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A general guide to ship manager's undertakings

ITIC is often asked by ship managers to comment on the wording of a “ship manager undertaking” or “letter of undertaking” (LOU) which they have been asked to sign. This is a situation which has become more relevant in the current financial markets.

A ship manager's undertaking is usually a document provided by a bank or other lender or financial institution (although we will simply use the term “the Bank” for the remainder of this article), but usually written in the guise of an LOU from the ship manager to the Bank which states that in consideration for remaining as (or being appointed as) the manager of the vessel, the ship manager will undertake that:

- (a) any and all claims the manager may have in respect of the vessel against third parties shall rank second to the claims of the Bank;
- (b) any and all claims the manager may have against the vessel's insurers will also be subordinate to the claims of the Bank;
- (c) the manager will forego their right to bring a claim (or obtain security) against the vessel or the Owner for any funds they are owed; and
- (d) that the ship management agreement will not be amended during the term of the loan the Bank is providing to the Owner.

Clearly the manager must take care when being asked to sign these documents.

It must always be remembered that the original ship management agreement (usually subject to a BIMCO Shipman 98 or 2009) is with the Owner and they remain the manager's principal. Therefore, the ship manager must not agree to any LOU unless the manager has the Owner's full permission to do so – as some of the terms within the LOU can be contrary to the interests of the Owner. It is always sensible to have the LOU countersigned by the Owner if the manager can arrange it. Failing this, the manager should obtain the owner's written permission to sign it.

ITIC would not recommend that the manager signs any LOU which includes multiple parties as they can become confusing and contain many provisions that do not relate to the manager. The LOU is an agreement between the manager and the Bank and should remain that way. However, this should not stop the manager having the owner sign the document to show that they have given permission for the manager to enter into the LOU.

If the LOU substantially alters the ship management agreement, the manager may need to consult with their professional indemnity insurer, as most covers are based on the management being “on terms no more onerous than those of BIMCO “Shipman 98” or “Shipman 2009” form unless otherwise agreed by the insurer. Also, the manager may be concerned as to how their professional indemnity insurance would be affected by them signing an LOU. The general answer is that there would be no effect, as the cover is there in the event that the manager’s negligent performance of the insured service leads to or causes a loss to a third party. What is most important about the signing of an LOU is that the manager is giving up their right to recover funds that may be owed to them.

ITIC have an e-learning video looking in more depth at the specific points, which ship managers should be wary of.