

RESTORING THE LUSTER TO THE
P & I LETTER OF UNDERTAKING

by
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The procedures for filing a surety bond to release a ship from arrest are clearly set forth in Federal rules and statutes. The shipowner is always entitled to obtain vacatur of the arrest by providing the Marshal with a bail bond in the principal sum of twice the amount claimed by the plaintiff.² In the alternative, the bond can be for a smaller principal sum, either agreed by the parties or fixed by the Court, which will be sufficient to cover “the amount of the plaintiff’s claim fairly stated with accrued interest and costs” up to the value of the vessel.³ In either case the bond also has to cover future interest,⁴ and customarily covers costs. The corporate surety issuing the bond is required to have a certificate of authority from the Secretary of the Treasury.⁵ The surety is also deemed to submit to the jurisdiction of the court for purposes of enforcing the bond against it, on post-judgment motion practice in the original action against the ship, and without the need for an independent suit against the surety.⁶

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² 28 U.S.C. § 2464(a).

³ 28 U.S.C. § 2464(c); F.R.C.P. Rule E(5)(a). If the claim exceeded the value of the vessel, the shipowner would no doubt petition for limitation of liability and avoid or obtain her release from arrest by posting security for her value plus pending freight. 46 U.S.C. § 30511(b).

⁴ F.R.C.P. Rule E(5)(a).

⁵ Local S.& E.D.N.Y. Civil Rule 65.1.1(c); 31 C.F.R. pt. 223. See the most current edition of Treasury Dep’t Circular 570, available on the Treasury Department website, for a list of the approved sureties.

⁶ F.R.C.P. Rule 65.1; F.R.A.P. Rule 8(b).

In the alternative, the Rules provide for release of an arrested ship simply on consent of the plaintiff, if the plaintiff is satisfied with substitute security which it has privately received from the shipowner.⁷

Obtaining a bail bond can take time and can be expensive. Among other things, the surety company generally will seek 100% cash collateral as countersecurity for the bond, as well as a premium, say $\frac{3}{4}$ of 1% of the principal amount annually, for issuing the bond. Nowadays it is very unusual for a shipowner to file a surety bond for release of its ship from arrest. Few currently active American admiralty lawyers or insurance claims managers have ever given or accepted one. An example of the typical, archaic wording of a bail bond is annexed as Exhibit A.

The reason bail bonds are scarcely seen is that ships are most often arrested in connection with insured claims – personal injury, cargo damage,

⁷ F.R.C.P. Rule E(5)(c).

collision, and salvage.⁸ The bulk of those claims are covered by p & i insurance, which, for greater than 90% of the global ocean going fleet, is provided by members of the International Group of P & I Clubs.⁹ While the clubs are not obligated under their rules to arrange for a ship to be released from arrest, they

⁸ In some cases the plaintiff's claim is not insured (e.g. release of cargo without production of the bill of lading); or a club, invoking the pay-to-be-paid characteristic of p&i cover, declines to give an LOU, perhaps because of unpaid calls. It may be noted that the English Third Parties (Rights Against Insurers) Act, 2010, §§ 9(5), (6) nullifies a pay-to-be-paid condition for all insurance claims, including maritime personal injury and death claims, but retains the condition for all other maritime p&i claims.

If the ship were arrested in a foreign country, the shipowner might ask a foreign bank where it has established a line of credit to issue a bank guarantee to the surety as substitute collateral. See *Deval Denizcilik ve Tigaret v. Agenzia Tripovich*, 513 F. Supp. 2d 6 (S.D.N.Y. 2007)[foreign bank guarantee to avoid lien on cargo in Italy]; cf. *Jaimie Shipping v. Oman Ins. Co.*, 2008 U.S. Dist. LEXIS 67765 (S.D.N.Y. 9/8/08)[foreign bank guarantee not acceptable security to release lien here]. But U.S. banks do not issue guarantees primarily because they are not permitted to do so on credit, and are also required to keep segregated the liquid collateral which they receive as security for it. 12 C.F.R. § 7.1017.

The preferred substitute in this country for a bank guarantee is a standby letter of credit which U.S. banks can issue without necessarily requiring collateral, but normally the credit will expire within a year – or at the most five years. U.C.C. §§ 5-106(c), (d). There are other restrictions on issuing standby letters of credit which make them less useful than foreign bank guarantees. See 12 C.F.R. § 7.1016.

Some admiralty lawsuits – particularly those which go on appeal – unfortunately take longer than five years, and the substitute security must stay in force for the duration of the suit. To get around this problem an “Evergreen” clause is added to the letter of credit providing for automatic renewal every year unless the bank notifies the beneficiary that it declines to renew. If the bank were to decline to renew, the beneficiary would be entitled to an immediate drawdown of the funds secured by the letter of credit. For obvious reasons, it is virtually unknown for a bank that has issued an Evergreen letter of credit to send a notice declining to renew it. If properly worded, the Evergreen letter of credit can be nearly as flexible as an LOU, although it will take longer and of course be much more expensive than if a local club representative had issued an LOU for which typically the shipowner is not charged. Hazelwood, *P & I Clubs Law & Practice* 260 (2d ed. 1994). The bank collects a fee each time the letter of credit is renewed, over and above whatever fees or interest it charges for loaning the applicant the funds needed to establish the letter of credit. Examples of an Evergreen letter of credit, and related side agreement, to release a ship from arrest is annexed as Exhibit B.

⁹ The clubs, of course, provide full cover for personal injury and cargo damage claims, subject to a deductible. Often they provide in addition one-fourth running down cover to supplement hull insurance which, indeed, was one of the primary reasons the clubs first came into existence. It is also not unusual to find the clubs giving security in salvage cases where they might be thought to have minimal if any exposure. Where the clubs are not 100% on the risks, they will frequently front for the hull underwriters since it is convenient for them to do so, at minimal expense, and the hull underwriters will provide counter-guarantees to the clubs.

will frequently do so in connection with a ship entered with the club belonging to a member in good standing.¹⁰

Shortly after World War II¹¹ the clubs realized that instead of providing countersecurity to a surety company, they could save the surety bond premium as well as speed up putting security in place, and thereby obtain release of arrested ships earlier, by directly offering a plaintiff private security signed by a local club representative which would be the equivalent of a bail bond, in the form of a letter of undertaking (“LOU”).

It was quickly recognized that this form of private security had the potential to be much more flexible than a bail bond. To begin with, a release from arrest bond is filed in the court where the arrest occurs. But the plaintiff and a club can agree to a different venue for the *in rem* suit against the ship.. It makes sense to do so, for example, in order to specify the venue of a court at the place which is provided in a choice-of-court or an arbitration clause contained in the contract

¹⁰ The club rules provide that if the club in its discretion issues an LOU, it does not imply any acknowledgement or admission of the club’s liability to cover the claim. See Hazelwood, *P & I Clubs Law & Practice* 261 (2d ed. 1994). If there is doubt about club cover, or the member has a large deductible, the club may require that the member provide countersecurity, sometimes in the form of a bank guarantee, as a condition for the club to issue the LOU.

¹¹ The first mention of a p&i letter of undertaking in a reported American case occurred in 1953 in *United Kingdom Mut. S.S. Ass’n v. Morewitz*, 1953 A.M.C. 2079 (E.D. Va.). By the late 1970s their use was routine. See *In re Cia Naviera Marasia*, 466 F. Supp. 900, 902 (S.D.N.Y. 1979).

plaintiff relies upon in arresting the ship.¹² So too in a collision case where the parties are agreeable that proceedings be heard in a particular forum, not necessarily the place where one of the ships was threatened with seizure or actually arrested.

While a bail bond will cover court “costs”, in the U.S. that term does not include attorneys fees. A provision can be inserted in an LOU to cover attorneys fees, if any be awarded, perhaps by arbitrators or a foreign court.

One of the biggest advantages of an LOU is that it can be tailored to eliminate the need for a general surety bond to avoid a ship’s arrest. The only provision in the rules for avoiding arrest requires that the principal sum of a

¹² It has been suggested that a change of venue provision in an LOU might run afoul of the doctrine that parties may not consent to give a Federal court subject matter jurisdiction, because the presence of the ship within the jurisdiction is required for subject matter jurisdiction in an admiralty *in rem* suit. See Wiswall, *The Development of Admiralty Jurisdiction & Practice Since 1800* 202-07(1970)(discussing the concept of “para-in-rem). But there is venerable precedent that security to avoid arrest which obligates a shipowner to defend his ship in a particular court, by subjecting the security to the jurisdiction of the court, suffices to enable the court to hear the suit *in rem* against the ship. *The PROVIDENCE*, 293 Fed. 595 (D.R.I.1923); see *Chan v. Society Expeditions*, 123 F.3d 1287, 1294n.4 (9th Cir. 1987), app. dismissed, 522 U.S. 1100 (1998); *Panaconti Shipping Co. v. M/V YPAPANTI*, 865 F.2d 705, 707 (5th Cir. 1989); *Cactus Pipe & Supply Co. v. M/V MONTMARTRE*, 756 F.2d 1103, 1107 (5th Cir. 1985); *O’Connell Mach. Co. v. M.V. AMERICANA*, 566 F. Supp. 1381, 1383n. 6 (S.D.N.Y. 1983), *aff’d*, 734 F.2d 1984 (2d Cir. 1984) [“equivalent to an arrest”]; see also *Farwest Steel Corp. v. Barge SEA SPAN*, 769 F.2d 620, 622-23 (9th Cir. 1985); cf. 46 U.S.C. § 30907(b) [providing for an *in personam* suit against the United States under the Suits in Admiralty Act to “proceed according to the principles of an action *in rem*”]; 28 U.S.C § 1605(c)[providing for an *in personam* action to foreclose a maritime lien on a ship owned by a foreign sovereign which proceeds according to the principles of “suits *in rem*”]. But it is important to recognize that since the LOU expressly preserves all of the shipowner’s defenses, the venue provision for suit against the ship is only for formal purposes, in connection with security, and does not supersede an otherwise applicable choice-of-court or arbitration clause applying to proceedings on the merits of claims.. See *Trafigura Beheer v. M/T PROBO ELK*, 266 Fed. Appx. 309 (5th Cir. 2007), cert. denied, 552 U.S. 1182 (2008); *Bison Pulp & Paper v. M/V PERGAMOS*, 1996 A.M.C. 2022 (S.D.N.Y. 1995); *National Material Trading v. M/V KAPTAN CEBI*, 1998 A.M.C. 201, 208 (D.S.C. 1997); cf. *Macsteel Int’l v. M/V LARCH ARROW*, 354 Fed. Appx 537 (2d Cir. 2009)[London jurisdiction clause in bills of lading; Dutch jurisdiction clause in LOU]. But see *Uniwire Trading v. M/V WLADYSLAW ORKAN*, 2008 A.M.C. 2152 (S.D.N.Y.)[agreement in LOU that New York was the “proper venue” for the *in rem* suit superseded the exclusive Polish choice-of-court clause in the bill of landing]; *Rice Co. v. Precious Flowers*, 523 F.3d 528 (5th Cir. 2008).

general bond be twice the amount of any claims which may be made against the ship.¹³ By contrast, the parties can negotiate terms in an LOU for a lower principal amount, similar to those that would be used to release a ship which has already been arrested, so as to avoid her threatened arrest altogether.¹⁴

By the late 1960s the procedure and format for issuing LOUs in the U.S. had become standardized. A sample LOU for avoiding arrest was published by Hugh Meredith as part of the 1969 program of Tulane Admiralty Law Institute.¹⁵

The principal features were:

1. The plaintiff's obligation not to arrest the ship, nor any other ships or property belonging to the shipowner on the same claim.¹⁶
2. The club's obligation to cause the shipowner to enter an appearance *in personam* (if claims were made against it personally) and to file a statement of interest in the vessel, obligating the shipowner to defend her against the claims made by the plaintiff, upon receiving future notice of commencement of a timely *in rem* suit by the plaintiff in the specified American court.¹⁷
3. The club's obligation to pay either a final judgment in plaintiff's favor against the vessel and her owner, after appeal if any, or a settlement between the parties, up to a specified amount plus (where a judgment is involved) interest and costs.
4. The club's duty, upon receiving a demand by the plaintiff, to file in the lawsuit a bail bond issued by an authorized surety, in the principal sum of the

¹³ F.R.C.P. Rule E(b)(2).

¹⁴ Occasionally a shipowner may be eager to have its club furnish an LOU to secure the plaintiff's claims because it will enable the shipowner to demand countersecurity from the plaintiff on a counterclaim for which security would otherwise be unobtainable. F.R.C.P. Rule E(7); see *Mateco v. M/V ELLI*, 103 F. Supp. 2d 70 (D.P.R. 2000)..

¹⁵ Meredith, *Fines, Penalties, and Other Miscellaneous Liabilities . . . Club Letters of Guarantee or Undertaking*, 53 Tul. L. Rev. 602, 612-14 (1969).

¹⁶ Breach of this clause by subsequent seizure of the shipowner's vessels gives rise to damages for wrongful arrest. *Coastal Barge Corp. v. M/V MARITIME PROSPERITY*, 901 F. Supp. 325 (M.D. Fla. 1994).

¹⁷ Although the obligation to enter an appearance for the vessel was not expressed in the LOU, it was implied in *Siberla Marine v. M/V WESTERN TEAM*, 2000 A.M.C. 799 (E.D. La. 1999). The plaintiff cannot sue the club for payment under the LOU until it first receives a judgment against the vessel, nor can plaintiff join the club in the *in rem* suit before it has gone to judgment. *Old Park Investments v. The LEDA*, 2005 A.M.C. 2856 (S.D. Fla.).

specified amount which, upon filing, relieves the club of any further obligations under the LOU.

5. The binding nature of the LOU regardless of whether the vessel be lost or not lost, plus notice that the LOU is given without prejudice to all rights or defenses which the vessel or her owner may have.¹⁸

This LOU would be signed by the club's local representative – perhaps even the attorney representing the shipowner – noting his capacity in acting only as an agent for the club as a disclosed principal, and without exposing himself to personal liability.

Some time thereafter the typical LOU format was expanded slightly to add:

6. An acknowledgment by the parties that the LOU was intended to put the plaintiff in the same position as if the ship had actually been arrested with security equivalent to that of a bail bond issued by an authorized surety to obtain her release.

7. Particularly in cases subject to arbitration, or where a foreign judgment was anticipated, to provide that the club's obligation to pay "costs" included "attorneys fees, if any be awarded".

A paradigm example of a current format of an LOU to avoid arrest of a vessel is annexed as Exhibit C.

During the 1970s and 1980s, since plaintiff's attorney often did not know in which club a vessel targeted for arrest was entered, ordinarily the first contact concerning security to avoid or release a vessel from arrest would be a telephone call from the attorney for the shipowner/club after the arrest had taken place or been threatened. Each P&I Club drafted its own wording for LOUs to release members' ships from arrest. But they generally followed the above-described

¹⁸ Since the LOU reserves the shipowner's defenses, an LOU to avoid arrest will be cancelled if suit is not timely filed. *A.S.T. v. M/V FRANKA*, 1998 A.M.C. 246 (D. Md. 1997); cf. *Petroleos Mexicanos Refinacion v. M/T KING A*, 554 F.3d 99 (3d Cir. 2009).

format. The universal custom arose for the club, rather than plaintiff's attorney, to draft the LOU.

There was a long history of trust in the shipping industry concerning the wording of forms commonly used by marine insurance companies.¹⁹ This trust was extended to LOUs. So it was not unusual, when an LOU was offered by a club, that often the first time the plaintiff's lawyer would see the wording would be when he was given the signed document by the club's lawyer.

At first, there were very few occasions when plaintiffs' attorneys would receive LOU wording which did not meet their expectations. But the problems eventually multiplied. And the trust which the American admiralty bar initially had in the drafting of LOUs by club lawyers dissipated. Now a club lawyer will often ask a plaintiff's lawyer to send over the draft of an LOU he is willing to accept, so that the club lawyer can seek instructions. Negotiations over the wording of an LOU thereafter can sometimes be protracted and contentious.

1. "Inclusive of interest and costs."

In the early days of LOU use, the first problem which plaintiffs' lawyers encountered was that a club lawyer would sometimes send over a signed LOU providing for a fixed sum, "inclusive of interest and costs", virtually always without highlighting the change from bail bonds which provide cover for interest and

¹⁹ Forty years ago English marine underwriters took a very long time to issue insurance policies. Indeed, sometimes a policy would not be issued until well after an insured event had occurred. Entire lawsuits were known to have gone forward to completion solely on the basis of a broker's cover note, with neither the attorneys, nor the court, nor arbitrators ever sighting the actual policy. Remarkably there are few if any reported common law decisions in favor of assureds who

costs separately. In practice, if the ship had actually been arrested, and the plaintiff's attorney caught the irregularity before consenting to her release, the club lawyer would promptly acquiesce to change the offending term to read "plus interest and costs" in order to avoid delaying the ship's departure. However, if the LOU were given at the last minute in order to avoid arrest of the ship, and the plaintiff's attorney was lulled into a false sense of security by being told the club would furnish an LOU, plaintiff's lawyer probably would not have continued with the necessary preparations to seize her. This created the possibility that if the LOU were rejected, she might be able to enter and leave while escaping arrest. A protest about the LOU terms might then be met with "it's too late today to get authority to change the wording from London", leaving the plaintiff's attorney no choice but to accept the LOU.

You get an education when you've had a bad experience. As plaintiffs' lawyers gradually became aware of this problem, they began to make clear early in negotiations with club lawyers that an LOU plus interest and costs was expected, since the LOU was supposed to be a substitute for a bail bond issued by an authorized surety. But especially during the last 10 years, a club lawyer sometimes became very insistent that the club would not issue an LOU unless it was "inclusive of interest and costs". This would then lead to negotiations about how much to increase the principal sum of the LOU to cover those items too.²⁰

complained that their justifiable expectations were frustrated by differences between the wording of cover notes and marine insurance policies issued after the event.

²⁰ This must always be done with an Evergreen letter of credit which a bank can issue only for a specific sum.

My firm was badly stung when it underestimated the surcharge in one case, and the proceedings took much longer than anyone anticipated, leading to an arbitration award where the interest and attorneys fees caused the total to balloon far above the amount of the LOU.²¹ Since then, I have adopted the position that if a club insists on an all inclusive LOU figure, I analogize to the situation in the rules where parties cannot agree on the principal sum for a bail bond, and require that the LOU cover double the amount of the claim.

2. Future increase in the amount of the LOU.

Generally speaking, if a claim is found to be overstated, there is rarely a problem in getting the plaintiff to agree voluntarily to reduce the amount of the LOU.²² Among other things, a plaintiff can be sanctioned for demanding excessive bail.²³

But increasing security is another matter altogether. To begin with, although the courts have the power to require a surety to increase the principal sum of a bail bond²⁴, they will exercise it only in cases, such as bankruptcy of the surety – i.e. where the inadequacy of the security is not the plaintiff's doing.²⁵ Otherwise, where the plaintiff simply underestimated the amount of security required, the court will not grant relief under the rules.²⁶ Nor may the ship be re-

²¹ See *Petroleos Mexicanos Refinacion v. M/T KING A*, 554 F.3d 99 (3d Cir. 2009).

²² But see *Stemcor v. M/V CERN URKMETZ*, 2000 A.M.C. 2104 (S.D. Ala.) [court lacks authority to reduce LOU].

²³ *Wertman v. Mar del Sud*, 1995 A.M.C. 1130 (D. Alaska).

²⁴ F.R.C.P. Rule E(6). There is no time limit for seeking an increase, as long as it is "before judgment". *United States v. Ames*, 99 U.S. (9 Otto) 35, 42 (1878); *The FRED M. LAWRENCE*, 88 Fed. 910 (E.D.N.Y. 1898), *aff'd*, 94 Fed. 1017 (2d Cir. 1899).

²⁵ *Moore v. M/V ANGELA*, 353 F.3d 376 (5th Cir. 2003).

²⁶ *Central Hudson Gas & Elec. Corp. v. M/V LUNAMAR*, 1991 A.M.C. 1667 (S.D.N.Y. 1990)

arrested, unless the mistake in the amount of the LOU resulted from fraud or misrepresentation.²⁷

However the parties can agree to add a clause to the LOU authorizing a court to increase or decrease the amount of the LOU. In one case, although the wording of the clause was nearly the same as the authority granted to a court in the Rules, the court broadly read the LOU to authorize an increase even where the need for one arose because the original amount proved to be inadequate.²⁸ One of the advantages of such a clause is that it eliminates the need of the plaintiff's lawyer to overestimate the value of the claim in order to be sure the plaintiff obtains enough security.

To avoid the risk that a court will interpret the clause as authorizing nothing more than the limited discretion it would have had if the security were a bail bond, it would be prudent to mention the inability of the parties to estimate damages so early as the reason for the clause. But even then, problems can arise. In a recent case an LOU authorized the plaintiff to arrest the ship if the amount of security proved to be insufficient. But the court, noting that the LOU also preserved all of the shipowner's defenses, construed the term as requiring a timely arrest of the vessel for additional security before the applicable statute of limitations had run on the claim.²⁹

²⁷ *Industria Nacional del Papel v. M/V ALBERT F*, 730 F.2d 622, 626 (11th Cir. 1984).

²⁸ *Crescent Towing & Salvage Co v. M/V CHIOS BEAUTY*, 2008 A.M.C. 2535, 2549 (E.D. La.).

²⁹ *Petroleos Mexicanos Refinacion v. M/T KING A*, 554 F.3d 99 (3d Cir. 2009). Plaintiff's argument that the seizure was a re-arrest of the vessel not subject to the statute of limitations was rejected. See text fn. 36 *infra* and accompanying text.

3. Omitting the obligation to file a surety bond on demand and/or the acknowledgment that the LOU was intended to be the equivalent of a bail bond.

There were probably two reasons why early on LOUs contained an obligation to file a surety bond. First, it served the same purpose as the later acknowledgment that the LOU was intended to put the plaintiff in the same position as if the ship had actually been arrested and then released by the filing of a bail bond. In other words, it established the context for interpreting the terms of the LOU.

For example, in a recent case the court relied upon such provisions to expand a club's obligations under an LOU which provided for it to be inclusive of interest and costs. The court analogized the provision to the rule requiring the principal sum of a bail bond to cover the claim as well as interest and costs which had accrued before the bond was filed, going on to require that the LOU, like a bond, also impliedly covered interest which accrued after the bond was filed.³⁰

A second reason for the obligation to file a surety bond on demand was that although the issuing club is liable for the full amount of the LOU, it is only a lightly capitalized mutual insurer³¹ which, under the agreements of the International Group of P&I Clubs, retains primary liability up to just a certain amount – currently \$8 million. If the LOU were for a larger amount, the issuing club would have to look to the pool created by other members of the International Group to make the larger amount good. But the plaintiff would not be able to

³⁰ *Crescent Towing & Salvage Co. v. MV CHIOS BEAUTY*, 610 F.3d 263 (5th Cir. 2010).

³¹ Standard & Poor rates the creditworthiness of the clubs. In the past some have received only a BB rating.

enforce the LOU directly against the other members of the International Group.³² The right to require the issuing club to substitute a surety bond offered some cold comfort that the Group would stand by the issuing club. Historically, too the clubs in the International Group have never been known to walk away from their pool obligations.

The club's duty to provide a surety bond on demand has led to some litigation in cases where the plaintiff felt aggrieved either by the club's unwillingness to settle, or by what the plaintiff regarded as club unreasonableness in some other way, leading plaintiff to demand the filing of a surety bond. A court held that plaintiff's motivation was irrelevant and ordered that the bond be filed.³³

Some admiralty judges, while enforcing an LOU, have characterized the acknowledgment that the LOU was intended to put the plaintiff in the same position as if the ship had actually been arrested and then released by the filing of a bail bond, as necessary to give the court *in rem* jurisdiction over the ship.³⁴

Occasionally a club lawyer has been tempted to offer an LOU to release

³² In the AMOCO CADIZ appeal the shipowner's club offered the oil company cargo owner an LOU in an amount far in excess of the club's retention, as a substitute for a *supersedeas* bond. But when the International Group declined to allow the cargo owner to cut through the LOU, so as to make it enforceable against the other clubs for the amount in excess of the issuing club's retention, the cargo owner insisted on a bond issued by an authorized surety. See also *Allied Maritime v. Rice Corp.*, 2004 A.M.C. 2450 (S.D.N.Y.) [club declined to grant cut-through in order to make LOU enforceable directly against parent company].

³³ *Chiquita Int'l v. Liverpool & London S.S. P&I Ass'n*, 124 F. Supp. 2d 158 (S.D.N.Y. 2000); see also *Mackensworth v. S.S. AMERICAN MERCHANT*, 28 F.3d 246, 252-53 (2d Cir. 1994).

³⁴ *Continental Grain Co. v. Federal Barge Lines*, 268 F.2d 240, 243 (5th Cir. 1959), *aff'd*, 364 U.S. 19 (1960); *L & L Marine Transp. v. M/V HORUETSU HOPE*, 895 F. Supp. 297, 300 (S.D. Ala. 1995).

or avoid an arrest which leaves out the club's obligation to file a surety bond,³⁵ or to omit the acknowledgment about the equivalent of the ship being arrested and bailed. But this can be seriously prejudicial to a plaintiff. In one case, where the LOU provided for substituting a surety bond, but did not mention the acknowledgment, a court ruled that the LOU did not create a constructive arrest of the ship.³⁶

4. Omitting the club's obligation to cause the shipowner to enter an appearance to defend against *in personam* claims against him.

The obvious purpose of this obligation is to eliminate the need to complete service of process on the shipowner who is sued *in personam* in the same lawsuit which the parties have agreed would hear the claims against the vessel *in rem*.³⁷ The rules allow a ship to be arrested to foreclose a maritime lien, and in the alternative, for the ship to be attached as security for a claim *in personam* against a party who owns an interest in the ship.³⁸ But where the *in personam* party does not own an interest in the ship, as for example a time charterer, the club would be justified in omitting from the LOU an obligation to cause that party to enter a personal appearance in the lawsuit

³⁵ Ten years ago, in the BIG RED BOAT litigation, when the club tendered an LOU without the obligation to file a surety bond, the court, without mentioning the objection to the LOU raised by a putative lienor with a huge claim, allowed the ship to sail. The lienor's claim was later dismissed. 339 F.3d 76 (2d Cir. 2003)

³⁶ *Petroleos Mexicanos Refinacion v. M/T KING A*, 554 F.3d 99, 105 (3d Cir. 2009)[“not intended to prevent service of an arrest warrant on the vessel”; hence later arrest of ship was not a re-arrest].

³⁷ Depending on the wording of the LOU, the agreement to cause the shipowner to enter an appearance might not be suffice as a substitute for service of process if the shipowner were a foreign sovereign. See *Shell v. MV ITANAGE*, 830 F. Supp. 1423 (M.D. Fla. 1993).

³⁸ F.R.C.P. Rule C(1).

Sometimes, if the club's lawyer thinks that the plaintiff's claims could turn out to be greater than the agreed amount of the LOU, he might see an advantage in trying to omit the obligation to cause the shipowner to make a personal appearance, in an effort to shield him from a deficiency judgment after the bond is exhausted. This area of U.S. law is rarely visited and still slightly unsettled.³⁹

But even in cases where the club might have a good reason to decline an obligation to cause the shipowner to make a personal appearance, it should be willing to consent, if only in a side agreement, to accept service of process on the shipowner in the suit, albeit without waiving any of the shipowner's jurisdictional defenses.

5. Provision for an LOU to be governed by English law and enforceable only in an English court.

It is not uncommon to find English clubs attempting to insert provisions in their LOUs which provide for exclusive enforcement of the club's obligations under English law and only by the English courts. Such LOUs are not truly the equivalent of surety bonds which are enforceable on motion practice in the suit against the ship and do not require a second suit against the surety.

Moreover, where the LOU supplements the contract of carriage on which the plaintiff sues, and contains additional obligations of the shipowner to which the club agreed in the LOU as an agent of the shipowner, issues involving the

³⁹ See *Central Hudson Gas & Elec. Corp. v. Empresa Naviera Santa*, 56 F.3d 359 (2d Cir. 1995).

shipowner under those parts of the LOU may be heard by the same forum that hears the plaintiff's claims against the shipowner under the carriage contract.⁴⁰

It might be possible to persuade a club to retract a proposed English law/English court clause, by rejecting the LOU on the ground that it is not the equivalent of a surety bond. The club's only alternative, then, would be to file a bond. Rather than incurring the expense of a bond, the club might pragmatically back down.

6. Stalling.

Perhaps the most distressing situation is where a plaintiff seeks an LOU and the club lawyer announces that he will recommend it, but the LOU never arrives.⁴¹ This hardly ever happens when the ship has actually been arrested since the result could be a long delay in getting her released.

The potential for this scenario to develop is far greater when the LOU is sought to avoid an arrest. The club lawyer may very well be sincere about his intentions. But the claims handler at the club may feel that the plaintiff is bluffing and really is neither prepared nor willing to shoulder the expense of an arrest. Or the shipowner may be behind in his calls; or have a very high deductible for which he is unable to provide countersecurity swiftly. Whatever the reason repeated assurances from the club's lawyer about his efforts to obtain authority to issue an LOU could lull the plaintiff's lawyer into a false sense of security,

⁴⁰ *Louis Dreyfus Negoce v. Blystad Shipping & Trading*, 252 F.3d 218 (2d Cir.), cert. denied, 534 U.S. 1020 (2001).

⁴¹ The plaintiff cannot compel the attorney to issue the LOU. *The PENN FUEL*, 36 F.2d 272 (S.D.N.Y. 1929).

causing him to neglect to complete all of the necessary steps to arrest the ship, thereby creating an opportunity for her to slip in and sail without being seized.⁴²

It is perhaps indicative of the decline in trust within the admiralty bar that all too often plaintiff's lawyers who get a sense that they are being stalled, conclude that the club lawyers' assurances might well be intended to facilitate the ship's escape.

To be prudent, a plaintiff's lawyer should assume as a rule of thumb that a club's willingness to issue an LOU is ascertainable within 48 hours after one is requested. At that point, if no authority has been given in principle to the club's representative to issue the LOU, the complaint should be filed with the court, the warrant of arrest obtained (but withheld from delivery to the Marshal), the availability of a substitute custodian established, the Marshal's office alerted and a tentative arrangement for launch service explored (if the ship will be anchored out). All of these activities will establish credibility that the threat of arrest is not a bluff.

7. Plaintiff refuses to accept an LOU as a substitute for a surety bond.

In some cases where a ship was arrested and the wording of an LOU could not be agreed, a club has moved for an order allowing it to obtain release of the ship from arrest in exchange for furnishing an LOU to the plaintiff whose

⁴² *State of Louisiana v. Kition Shipping Co.*, 653 F. Supp. 2d 633 (M.D.La. 2009).

terms have been approved by the court. Occasionally the club has been successful.⁴³

But those decisions are aberrational. Other cases make clear that an arresting plaintiff is entitled to a bail bond and cannot be forced to consent to receive an LOU as substitute security.⁴⁴ To begin with, judges are authorized to approve as security only a bond or undertaking/stipulation secured by cash or government securities deposited in the registry of the court, a bond issued by a surety approved by the Secretary of the Treasury, or an undertaking/stipulation guaranteed by two individual residents of the district in which the ship was arrested who own property there worth double the amount of the undertaking/stipulation over and above all of their other debts.⁴⁵ Club LOUs fall into none of those categories. Moreover, to the extent that the amount of the LOU exceeds the club's retention and is backed only by the pool of other clubs in the International Group, it represents an unregulated financial risk which presumably would not be presented by a bond issued by an authorized surety.

⁴³ See *In re Sobodna Plovidba*, 1987 A.M.C. 2209 (W.D. Mich.); cf. *Acacia Vera Navigation v. Kezia*, 78 F.3d 211, 214 (5th Cir. 1996)[motion granted to substitute LOU for a surety bond after trial resulted in reduced damages].

⁴⁴ *Thyssen v. M/V SENA DENIZ*, 2001 A.M.C. 867 (E.D. La. 2000); *Koch Ref. Co. v. M/V JENNIFER BOUDREAUX*, 1992 U.S. Dist. LEXIS 3739 (E.D. La. 3/23/93) [club LOU not acceptable to establish limitation of liability fund over objection of a claimant]; *Akermanis v. Sea-Land Servs.*, 1982 U.S. Dist. LEXIS 9292 (S.D.N.Y. 1/25/82)[club LOU not acceptable as supersedeas bond]; *In re Compania Naviera Marasia*, 466 F. Supp. 600 (S.D.N.Y. 1979) [club LOU acceptable to establish limitation of liability fund but only if no claimant objected]; cf. *Jaimie Shipping v. Oman Ins. Co.*, 2008 U.S. Dist. LEXIS 67765 (S.D.N.Y. 9/8/08)[foreign bank guarantee not acceptable security]; *Board of Comm'rs v. M/V BELLE OF ORLEANS*, 439 F. Supp. 2d 1178, 1185(S. D. Ala. 2006), rev'd on other grounds, 535 F.3d 1299 (11th Cir. 2008)[LOU accepted for 10 days to be replaced by surety bond]. See also *The NEPTUNE DORADO*, S.M.A. No. 3962 (N.Y. Arb. 2007)[arbitrators were skeptical about club assertion that obligation to substitute a surety bond was premature before arbitrators issued an award].

⁴⁵ Local S. & E.D.N.Y Civil Rule 65.1.1(b).

But a court is not entirely without power to force a plaintiff to consent to take an LOU, because the court has discretion to fix the amount of the security. At least one court confronted with the refusal of a plaintiff to accept an LOU, dealt with the matter by exercising its discretion to fix the amount of security as zero, thereby allowing the ship to be released without the charterer having to provide any security.⁴⁶ Ironically, the court knew enough about LOUs to appreciate their role, but not really enough about the world of p & i insurance. The particular club was not a member of the International Group and therefore lacked the substantial backing, history of financial responsibility, and stability of the pool formed by the Group members, as well as the reinsurance of the Group which is reputed to be the largest of its kind in the world. This could well have been a case where the LOU was justifiably refused.⁴⁷

Conclusion

The LOU is an unusually creative and valuable document: it is cheap and mutually advantageous since it can be quickly provided anywhere, as well as easily adapted to even the most unusual circumstances in connection with a threatened or actual ship arrest. But the extraordinary usefulness of the LOU to the shipping industry has been impaired in recent years by club efforts to reduce

⁴⁶ *Allied Maritime v. Rice Corp.*, 2004 A.M.C. 2450 (S.D.N.Y.); cf. *Nelson Marketing Int'l v. Wilhelmsen Lines*, 2000 A.M.C. 1325 (C.D. Cal.)[court ordered plaintiff to accept an LOU for the amount of the COGSA package limitation].

⁴⁷ Cf. *Petroval Bunker Int'l v. CMA CGM*, 636 F. Supp. 2d 300 (S.D.N.Y. 2009)[defendant's "corporate promise" not the equivalent of security]; *Pancoast Trading v. Eurograni*, 2008 A.M.C. 859 (S.D.N.Y.); cf. *In re Austin-Lacey*, 2006 U.S. Dist. LEXIS 92790 (M.D. Fla. 12/22/06).

the obligations they assume when issuing them. Such efforts have generated substantial mistrust within the admiralty bar.

The high regard previously accorded to LOUs can and should be restored. Indeed it should be carefully protected. But this can be accomplished only if the clubs renew their resolve that the security they offer in an LOU is “as substantial, risk free and available as either the arrested vessel tied to the dock and ready for execution, or a bail bond.”⁴⁸ For the clubs to continue to chip away at this standard would be seriously counterproductive.

-end-

⁴⁸ *Richardson Int'l v. ZAO RPK STARODUBSKOE*, 2002 FCT 482 (Can. Fed Ct.){Hargrave, P.}.

EXHIBIT A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
IOLANTHE CHARTERING CO.,

10 Civ. 77777 (_____)

Plaintiff,

- against -

RELEASE OF ARREST BOND

BUTTERCUP SHIPPING CO., and
M.V. PINAFORE, her engines, tackle, etc. *in rem*,

Defendants.

-----X

Buttercup Shipping Co., as Principal and Mikado Insurance Company, as Surety, are held and firmly bound in the sum of Two Hundred Twenty Five Thousand (\$225,000.00) dollars to the use of the plaintiff in the within proceeding.

The condition of this obligation is such that if the plaintiff shall obtain a judgment or award against the Defendant M.V. PINAFORE, in rem in this action (after appeal, if any), that the Defendant M.V. PINAFORE shall satisfy the judgment and or award with interest and costs (including attorneys fees, if any be awarded), and if it fails so to do, the within named Surety shall do it for the Defendant M.V. PINAFORE; then this obligation shall be void; and otherwise it remains in full force and effect.

Dated: New York, New York
October 1, 2010

BUTTERCUP SHIPPING CO.

By: _____
Rafe Rackstraw
As Master of M.V. PINAFORE

MIKADO INSURANCE COMPANY

By: _____
K.K. San
As Attorney-In-Fact

EXHIBIT B

SAMPLE "EVERGREEN" LETTER OF CREDIT

Iolanthe Chartering Co.
c/o Gilbert & Sullivan LLP

Dear Sirs:

We hereby open our irrevocable letter of credit in your favor on behalf of Buttercup Shipping Co. (hereinafter referred to as "Buttercup"), as owners of the M.V. PINAFORE, up to an aggregate amount of \$450,000 available by your draft on ourselves at sight accompanied by the following documents:

1. A certified copy purporting to be a final judgment, of the United States District Court for the Southern District of New York in your favor against Buttercup and/or the M.V. PINAFORE in a suit for loss, damage or contamination of a cargo of snickersnees carried from Titipu to Cornwall in July of 2010.

2. An affidavit purporting to be made by one of your attorneys, Gilbert & Sullivan, LLP, certifying that the aforesaid judgment and notice of entry have been served upon Buttercup's attorneys Porter & Nankipoo, LLP and that

a. the period of appeal from the judgment has expired or

b. (i) the judgment was appealed, and

(ii) the judgment was affirmed or modified in your favor on the appeal, in a stated amount, and

(iii) notice of entry of the disposition of the appeal has been served upon Porter & Nankipoo, LLP, and

(iv) no further appeal from the judgment is available or the period for any such further appeal has expired.

3. In lieu of the documents described in paragraphs 1 and 2 above, a settlement agreement purporting to be jointly executed by your attorneys, Gilbert & Sullivan, LLP, and Buttercup's attorneys, Porter & Nankipoo, LLP providing for payment of a sum of money under this Letter of Credit as full and final settlement of your above-described claims.

If the suit brought by you in the United States District Court for the Southern District of New York as described in paragraph 1 above is dismissed after final appeal, if any, this Letter of Credit will thereupon terminate.

Upon payment of your draft, the unpaid balance of this Letter of Credit, if any, will be cancelled.

This Letter of Credit will expire on September 30, 2011. It is a condition of this Letter of Credit that it shall be extended for an additional period of one year from the present or any future expiration date hereof unless 30 days prior to such date we have notified you in writing that we elect not to renew this Letter of Credit for such additional period. Upon receipt by you of such notice, you may draw hereunder by means of your draft on us at sight, without any of the documents referred to in the preceding paragraphs.

This Letter of Credit will terminate before expiration upon receipt back by us of the original Letter of Credit for cancellation, or our receipt of a certified copy of a final judgment by the aforesaid court against you, accompanied by affidavit by Porter & Nankipoo purporting to certify that the judgment and notice of entry have been served upon your attorneys, Gilbert & Sullivan, LLP, and that

- a. The period for appeal has expired, or
- b.
 - (i) the judgment was appealed, and
 - (ii) the judgment as affirmed or modified continues to be in favor of Buttercup and against you and that no sums are due you, and
 - (iii) notice of entry of the disposition of the appeal has been served upon Gilbert & Sullivan, LLP, and
 - (iv) no further appeal from the judgment is available or the period for any such further appeal has expired.

We engage with you that all drafts drawn under and in compliance with the terms of this Letter of Credit will be duly honored upon delivery of the documents specified above if presented at this office on or before the expiration date, or any automatically extended expiration date.

This Letter of Credit is subject to the Uniform Customs and Practice for Documentary Credits ((2007) Revision, International Chamber of Commerce Publication No. 600).

Yours truly.

Ruddigore National Bank

SIDE AGREEMENT

THIS AGREEMENT is made on this 1st day of October 2010 between BUTTERCUP SHIPPING CO. ("Buttercup") and IOLANTHE CHARTERING CO. ("Iolanthe") through their undersigned attorneys.

WHEREAS Iolanthe has threatened to commence an action against Buttercup in the United States District Court for the Southern District of New York for loss, damage or contamination of a cargo of snickersnees carried by the M.V. PINAFORE from Titipu to Cornwall in July 2010.

WHEREAS Buttercup has provided substitute security in the form of a Standby Letter of Credit for \$450,000 established by Ruddigore National Bank ("Letter of Credit").

NOW THEREFORE IT IS HEREBY AGREED:

1. Iolanthe agrees not to arrest the M.V. PINAFORE, and not to seize or attempt to seize any other ships or property belonging to Buttercup in connection with the above-described claims.

2. Buttercup will file or cause to be filed a [general appearance *in personam* and]¹ claim of ownership and/or interest in the M.V. PINAFORE, on behalf of the owner of said vessel, in any proceedings which Iolanthe timely commences against the vessel and/or her owner in the United States District Court for the Southern District of New York and/or in arbitration as provided in the charter party dated July 4, 2010, for loss, damage or contamination to a cargo of snickersnees carried by the M.V. PINAFORE from Titipu to Cornwall in July 2010.

3. [Since the parties cannot at this early stage accurately estimate how much the plaintiff's claim ultimately will total, it is agreed that the arbitrators, or if no arbitral tribunal has been established, then the United States District Court for the Southern District of New York, shall have jurisdiction to order Buttercup to increase or decrease the principal amount of the Letter of Credit for good cause shown]².

4. Upon demand to cause to be filed a bond in form and sufficiency of surety satisfactory to the Court in the amount of \$225,000 plus interest and costs (including costs of attorneys fees, if any be awarded) securing your claims against the vessel in the aforementioned proceedings. In the event this bond is filed, then Iolanthe will forthwith return the original Letter of Credit to the Ruddigore National Bank for cancellation and this Side Agreement will expire.

5. All of the foregoing is without prejudice to any claim, rights or defenses which the M.V. PINAFORE and/or her owner may have under the law applicable to the

¹ Text in brackets deleted if no claim *in personam* is made by Iolanthe against Buttercup.

² Text in brackets subject to negotiation depending on the circumstances.

above-described claims, none of which are to be regarded as waived, and the giving of this Letter of Undertaking is not to be construed as an admission of liability.

6. The Letter of Credit is intended to place Iolanthe in the same position, to the extent herein provided as that if an admiralty bond or undertaking in the customary form and in the principal sum of \$225,000 plus interest and costs (including costs of attorneys fees, if any be awarded), had been provided by the owners of the said vessel to obtain the release of the M.V. PINAFORE had she been arrested; but payment under the Letter of Credit shall not in any event exceed \$450,000.

7. If Ruddigore National Bank elects not to renew the Letter of Credit and provides notification of such pursuant to the terms of the Letter of Credit, Iolanthe agrees that, absent the posting of substitute security acceptable to Iolanthe, if funds are drawn on the Letter of Credit without presentation of documents referred to paragraphs 1 or 2 thereof, such funds will be deposited in the registry of the Court and the parties agree to use their best efforts to cooperate to have those funds placed in an interest bearing account.

Gilbert & Sullivan LLP
Attorneys for Iolanthe Chartering Co.

Porter & Nankipoo LLP
Attorneys for Buttercup Shipping Co.

EXHIBIT C

SAMPLE & LETTER OF UNDERTAKING

Iolanthe Chartering Co.
c/o Gilbert & Sullivan LLP

Dear Sirs:

In consideration of your agreeing not to arrest the M.V. PINAFORE, and agreeing not to seize or attempt to seize any other ships or property belonging to Buttercup Shipping Company in connection with your claims for loss, damage or contamination of a cargo of snickersnees carried by the M.V. PINAFORE from Titipu to Cornwall in July 2010, The Gondoliers Mutual Steamship Protection and Indemnity Association hereby undertakes and agrees:

1. To file or cause to be filed a [general appearance *in personam* and]¹ claim of ownership and/or interest in the M.V. PINAFORE, on behalf of the owner of said vessel, in any proceedings which you timely commence against the vessel and/or her owner in the United States District Court for the Southern District of New York and/or in arbitration as provided in the charter party dated July 4, 2010.

2. In the event a final judgment (after appeal, if any) be entered in your favor against the M.V. PINAFORE and/or her owner on the above-described claims, whether in an arbitration award or otherwise, then the undersigned Association agrees to pay and satisfy said final judgment for any sum up to but not exceeding \$225,000 plus interest and costs (including costs of attorneys fees, if any be awarded), or any lesser amount decreed by the court, or settled between the parties without final decree being rendered, ship lost or not lost.

3. [Since the parties cannot at this early stage accurately estimate how much the plaintiff's claim ultimately will total, it is agreed that the arbitrators, or if no arbitral tribunal has been established, then the United States District Court for the Southern District of New York shall have jurisdiction to increase or decrease the principal amount of this LOU for good cause shown;]².

4. Upon demand to cause to be filed a bond in form and sufficiency of surety satisfactory to the Court in the above amount securing your claims against the said vessel in the aforementioned proceedings. In the event this bond referred to is filed, then the undersigned Association shall be released from the obligations provided for in paragraph 2 herein.

¹ Text in brackets deleted if no claim *in personam* is made by Iolanthe against Buttercup.

² Text in brackets subject to negotiation depending on the circumstances.

5. All of the foregoing is without prejudice to any claim, rights or defenses which the M.V. PINAFORE and/or her owner may have under the law applicable to your above-described claims, none of which are to be regarded as waived, and the giving of this Letter of Undertaking is not to be construed as an admission of liability.

6. This letter is intended to place you in the same position, to the extent herein provided as that if an admiralty bond or undertaking in the customary form in the principal sum of \$225,000 plus interest and costs (including costs of attorneys fees, if any be awarded) had been provided by the owners of the said vessel to obtain the release of the M.V. PINAFORE had she been arrested.

It is understood that the signing of this letter by Joseph Porter shall not be construed as binding him personally nor binding Porter & Nankipoo LLP, but is to be binding only upon The Gondoliers Mutual Steamship Protection and Indemnity Association.

Very truly yours,

Porter & Nankipoo LLP
As agents only for
The Gondoliers Mutual
Steamship Protection and
Indemnity Association