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Tuesday 3rd February 2026

ITIC Circular

Guidance on Letters of Undertaking to provide security when facing claims for owners' issues

Introduction

ITIC insures many ship agents around the world. ITIC has decades of experience handling a variety of disputes and issues faced by ship agents. As the local representative of their principals, ship agents can often find themselves in the unfortunate position of facing a claim from a third party that should be against the ship/shipowner.

In recent years ITIC has seen an increase in issues in these situations where a ship agent faces being named directly in proceedings for claims and losses that relate to a problem or an incident on the ship, such as cargo damage or misdeclarations in ship's stores. The only reason the claimant or the authorities have involved the ship agent, is because they were the local representative of the principal and have an office local to the cargo interests or the local authorities.

Generally, the shipowner is obliged to defend their agent in these circumstances, but it has become increasingly difficult for the ship agent to obtain security from the shipowner (or most likely, the P&I Club).

ITIC's recommendation in these circumstances is to notify us as soon as possible and where appropriate we can involve either a local correspondent or lawyer to urgently seek security from the P&I Club.

Why is security so important?

ITIC recommends that you get security because shipowners usually operate as a 'one ship owning company' as the 'registered owner' with little or no assets. It is often the case that when it comes time to call on the shipowner to pay a claim or indemnify the agent, the shipowner (or their asset, the ship) is gone. Claims for cargo damage can take on average two or more years to resolve, and fines against the ship can be even longer, in some jurisdictions it can take over ten years from the ship's call in port until the matter is resolved.

We have seen claims where security was belatedly requested, and could not be obtained, leaving the ship agent exposed.

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It is additionally important to involve the shipowner and their P&I Club as soon as possible after the incident, firstly because the ship and/or shipowner can move P&I Clubs, so approaching them after some time has passed may result in the P&I Club's refusal to secure the claim. Secondly notifying them early has the added benefit of not only obtaining security but also relieving the ship agent of the need to appoint their own lawyers as the shipowner's lawyers can step in and defend both parties.

Security considerations

What are the points to consider when seeking security from the P&I Club?

1. **Timing:** If the ship is in port, demand security ASAP. The threat of detention of the ship (if possible) creates leverage for the agent and puts pressure on the P&I Club. In general, ITIC's experience has been that it has become slightly more difficult to obtain LOU's in recent years so it is always recommended to seek security as early as possible.
2. **Amount of security:** This should be enough to cover the estimated value of the claim, plus an additional sum for costs and interests, from the outset. ITIC has seen instances where a ship agent was initially under secured and unable to persuade the P&I Club to increase the value of the security at a later date.
3. **Identity of the LOU provider (the guarantor):**

It is recommended that the provider of the LOU is the P&I Club itself. The reason security from an IG P&I Club is so valuable is because the P&I Club will pay even after the ship is no longer insured by the P&I Club or the shipowner ceases to exist. If the shipowner wants to provide a full bank guarantee this would usually be considered adequate security as long as it is from a first-class bank. However, given the choice the IG P&I Club LOU is probably preferable.

The International Group of P&I Clubs have existed for over 100 years and one of the hallmarks of the Group is their financial strength and security. An LOU from an IG P&I Club is recognisable around the world and can carry the same value as a bank guarantee in most key shipping jurisdictions.

Many P&I Clubs have satellite offices and there could be instances where they seek to provide security from such an office. This office may not have the capital and there remains a risk that the satellite office will not be able to honour the LOU. Therefore, the LOU should be provided by the Club itself, not a particular office or a correspondent's office.

4. Terms of the LOU:

- a) Check the terms of the LOU (either by a lawyer or ITIC will be happy to help) clearly define the scope of the dispute/claim for which the LOU is being given.

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- b) Check there is no expiry on the LOU. Where there is an expiry date and the ship agent fails to renew the LOU in time, they may find it can no longer be relied upon. This is more commonly found in bank guarantees.
- c) Check the terms for triggering payment. This is often upon the presentation of a final unappealable judgment in the ship agent's favour or under a settlement agreement between the parties, but where possible it is preferable to seek payment "on demand".

5. Law and jurisdiction:

This is the clause that sets out which law and jurisdiction will apply to the LOU and will govern it in case of any disagreement. ITIC has seen a trend for ship agents in certain jurisdictions to show reluctance to have any law and jurisdiction clause in the LOU, to preserve in their view, the right to interpret (or enforce) the LOU under their local law. However, with the absence of any law and jurisdiction clause there is no guarantee as to where the LOU will be considered or validly enforced.

Whilst ITIC understands that many members may feel unfamiliar with English law if they are not connected to this jurisdiction, for enforcement, ITIC recommends that English law and jurisdiction clauses are inputted into the LOU. Why?

- a) If a claim comes to the stage of requiring enforcement, it will be after the ship agent has had to pay the claim. If it's an ITIC covered matter, ITIC will be the party seeking an indemnity from the P&I Club on your behalf. So, the ship agent will not need to worry about having to seek their recovery as ITIC will be here to help.
- b) ITIC is familiar with English law procedures and has enforced LOU's under English jurisdiction many times and it is relatively straightforward process which could include a fast-tracked procedure called a 'summary judgment' where a judgment is sought early on in proceedings without a full hearing on the basis that the defendant has no real prospect of success.
- c) The majority of P&I Clubs are based in the UK, so enforcing an English law LOU against the guarantor in the UK is relatively straightforward.
- d) For completeness ITIC always recommends that the LOU contains a law and jurisdiction clause. Without one, the parties leave themselves open to a dispute over which law and jurisdiction should apply. This could be a long and expensive process.

6. ITIC cover: Finally, it is worth noting that ITIC's cover includes the costs of obtaining the LOU and of enforcing where necessary.

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In conclusion, it is worth noting that the reason the system of LOU's from IG P&I Clubs works so well is that there is a general ethos and history around them being honoured. If the P&I Club failed to honour an issued and valid LOU that would break the trust in the system and that is the reason so many companies around the world recognise and accept an IG P&I Club LOU to secure their potential claims. Therefore, it would be very rare that an IG P&I Club would refuse to honour an LOU once granted. It is obtaining it in the first place that can prove more difficult however we hope the tips and guidance above should assist in obtaining the most protective LOU as needed.

For more information, please contact your [ITIC account executive](#).

Please note that this circular is intended for general information only and does not constitute legal advice. You should seek professional guidance or specialist advice before taking, or refraining from, any action based on the content herein.

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