China, anecdotal evidence suggests it is now standard practice to discharge and deliver cargoes against LOIs. The LOI, which was originally devised as a stop-gap remedy for exceptional cases, has thus become an essential mechanism in the ocean going trade in bulk mineral cargoes.

Lessons from the Shanxi Haixin claims

The events that followed the collapse of Shanxi Haixin Iron and Steel Group ("Shanxi Haixin") provide a sobering reminder to those importing bulk cargoes into China of the risks involved in relying on such LOIs. In summary, following Shanxi Haixin's collapse, PRC banks arrested a number of ships alleging misdelivery to Shanxi Haixin without production of OBLs. The banks had in effect financed the trade by opening letters of credit in favour of Shanxi Haixin without receiving any counter-security from their customers. When Shanxi Haixin defaulted on the payments, the banks were left holding the OBLs.

Art. 71 of the PRC Maritime Code recognises that the holder of OBLs has title to the cargo. A 2009 notice of the PRC Supreme Court further explained that if delivery of the cargo is made to any party except the holder of the OBL, the holder of the OBL has title to sue the carrier for misdelivery of the cargo and a maritime claim against the carrier's vessel. A number of recent cases demonstrate that the PRC Maritime Courts will generally support the holders of OBLs with misdelivery claims so long as the claim is brought within one year. In the circumstances, the arresting banks then pursued their substantive claims in China under the OBLs against the carriers involved.

With its ship arrested for a misdelivery claim in China, what legal options does the carrier have?

Action against the receivers - One option is to challenge the jurisdiction of the substantive proceedings brought for misdelivery under the OBLs in China. As a matter of English law, bills of lading typically incorporate the terms of the charterparty, usually English law and London arbitration. However PRC Courts generally refuse to recognise that such law and jurisdiction provisions are binding on cargo receivers. Having said that, recent cases demonstrate that the carrier in this situation may apply to the High Court in England for an anti-suit injunction ordering the receiver to desist from bringing proceedings which are contrary to the law and jurisdiction agreement incorporated into the bills of lading. If the receiver obeys the order, but is forced to bring substantive proceedings in England outside the one year time limit, an interesting question arises as to whether the English Courts would treat the new action as time barred. However, if the receiver does not comply with the order, there are little practical sanctions or steps that can be taken.

Pursuing the LOI provider - However, rather than fight the misdelivery claim, most carriers in this situation would prefer to demand that the LOI provider secures the release of the vessel from arrest and deals with the misdelivery claim itself. If the LOI provider refuses to comply with such a request under the LOI, the carrier then needs to consider how to enforce the LOI obligations against the LOI provider.

The standard IG P&I Club wording states: "*This indemnity shall be governed and construed in accordance with English law and each and every person liable under this indemnity shall at your* [the beneficiary's] *request submit to the jurisdiction of the High Court of Justice of England.*" In other words, the LOI incorporates a non-exclusive jurisdiction clause, giving the carrier the right, but not the obligation, to bring proceedings in the English High Court. The non-exclusive jurisdiction clauses in standard LOIs leave the carrier in this situation with a dilemma over an important decision.

By way of example, if the LOI provider is based in China, PRC Courts do not recognise English Court judgments. So if the carrier pursues a claim against an LOI provider in the High Court, the carrier may be left with an unenforceable High Court injunction and judgment against the LOI provider. On the other hand, if the

carrier elects to bring the proceedings in China, the carrier will likely find that the PRC Court is not as willing to grant mandatory injunctions as the English Court would be, and will only provide the carrier relief for losses that have actually crystallised. In short, the LOI does not afford any tangible protection against misdelivery claims in this situation. To minimise this difficulty, it may be better if standard LOIs incorporated arbitration agreements (such as LMAA Terms), as arbitration awards are much more widely enforceable than court judgments, and tribunals also have the jurisdiction to grant injunctive relief. This change, however, will not assist a carrier if the LOI provider is insolvent.

Apart from difficulties in relation to a carrier's legal recourse following a misdelivery claim, the customary shipping practice/procedure in China relating to discharge and release of cargoes does little to prevent potential misdelivery claims. It is customary in the trade for shipping agents, who control the cargo after discharge in China, to be nominated by the cargo's end user, even if they are appointed by the carrier. The shipping agent retains control over the cargo until it issues a delivery order ("D/O") to the party claiming title to the cargo. That party can then use the D/O to clear the cargo with customs and release it from the port. OBLs are typically not required for port clearance in China. In reality, therefore, once the cargo is off the ship, the D/O, not the OBLs, becomes the "key to the warehouse", regardless of who holds the OBLs. Best practice amongst shipping agents in these circumstances is, of course, not to release D/Os to any party alleging title to cargo without production by that party of the OBLs. However, often such best practice is not observed, which is what happened in the Shanxi Haixin cases. The consequences of not adhering to such best practice following the collapse of Shanxi Haixin, was that the holders of the OBLs (i.e. the banks) later claimed title to the cargoes after it has already been released.

Concluding thoughts

LOIs have become an essential instrument for the carriage of bulk mineral cargoes to China. But where misdelivery claims arise, as with the recent Shanxi Haixin cases, LOIs may nevertheless leave carriers exposed. The general view is that the recent misdelivery claims in China are unlikely to be one-off events.

P&I Clubs do not typically insure carriers for delivery without production of OBLs. Specialist insurance can be purchased – at a price – but in effect that merely transfers the risk of claims rather than dealing with the underlying problem itself. Equally, however, it is not realistic to expect carriers to change the prevalent use of LOIs. It is commonly suggested that carriers should instead mitigate the risk of enforceability of LOIs by requiring counter-signature of the LOIs by first class banks. In practice, however, that is often considered to be no more realistic as a solution than refusing to discharge the cargo.

More practical solutions, we suggest, are first, to change the P&I Club LOI wording to London arbitration, rather than High Court jurisdiction in order to make such LOIs more widely enforceable, and secondly for carriers to retain greater control over the shipping agents who control the cargo after discharge, particularly in China and other jurisdictions where cargo might easily be released without presentation of OBLs.

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