

# Ad valorem bills and references to letters of credit in bills of lading: a practical guide

The club has recently received a number of queries from members in respect of the potential impact a reference to a letter of credit (L/C) in a bill of lading might have on their liability towards a cargo interest and on their club cover. This article explores the issue and offers some practical tips for carriers and charterers.



**Professor Charles Debattista**  
Barrister, St Philips Stone  
T +44 20 7440 6900  
E cdebattista@st-philipsstone.com



**Elisabeth Birch**  
Senior Claims Executive  
T +44 20 3320 2279  
E elisabeth.birch@ctplc.com

## The issue

Why do shippers ask for references to a letter of credit in a bill of lading?

Commonly, in the context of a sales contract transaction, the buyer (or one of the banks involved in financing the transaction) insists on the insertion of a reference to an L/C in the bill of lading.

The object is to ensure that the bill of lading issued matches and represents the same goods which form the subject of the credit facility. The buyer may also have an ulterior motive: to use the extra time needed for checking compliance with the requirement as a means to extend the period of time before the buyer must make the payment.

For the bill of lading carrier, this creates a potential problem: a reference to an L/C may render a bill of lading an *ad valorem* bill of lading, which in turn, by virtue of rule 3.13.3(12) of the club rules<sup>1</sup>, prejudices the member's right to limit its liability for cargo loss or damage.

This article addresses the following questions:

- What is an *ad valorem* bill of lading?
- Why does a shipper ask for a reference to an L/C in a bill of lading?
- Does a reference to an L/C make a bill of lading an *ad valorem* bill of lading?

- How should a member react to a request by a shipper to insert a reference to an L/C in a bill of lading?

## What is an *ad valorem* bill of lading?

An *ad valorem*<sup>2</sup> bill of lading is one that expressly states the value of the subject cargo on the face of the bill of lading. The purpose is to sidestep the package/unit limitation set out in Article IV Rule 5(a) of the Hague or the Hague Visby Rules (the Rules), which limits the amount of damages recoverable by a cargo claimant 'unless the nature and value of [the] goods have been declared by the shipper before shipment and inserted in the bill of lading'. In the event that cargo loss or damage is suffered, a cargo claimant which ships valuable goods will want to recover the maximum amount of damages recoverable at law and, to that end, the Rules allow him to break limitation by issuing an *ad valorem* bill of lading. As a result, an *ad valorem* bill of lading deprives the carrier of his valuable right to limitation of liability per package or unit.

However, the Rules are not entirely clear about what amounts to an *ad valorem* bill of lading. The Rules provide that the shipper needs to declare the value and the nature of the goods in the bill of lading before shipment.

<sup>1</sup> '... goods carried under a document containing or evidencing the contract of carriage where the value per unit, piece or package has been stated to be in excess of \$2,500, or the equivalent in any other currency, which may deprive the member of the right to rely on defences or rights of limitation which would otherwise have been available to him, to the extent that such liabilities exceed that sum'.

<sup>2</sup> Latin *ad valorem*: 'to the value'

This creates two additional points of potential difficulty:

- It is not always clear what constitutes the nature of the goods and what exactly needs to be declared for the shipper to fulfil this requirement.
- Bills of lading are often issued *after* shipment: this raises a question as to the status of a declaration of value and nature made *after* shipment, but before the bill of lading is issued.

Leaving to one side these additional areas of difficulty, the key point is that issuance of an *ad valorem* bill of lading deprives the carrier of its valuable right to limitation of liability per package or unit. *Ad valorem* bills of lading are therefore generally bad news for carriers.

It is with this in mind that the International Group Pooling Agreement excludes cover where the effect of an *ad valorem* declaration takes the value of the goods beyond the relatively modest figure of \$2,500 per unit.<sup>3</sup>

A member may, therefore, find itself in a difficult position, faced with the conflicting expectations of its cargo interest counterparties and its P&I club. On the one hand, a shipper is insisting that a bill of lading be issued stating a specific value for the goods shipped, whilst on the other, the P&I cover is compromised if the resultant value of the cargo declared exceeds \$2,500 per unit.

### Why do shippers ask for references to a letter of credit in bills of lading?

The shipper's request is likely to be rooted in the commercial demands of the cargo receiver or one of the banks involved in the sales contract transaction. The intention may be innocent enough: to ensure that the bill of lading that has been issued marries up with and represents the same goods for which the sum payable under the L/C is due. The effect of the requirement may, however, cause more trouble than was intended. Difficulties might potentially arise if the L/C number is incorrectly transposed onto one or more ancillary documents or an ancillary document does not carry the L/C number.

These are problems that a document checker may need time to deal with, checking with documentary supervisors what a particular bank's policy is in such cases, or checking back with the buyer of the goods to see whether a waiver of the discrepancy can be obtained. This is where the intention of requiring such a reference may not, in fact, be as benign as one might think: the requirement might just be – and sometimes is – simply a ruse put in place by the buyer of goods in order to delay payment for the goods, possibly until after they are discharged at destination. The result is that it is now the *shipper* who is between a rock and a hard place: the bank will not pay unless the shipper presents a bill of lading referring to the L/C by number, but on the other hand, the carrier is reluctant to issue such a bill of lading, inspired no doubt by the cautionary advice given by its club against *ad valorem* bills of lading.

### Does a reference to a letter of credit make a bill of lading an *ad valorem* bill of lading?

This brings us to the central question in this article. Money turns on this question because if the answer is yes, then the carrier loses its limitation under the Rules; and *may* lose its P&I cover. A carrier will therefore argue that the answer to this question is no, claiming that:

- an L/C number is not a declaration of the nature and value of the goods, as per the Rules formulation
- the actual value of the goods will be found in the L/C itself, so this is not a value inserted in the bill of lading.

On this basis, a reference to an L/C in a bill of lading does not make a bill of lading *ad valorem* – and a carrier need therefore fear no loss of its limitation and that clubs need not deprive cover from carriers issuing such bills of lading. The difficulty is that, perhaps somewhat curiously, there is no decided case confirming such an approach. Carriers – and clubs – inevitably therefore have to ask themselves: what if this approach is not upheld by the courts when tested in an actual case?

To that end, at the International Group level, a further key exception to cover has been inserted in the Pooling Agreement.<sup>4</sup>

This exception to cover provides that if a reference to an L/C were to be considered as an agreement by the carrier to contract on terms less favourable than the limitation of liability

<sup>3</sup> Pooling Agreement 2016, Appendix V, para. 14(f):

'...The following losses shall be Excluded Losses save only as they may be treated as sue and labour expenses or expenses incurred by direction of an Association... 14. Cargo Claims...Liabilities, costs and expenses in respect of the carriage of cargo arising out of any of the following save insofar and to the extent that the Insured Owner satisfies Directors of an Association that it took such steps as appear to those Directors reasonable to avoid the event or circumstance giving rise to such liabilities, costs and expenses...

(f) Carriage under an *ad valorem* bill of lading or other document of title, waybill or other contract of carriage in which a value of more than two thousand five hundred Dollars (\$2,500) (or the equivalent in any other currency) is declared and/or inserted by reference to a unit, piece, package or otherwise, where the effect of such a declaration/insertion is to deprive the carrier of any right or rights of limitation to which he would otherwise have been entitled and cause him to incur a greater liability than he would have done but for such declaration/insertion, to the extent that such liability thereby exceeds two thousand five hundred Dollars (\$2,500) (or the equivalent in any other currency) in respect of any such unit, piece or package.'

<sup>4</sup> Pooling Agreement 2016, Appendix V, para. 13(a):

'The following losses shall be Excluded Losses save only as they may be treated as sue and labour expenses or expenses incurred by direction of an Association...'

'...Liabilities, costs and expenses in respect of the carriage of cargo arising out of the following (save insofar as an Association shall exercise a discretion under its Rules):

(a) Contracts for carriage by sea on terms less favourable than those of the Hague or Hague Visby Rules, provided that insofar as concerns liabilities, costs and expenses arising out of any such contract for carriage, the reference to discretion in the preamble to this paragraph 13 shall be deemed to be a reference only to a discretion as to whether to accept the claims in respect of such liabilities, costs or expenses exercised after the occurrence of the event which gives rise to them...'

allowed by the Rules under the law applicable to the contract of carriage, then any resulting liability is an excluded loss under the Rules and cover will only be available on a discretionary basis – so carrier beware!

The result of both exceptions (paras. 13(a) and 14(f) Appendix V, Pooling Agreement) when read together is, therefore, that if the bill of lading declares, whether in terms or through a reference to an L/C, a value of the goods at less than \$2,500 per unit, then cover will not be compromised. If, however, the value of the cargo is higher than that figure, then it is likely that cover will be prejudiced and will only be available on a discretionary basis.

#### **How should a member react to a request by a shipper to insert a reference to a letter of credit in a bill of lading?**

The response of the member will depend on whether the member (either as owner or charterer) is the carrier under the bill of lading.

If the member is a carrier, it will be directly liable to cargo interests in respect of any cargo claims.

In this position:

1. A member should first notify its liability insurer in order to clarify whether, in the club's view, on the basis of the circumstances as they have transpired, cover is at risk.
2. The carrier should resist and query the reason behind the request to include in the bill of lading a reference to an L/C. The carrier should also consider whether compliance with the request would delay the issue of the bill of lading and possibly payment. This allows the carrier some time to obtain advice regarding cover from its club – and may give the shipper pause for thought and reconsideration.
3. If the shipper persists, then the carrier may counter with a request for *ad valorem* freight, on the basis that if they must suffer complications, so must the shipper.

If the member is a charterer but is not a carrier under the bill of lading, it is unlikely to face claims from cargo interests directly. However, members in this position should be aware that their charterparties may include indemnity provisions in favour of their owner counterparties (eg express clauses or incorporation of the Inter-Club Agreement) for liabilities that have been incurred as the result of the member ordering insertion of a reference to an L/C into a bill of lading. The same provisos as to club cover detailed above would apply to a charterer member in these circumstances.

#### **Conclusion**

This is a somewhat unhappy area for carriers: increasing demands for references to L/Cs in bills of lading; uncertainty in the Rules as to what exactly amounts to an *ad valorem* bill of lading and, in particular, whether reference to an L/C makes a bill of lading *ad valorem*; and, finally, the risk of the loss of P&I cover if the member issues *ad valorem* bills. The bottom line is: take care, exercise caution and refer to your club, if in doubt.

