SHIPPING INDEMNITIES – ARE BANKS ADEQUATELY PROTECTED

The first of the bi-monthly series of lectures for the current year was held on Wednesday 26 July 2006 at the Peoples Bank auditorium. The facilitators were Mr. A. Kathiravelupillai and Mr. Parama Dharmawardene. We reproduce the highlights of the lecture / discussion for the benefit of the members.

01. Introduction

A traditional bill of lading is also a document of title to the goods. The contract of carriage between the shipper and the shipping line is for the shipping line to release the relevant delivery order at the port of destination, on surrender to them of the sole original, or if issued in more than one original, one of the original bills of lading by the true owner. In a situation when the goods arrive at the port of discharge prior to the receipt of the documents containing the original bill of lading and the importer wishes to clear the goods without incurring demurrage a shipping clauses contained in the forms to ensure that ther

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03. Security for a shipping indemnity

Banks usually obtain the counter-indemnity of the importer for issuing shipping indemnities. However some of the formats for these counter-indemnities used by banks appears to be very weak and therefore it is important that they review the wording in these forms with the help of their lawyers to ensure that the bank does not suffer a loss due to shortcomings in the indemnity they obtain. One issue almost all banks appear to have not included in their forms is an undertaking from the importer to submit an original bill of lading to the shipping line and have the indemnity cancelled within a period of three weeks (which is the period usually required by the shipping lines).

Banks, in addition, usually take up to 110% of the invoice value as a margin deposit. This can vary from bank to bank and from customer to customer. However it is important to note that most bank do not have a practice of having a person who has delegated credit authority to take the decision whether or not to approve the issue of the indemnity for 300 percent of the invoice value by obtaining a deposit covering only about one third of that liability.

04. Claims made under shipping indemnities

Although it may be very rare, a Shipping line can lodge a claim on a bank, which has countersigned a shipping indemnity in the event of the delivery of goods to someone other than the true owner. Banks must also safeguard themselves against fraudulent claims by unscrupulous shipping lines by requesting them to provide sufficient information to justify their claim. Although the bank cannot refuse to honour a claim under the indemnity given by them they have very right to seek documentary evidence for the loss incurred by the shipping line.

05. Shipping indemnity fees

There does not appear to be a uniform practice among banks as to the basis of charging fees for countersigning shipping indemnities. Most banks charge as compensation a commission, which is a percentage based on the invoice value, while some others charge based on 300 percent of the invoice value being the amount of their liability, which may not be incorrect.

Although some banks charge commission once and for all at the time of issue of the shipping indemnity some others have a practice of charging an additional commission when the shipping indemnity is outstanding for a period over three months, until it is duly cancelled.

It is the usual practice of banks in Sri Lanka to get the importer to submit the same to the bank the cancelled indemnity by surrendering an original bill of lading to the shipping line. However some of the banks provide a service to theft customers by arranging for the cancellation of the indemnities by levying a cancellation fee and hence better managing the shipping indemnities outstanding to a minimum.

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06. Risks associated with shipping indemnities

The risks taken by banks in countersigning shipping indemnities include the following:

- The value of the invoice in the original documents received being higher than the value of the invoice submitted by the importer for the issue of the shipping indemnity.
- A shipping indemnity issued on the basis that the payment is on D/A terms (without obtaining a margin deposit) but the original documents received are on DP terms.
- Documents submitted under LC discrepant, but cannot be rejected since the goods have been released to the buyer.
- Documents received are not in conformity with the prevailing Exchange Control I Import Control regulations in Sri Lanka. This will compel the bank to intervene in obtaining the approval of the regulatory authorities to avoid a major problem.
- A shipping indemnity has been countersigned by the bank and the buyer has taken delivery of the goods, but the original documents not received by the bank.

Rejecting documents drawn under a LC due to discrepancies when a shipping indemnity has been issued and the Credit applicant has taken delivery of the relative goods, can lead to a dangerous situation. The shipper could in turn make a claim on the shipping line for releasing the goods without the surrender of the original bill of lading and the latter will be forced to make a counter-claim on the bank under the indemnity, which they have countersigned. The value of such a claim may be very much higher than the invoice value as it may include legal and other charges, loss of profits etc.

07. Shipping indemnities on other payment terms

Banks should exercise extreme care in countersigning shipping indemnities on Advance Payment and Open Account terms, as it is not possible for the bank to have any control over the transaction. Furthermore, the importer will be reluctant to place a margin deposit with the bank for this purpose. Due to the same reasons banks should avoid endorsing shipping indemnities for Non-commercial Imports.

A Non-negotiable Sea Waybills is not a document of title to the goods and banks should decline any request for endorsing shipping indemnities covering such shipments.

Countersigning Indemnities for the issue of a duplicate set of negotiable bills of lading in lieu of lost Bills of Lading should be avoided as far as possible as the indemnity will very likely remain outstanding for ever in the bank's books if the lost bills of lading are never found.

08. Cancellation of Shipping Indemnities

As long as a shipping indemnity is not cancelled by surrendering the original bill of lading to the shipping line, the bank will carry a potential liability to shipping line. Therefore the bank should take steps to arrange for the cancellation of the indemnity immediately on receipt of the original documents. Furthermore, as long as a shipping indemnity is outstanding a liability will have to be carried in the bank's books for which capital adequacy requirements also apply.
The Hamburg Rules or the Hague Visby Rules are the conventions applicable for carriage of goods by sea. The latter is what Sri Lanka has adopted. In terms of Hague Visby Rules the shipping line gets a valid discharge if there is no claim made for goods released within a period of one year from the date of release of goods. In the case of shipping indemnities outstanding for over an year some shipping lines agree to free the bank of its liability by taking cover under this provision.

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09. Some Recent Developments

Some shipping lines have recently started making claims on banks for non- submission of an original bill of lading within a period of three weeks from the date of releasing the delivery order. Although this is due to a violation of one of the conditions covered by the indemnity and it appears to be legally valid to make a claim for violating a condition in the indemnity, it can also be argued that the shipping line has not suffered any loss and whether it tantamount to unjust enrichment. Therefore it may be prudent for the bank to ascertain the actual loss suffered by the shipping line and obtain a detailed breakdown of the amount claimed. However some banks may consider it important to honour their commitment on first demand and then ask for details thereafter. This is an issue for each individual bank to decide.

It is also learnt that some shipping companies have revised their indemnity form whereby the liability is solely on the Bank and not jointly with the importer. Therefore it is extremely important for banks to check the wording of the indemnity form before countersigning.

10. Minimising / Eliminating the risk under a Shipping Indemnity

Banks must ensure that they obtain the name of the shipping line and the name and address and contact details of their local agent prior to countersigning a shipping indemnity. Then, if required the bank is able to deal with them direct in the event of the importer is not providing the necessary assistance from the importer for the cancellation of the indemnity used. In the case of shipments made from the countries in the region having a small voyage time to Sri Lanka, it is prudent to resort to the practice for the supplier to arrange with their bankers to provide sufficient information on the shipment such as the value, terms of payment by telex / SWIFT or other authenticated message direct to the importers bank thereby reducing the level of uncertainty about the transaction. Banks are under no obligation to countersign shipping indemnities and they have every right to refuse a customer's request to countersign such an indemnity, if they are not satisfied with the risk to be undertaken by them.

11. Other

The Technical Committee of the TFAB is in the process of drafting a common format for the rubber stamps used for stamping of invoices for Customs purposes. Thereafter approval for their use will be obtained from the relevant authorities in order to have a uniform method of satisfying the requirements of the regulatory authorities.

Release of goods by airfreight / parcel post prior to the receipt of documents does not involve any guarantee or indemnity by the bank. In such situations the bank is only facilitating the clearance of goods by the importer.

12. Conclusion

In view of the matters discussed above, banks are requested to review the documents used by them by obtaining legal opinion so that they have sufficient protection for the risks involved. Each bank will have to decide for themselves the risks involved and the best possible way to manage them and receive compensation for taking such risks.

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