



## **The shipowner's hero – a club letter of undertaking**

P&I clubs provide the immensely useful service of guaranteeing payment for claims made against the ship and shipowner in the form of a P&I club letter of undertaking (LOU). The provision of an LOU allows a ship arrested or threatened with arrest to sail, minimising business interruption and consequent financial losses.

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## Introduction

Ships travel the world. Claimants sometimes fear that when the ship sails, so goes their chance of recovery for losses caused by operation of the ship. Claims range from damage to property, the environment to injury to people. Claims may come from individuals, businesses and governmental entities. A ship arrest results in immediate additional costs such as crew maintenance, port and agency fees and hire costs. Prolonged arrest will result in consequential financial losses, for example loss of future charters, deterioration of the vessel and any cargo aboard. When claims fall within the P&I cover, International Group clubs may come to the rescue by quickly providing an LOU as security and getting the vessel back in business.

In essence, a club LOU is a written promise whereby the club agrees to promptly pay a final and unappealable judgement by a competent court or, if the club so agrees, a sum in settlement of the claim. The LOU is conditioned on the claimant either lifting an arrest or agreeing not to arrest the vessel. An LOU from a club that is a member of the International Group is trusted because of the history of clubs honouring their promise to pay and because of the financial strength of the clubs individually and collectively under [the Pooling Agreement](#). Because LOUs are in published and standard form, they are easily understood and do not require detailed negotiation over terms.

**Wide acceptance and variety of terms** The standard form club LOU is an acceptable form of security in most jurisdictions. The LOU can be posted either directly by a club – which is common practice – or sometimes indirectly via local correspondents acting as agents for a club. In some jurisdictions, local standard forms prevail - many of which are acceptable alternatives to the standard club wording. If required, LOUs can be altered to fit local demands without losing their basic character and essential clauses retaining all defences and the right of appeal. Gard will often know which amendments can be expected and can shorten negotiations through proposing terms we know have been accepted previously.

**Saving time and money** Clubs recognise the importance of LOUs to their members and, although under no obligation to do so, usually exercise their discretion to post security for covered claims provided acceptable terms are agreed. With a growing trust in electronic signatures and documents, LOUs can be in the hands of a claimant in a matter of hours on any day of the week. Most claimants will accept an electronic copy of an LOU, to be followed by the original. With more and more business conducted digitally, expect to see additional language to the effect that *"the electronically scanned copy shall have immediate effect and be deemed to have the same effect as the original"*.

In contrast to an LOU, a bank guarantee or bond often takes several business days to arrange. Moreover, banks are unlikely to agree to open ended arrangements and will likely require an 'expiration date' in the guarantee. Given the costs of bank fees and commission rates (between 0.25 and one per cent per annum) LOUs result in substantial savings in addition to the member's financial losses being kept to a minimum by the ship being able to leave quickly.

**When claims are outside P&I cover** A P&I club would exercise caution not to expose its capital to uninsured claims by providing LOUs in respect of substantial claims outside the scope of cover. Such exposures may be contrary to regulatory provisions that apply to the club's activities and/or lead to an unacceptable counter-party credit risk exposure for the club

Gard may, in extraordinary circumstances, provide an LOU against adequate counter-security for claims outside of cover. Generally, Gard would require counter-security in the form of a cash deposit and signed pledge agreement, or a bank guarantee from a first class bank domiciled in a country where such counter-security can be effectively enforced.

Gard may also decide to provide an LOU for claims that fall within a deductible or where the liability is placed partially with another insurer, for example where Gard is covering three

fourths of collision liability. Gard would then accept counter-security from the second insurer for the remaining one-quarter collision liability.

Conclusion The LOU plays a crucial role in keeping ships moving in the maritime industry. The International Group clubs' practice of honouring their LOUs leads to ever-increasing acceptance of club security by claimants including Governmental entities.

*For more detailed information, please see [Gard Guidance on Maritime Claims and Insurance, pg. 504-507](#) and [Guidance to Rule 88 in the Gard Guidance to the Rules](#).*

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