NUS Law Working Paper 2019/010
NUS Centre for Maritime Law Working Paper 19/02

COGNITIVE BIASES, LETTERS OF CREDIT AND LETTERS OF INDEMNITY: THE CASE STUDY OF *THE ERIN SCHULTE*

Dr Miriam Goldby

Visiting Senior Research Fellow, Centre for Maritime Law, Faculty of Law, NUS
Reader in Shipping, Insurance and Commercial Law,
Centre for Commercial Law Studies, Queen Mary University of London

[Uploaded May 2019]

Cognitive biases, letters of credit and letters of indemnity: the case study of *The Erin Schulte*

Dr Miriam Goldby[*]

This working paper analyses the facts and decisions that led to the dispute in *The Erin Schulte* in order to identify the kinds of cognitive biases that may affect decision-making in complex situations affecting the performance of letter of credit and carriage contracts. It identifies various cognitive biases that may be at work in these situations, including loss aversion, the ambiguity effect, status quo bias and optimism bias. It proposes ways in which these biases may be countered in order to ensure better decision-making in these contexts, including making use of cautionary tales in the process of giving legal advice and using electronic alternatives to transport documents.

Keywords: Cognitive biases, letters of credit, letters of indemnity; bounded rationality, loss aversion, optimism bias.

[*] Reader in Shipping, Insurance and Commercial Law at the Centre for Commercial Law Studies, Queen Mary University of London, Deputy Director of the Centre's Insurance Law Institute, Co-Academic Director of its Institute of Transnational Commercial Law and Director of its LLM in International Shipping Law. An early version of this working paper was presented at the Global Shipping Law Forum on Indemnities and Guarantees in Maritime Law hosted by CML in 2015. The paper was finalised during my recent research visit to CML. I would like to thank CML for the funding that supported this research.

1 Introduction

This paper analyses an example of a bank-financed cross-border string-sale transaction in an attempt to gain some insight into the processes whereby decisions are made by business people in these complex situations. The scenario examined is that which forms the backdrop of *The Erin Schulte*.[1] The objective is not to analyse the High Court's and/or the Court of Appeal's reasoning and decision in this case. Rather it is an attempt to gauge the extent to which business decisions that have important effects on the decision-maker's legal position are made under the influence of heuristics and biases which may make the decision sub-optimal in utility-maximisation terms. I will use behavioural economics research to conjecture why the complicated set of facts in *The Erin Schulte* might have unfolded the way it did. I shall also discuss how mechanisms countering the cognitive biases that were in evidence in the *Erin Schulte* scenario may be adopted both in the giving of legal advice and in the development of commercial information technology tools.

2 The facts in *The Erin Schulte*

The facts of the case were as follows. Gunvor sold 18,000 metric tons (mt) of gasoil to United Infrastructure Development Corporation (UIDC) shipping 9,466 mt on the *Maria E* and 9,208 mt on the *Erin Schulte*, both owned by Dorchester LNG (the defendants in the case). UIDC on-sold the cargo to Cirrus. A letter of credit was opened by Cirrus in favour of UIDC as Beneficiary with United Bank of Africa (UBA) (the 'prime letter of credit'). This was confirmed by UIDC's bank, Standard Chartered Bank (SCB). The letter of credit was transferred to Gunvor who therefore became the second beneficiary (the 'transfer letter of credit'). Société Generale (SG) acted as Gunvor's agent for the purposes of drawing under the transfer letter of credit. The bills of lading covering the cargo recorded that the shipper was Gunvor and the consignee 'to the order of Société Generale, Paris'.

[1] *Standard Chartered Bank v Dorchester LNG (2) Ltd (The Erin Schulte)* [2013] EWHC 808 (Comm), [2013] 2 Lloyd's Rep 338 (*Erin Schulte* HC).

On the vessels' arrival at destination (Takoradi, Ghana)[2] and the testing of a sample, the cargo was found not to be of the required quality and UIDC and Cirrus rejected the cargo on both vessels. Cirrus offered to purchase the cargo on the *Maria E* at a reduced price for a use different from the one originally intended; however, it did not wish to buy the cargo on the *Erin Schulte*, even at a reduced price. As a result, an amendment to the prime letter of credit was requested by UBA and advised to SCB reducing the value and quantity of cargo to that shipped on board the *Maria E*. SCB sought the consent of UIDC to the amendment.

Gunvor presented documents in respect of the cargo on board the *Maria E* and obtained payment a few days later. In the meantime, UIDC notified SCB of its agreement to the amendment. On the same day SCB sought Gunvor's consent to the amendment. This is where things started to go wrong as, rather than wait for Gunvor's reply, SCB, also on the same day, advised UBA of UIDC's consent to the amendment, the effect of which was to make the amendment effective as between UBA and SCB, though the terms as originally agreed still applied as between SCB and Gunvor. SCB thus lost its right of recourse to UBA with respect to the portion of the payment for the cargo on board the *Erin Schulte*.

Meanwhile, UIDC had found two new buyers for the cargo: Chase Petroleum Ghana Limited (Chase) and UBI Energy Petroleum Ghana Limited (UBI). Two new letters of credit were opened in favour of UIDC, one by SCB (Chase letter of credit) and the other by Trust Bank Ghana (UBI letter of credit). UIDC requested SCB to transfer the Chase letter of credit to Gunvor, but this did not occur as concurrently Gunvor presented, at SCB's London office, the documents, including the relevant bills of lading, in respect of the cargo on board the *Erin Schulte* under the original transfer letter of credit. The bills of lading had been indorsed in favour of SCB. A few days later SG advised SCB that Gunvor had rejected the amendment to the letter of credit.

SCB's service centre, having checked the documents, and being under the mistaken impression that the letter of credit terms had been amended, issued to SG an Advice of Refusal on the basis that the letter of credit had been overdrawn and the quantity

[2] *Erin Schulte* HC (n 1) [5].

overshipped. The Advice noted that the documents were being held at the disposal of SG. It turned out that this Advice of Refusal was in breach of the letter of credit as the presentation had been compliant.

SCB sought a commercial solution, advising SG that the documents should be presented under a different letter of credit. However, SG held its ground insisting that the presentation had been compliant. UIDC made it clear to SCB that any payment by SCB under the transfer letter of credit was at its own risk and UIDC could not accept such payment because the transfer letter of credit related to 'a separate product and contract which [Gunvor] failed to honour'.[3] By this time the transfer letter of credit had expired.

At this point Gunvor, who was the sub-voyage-charterer of the *Erin Schulte*,[4] instructed Dorchester LNG, the shipowners, to discharge the cargo against letters of indemnity, in spite of a letter sent by SCB to Gunvor's lawyers, Ince & Co, pointing out that it (SCB) was the rightful holder of the bill of lading. The indemnity was given by Gunvor to Dorchester LNG and the cargo was delivered to Chase and UBI. No indemnity was demanded by Gunvor from the receivers or from UIDC. Threatened by legal action and motivated by reputational concerns, SCB finally paid Gunvor in full, with interest and legal costs.

SCB sued Dorchester LNG for misdelivery and was successful both in the Queen's Bench and in the Court of Appeal for different reasons. Briefly, Teare J at the QBD stage found that SCB had become the holder of the bill of lading when Gunvor first presented the documents, including the bill of lading indorsed to SCB, and prior to the cargo being delivered. The Court of Appeal disagreed, as SCB had rejected the transfer of the bill of lading to it by Gunvor when it made an Advice of Refusal, but found that Gunvor's claim for payment was a claim in debt,[5] that SCB had become the holder of the bill of lading when it paid Gunvor and that even though

---

3 *Erin Schulte* HC (n 1) [18].

4 *Erin Schulte* HC (n 1) [2].

5 *Standard Chartered Bank v Dorchester LNG (2) Ltd (The Erin Schulte)* [2014] EWCA Civ 1382, [2016] QB 1 (*Erin Schulte* CA) [51] (Moore-Bick LJ): 'Whatever view may have been taken at the time when letters of credit were in their infancy, in my view the modern cases support the proposition that if the opening or confirming bank fails to pay against presentation of conforming documents under a letter of credit payable at sight, the beneficiary may sue in debt to recover the value of the credit, provided he is willing and able to transfer the documents to the bank against payment.'

it was common ground between the parties that the bill of lading had become 'spent' once the goods were discharged and delivered,[6] SCB had still become the holder of the bills pursuant to s 2(2)(a) of the Carriage of Goods by Sea Act 1992 (UK) (COGSA) as the transaction had been effected in pursuance of the letter of credit, which was a contractual arrangement made before the bill had become spent.

Because there was an indemnity in place between Dorchester LNG and Gunvor, Gunvor defended Dorchester LNG in the action brought by SCB. In effect, when SCB won its action, Gunvor had to pay back a portion of the money received under the letter of credit to the bank, in spite of having delivered the cargo to UIDC's buyers who had paid UIDC. Thus, UIDC received a windfall.

3 Bounded Rationality

The outcome of the scenario described above was not a good one for Gunvor and it is likely to have felt hard done by. The truth is, however, that the outcome was largely the result of its imperfect decisions, as discussed under heading 4 below. While Gunvor is a sophisticated commercial actor who had access to both financial and legal advice, the decision-makers at Gunvor still appear to have fallen prey to bounded rationality. Established expected-utility maximisation theories posit that rational decision-makers will select the outcome that allocates resources in such a way as optimally to satisfy their preferences,[7] but as aptly put by Devlin:

> The purest neoclassical [economic] models impose demanding standards of rationality, specifically that people … process all relevant information pursuant to a cost-benefit calculus … . [But] a variety of defects undermines people's capacity for rational choice … .

[6] *Erin Schulte* CA (n 5) [53]. But note that the CA did not agree that this was the case (ibid).

[7] Law and economics defines rationality via the axioms drawn from the writings of the Swiss economists John von Neumann and Oskar Morgenstern in *The Theory of Games and Economic Behavior* (Princeton University Press 1944). For a discussion of these axioms see C Camerer, 'Individual Decision Making', Chapter 8 in J Kagel and A Roth (eds), *Handbook of Experimental Economics* (Princeton University Press 1995) 587, 617–621. For a background discussion of classic utility theories in law and economics see A Devlin, *Fundamental Principles of Law and Economics* (Routledge 2015), Chapter 1.

> [C]ognitive psychology identifies assumptions that more closely mirror real-life decision making. The behavioural economics literature has identified and explored the imperfections that fetter our mental processes, leading us to err. [8]

'Bounded rationality' thus provides an explanation of why people make imperfect decisions. In *The Erin Schulte,* the decisions made by Gunvor's decision-makers exhibit bounded rationality, which is not to say that they were irrational or lacked plausible justification, but that they did not exhibit perfect rationality in utility-maximisation terms. This has to do with the way in which Gunvor appears to have evaluated the decisions' outcomes. It may be argued that, in taking these decisions, Gunvor's decision-makers were affected by certain heuristics and biases which shall be discussed below.

4 Gunvor's decisions

Gunvor was the beneficiary under the transfer letter of credit. This meant that it had a right under the letter of credit to be paid; a right that was autonomous from its obligations under the underlying contract of sale. [9] In spite of the fact that Gunvor presented complying documents, it was refused payment and given a notice of refusal. As noted, there is evidence that this was due to an error made by SCB's service centre. However, SCB continued to refuse payment even after the error was discovered for two reasons: first, it had, through its own fault, lost its legal right of recourse to the issuing bank; secondly, Gunvor's buyer, UIDC, was insisting that because of Gunvor's breach of the contract of sale it (UIDC) would not reimburse SCB if SCB were forced to pay out. Hence SCB's attempt to seek a commercial solution. The first decision Gunvor (and its agent SG) made was to rebuff this attempt categorically — they chose instead to rely on the autonomy of the credit. Why was Gunvor so intractable when it came to finding a commercial solution to the situation?

---

8 Devlin (n 7) 401. For a discussion of the major heuristics in operation in human decision-taking see D Kahneman, *Thinking Fast and Slow* (Penguin 2011), Part II.

9 Uniform Customs and Practices on Documentary Credits 2007 (UCP 600), Art 4. See also *United City Merchants v Royal Bank of Canada (The American Accord)* [1983] 1 AC 168, 182–183.

4.1 The anchoring and adjustment heuristic, prospect theory and the endowment effect

The first thing to note is that SG was acting as Gunvor's agent for the purposes of drawing under the letter of credit,[10] and it can be assumed that, SG being a bank, the decision-makers at SG would have been very familiar with the way letters of credit operate and in particular with the notion of the autonomy of the credit. Gunvor itself must have preferred to be paid first and argue about the goods later. The case reports do not indicate the figure that Gunvor was to be paid under the transfer letter of credit. While we do have an idea of what the actual value of the goods was (approximately US$ 6,132,355.7[11]), there would have been uncertainty on this point at the time and one may infer from Gunvor's behaviour that (a) the difference between the letter of credit amount and the sum that UIDC had agreed to pay having found new buyers for the goods must have been sufficiently large to make insistence on the former more attractive than reaching a commercial solution; and (b) applying the prospect theory, Gunvor must have taken the letter of credit figure as a 'reference point'.

Social psychologists and decision theorists have identified a number of cognitive shortcuts or heuristics that are used by decision-makers, one of which is the 'anchoring and adjustment heuristic'.[12] This means that a decision that needs to be made will be anchored to a reference point. The prospect theory, propounded by Daniel Kahneman and Amos Tversky in a ground-breaking article published in 1979,[13] posits that whether a person experiences satisfaction or unhappiness from a certain level of wealth depends on that person's reference point. An outcome that produces a more favourable result than one's reference point is desirable, while a less favourable result is perceived and experienced as a loss. Experiments conducted by behavioural economists have also shown that decision-makers who stand to gain (in relation

10 *Erin Schulte* HC (n 1) [4], [18].

11 This was the amount awarded to SCB by Teare J, being the agreed sum which SCB could have realised by selling the cargo, together with interest and costs. As the portion of the sum representing interests and costs is not specified, the amount is only indicative.

12 See the brief but illuminating explanation in JMA DiPippa, 'How Prospect Theory can improve Legal Counseling' (2001) 24 *University of Arkansas at Little Rock Law Review* 81, 85–90.

13 D Kahneman and A Tversky, 'Prospect Theory: An Analysis of Decision under Risk' (1979) 47 *Econometrica* 263.

to their reference point) are risk-averse and those who stand to lose are risk-seeking.[14] Where the reference point falls is affected by what is known as the 'endowment effect',[15] that is the decision-maker's perception of what is already his or hers, because as the research has shown, 'people tend to value what they have more than equivalent items or things that they do not yet possess'.[16] Arguably Gunvor (and SG, its agent) must have perceived the letter of credit amount as something to be lost (if they agreed to a commercial solution) rather than something that needed to be gained (by handing over the documents to the bank, precluding the ability to pass those documents, and therefore the goods, on to anyone else).

Evidently Gunvor's reference point did not take into account its wider legal position. Even had SCB not lost its right of recourse and not have had to sue Dorchester LNG for misdelivery, Gunvor might not have been able to keep all of the money paid to it under the letter of credit because it would still have had to face UIDC's claim for compensation for breach of the contract of sale — it appears from the case report that the goods delivered were not of the quality required by the contract.[17] However, in experiments testing the prospect theory (according to which people tend to seek risk in a situation where any outcome is likely to be neutral or a loss), research has found that, in accordance with the theory, a person in the

---

14 For a good background discussion of the work done in this field see C Guthrie, 'Prospect Theory, Risk Preference and the Law' (2003) 97 *Northwestern University Law Review* 1115, 1117–1119.

15 For an account see Kahnemann (n 8) Chapter 27. The endowment effect has generated a large literature that numbers to more than 1,600 articles — see R Korobkin, 'Wrestling with the Endowment Effect, or How to Do Law and Economics without the Coase Theorem' in E Zamir and D Teichman (eds), *The Oxford Handbook of Behavioral Economics and the Law* (OUP 2014) 300–334. The endowment effect refers to the difference between individuals' 'willingness to accept' — the amount which would induce them to part with what they have got — and the 'willingness to pay' — the amount they would pay to purchase the same entitlement. The value that the individual puts on such entitlement will therefore vary depending on whether he or she stands to gain it or lose it, and the reference point is established accordingly. Note that certain studies suggest that the endowment effect does not tend to operate where people act through institutions. See J Arlen, M Spitzer and E Talley, 'Endowment Effect with Corporate Agency Relationships (2002) 31 *Journal of Legal Studies* 1 and more recently J Arlen and S Tontrup, 'Does the Endowment Effect Justify Legal Intervention? The Debiasing Effect of Institutions' (2015) 44 *Journal of Legal Studies* 143. However, as is noted by Guthrie (n 14) 1162: '[u]ntil psychologists generate sufficient experimental evidence to reach some conclusions about group decisionmaking, legal scholars should be wary of assuming that prospect theory captures the way groups behave in legal settings. On the other hand, legal scholars should also be wary of assuming that groups make decisions as groups. Many groups such as corporations are hierarchical, and individual group members are often assigned responsibility for certain decisions. In circumstances where the relevant decisionmaker is likely to be an individual rather than the group, scholars can more comfortably rely on prospect theory's predictions about the "group" decision.'

16 A Devlin (n 7) 399.

17 *Erin Schulte* HC (n 1) [6].

position of defendant is less likely to settle a dispute.[18] Thus, Gunvor, being in the position of defendant in its contract of sale dispute with UIDC, may have preferred to engage in litigation than to settle the dispute at an early stage, hence its insistence on full payment under the credit.

The second decision made by Gunvor was to issue a letter of indemnity in order to release the cargo in the absence of the bill of lading (still in the physical possession of the bank). By so doing, Gunvor took upon itself the risk that SCB would itself have recourse to the only legal solution left open to it, the commercial solution proposed by it having failed. This is because in order to be paid Gunvor had to comply with the letter of credit terms whereby payment was against conforming documents. Indeed, while the letter of credit is autonomous from the contract of sale, in the sense that payment under the letter of credit is not conditional upon performance of the contract of sale, it does not contain an *unconditional* undertaking to pay, and the bank is not obliged to pay otherwise than against conforming documents.[19] Once the bill of lading was accepted by SCB in exchange for payment, SCB also obtained the legal right as against the carrier to claim delivery of the goods, which it promptly did. Thus, the decision to issue the letter of indemnity is hard to justify on rationality grounds.

4.2 The ambiguity effect

The situation opened the door to an ambiguity effect, whereby decision-making is affected by incomplete or ambiguous information. In 1961, Daniel Ellsberg[20] found that people's choices in situations of uncertainty tend to be affected by what he called the ambiguity of their information regarding the relative likelihood of events.[21] He described this ambiguity as 'a quality depending on the amount, type, reliability and "unanimity" of information, and giving rise to one's degree of "confidence" in an estimate of relative likelihoods.'[22] He

---

18 See JJ Rachlinksi, 'Gains, Losses and the Psychology of Litigation' (1996) 70 *Southern California Law Review* 113 and C Guthrie et al, 'Inside the Judicial Mind' 86 *Cornell Law Review* 777, esp 796–797.

19 UCP 600 (n 9) art 5. See also *Equitable Trust Company of New York v Dawson Partners Ltd* (1927) 27 Ll L Rep 49, 52 and *JH Rayner and Co Ltd v Hambro's Bank Ltd* [1943] KB 37.

20 D Ellsberg, 'Risk, Ambiguity and the Savage Axioms' (1961) 75 *The Quarterly Journal of Economics* 643–669.

21 Ellsberg (n 20) 657.

22 Ellsberg (n 20) 657.

observed that the ambiguity of the information as to probability of different outcomes of the decision has an influence on the choice a person makes, leading them to opt for the outcome the probability of which is known (the risky choice), rather than another outcome the probability of which is not known (the ambiguous choice),[23] a phenomenon also referred to as 'ambiguity aversion'. These observations went against expected utility theory[24] (according to which the decision-makers should have been indifferent between the two options) by showing that people appeared to be strongly influenced by the precision with which the relevant probabilities were stated, and avoided options with uncertain or ambiguous probability information. Thus, the risky option may appear more attractive (in spite of the fact that, in expected utility terms, the outcome if it is chosen is no better than the outcome of the ambiguous option) as the variance of the ambiguous option is higher. Research done subsequently connected ambiguity aversion to fear of negative evaluation (FNE) by one's peers. [25] As aptly explained by Trautmann, Vieider and Wakker in 2008:[26]

> If a bad outcome were to result from a prospect about which an agent had comparatively little knowledge, her failure may be blamed on her incompetence or 'uninformed' choice …. . A bad outcome resulting from a risky prospect, on the other hand, cannot be attributed to poor judgment. All possible information about the risky prospect was known, and a failure is simply bad luck … .

---

23 Ellsberg (n 20) 664.

24 The objective expected utility model was proposed by D Bernoulli, 'Specimen Theoriae Novae De Mensura Sortis,' *Commentarii Academiae Scientiarum Imperialis Petropolitanae [Papers of the Imperial Academy of Sciences in Petersburg] V* (1738), 175–192. English Translation: 'Exposition of a New Theory on the Measurement of Risk,' (1954) 22 *Econometrica*, 23–36. It was formalised by J von Neumann and O Morgenstern, *Theory of Games and Economic Behavior* (n 7 — see also 2nd edn, 1947; 3rd edn, 1953); J Marschak, 'Rational Behavior, Uncertain Prospects, and Measurable Utility' (1950) 18 *Econometrica* 111–141 ('Errata' (1950) 18 *Econometrica* 312); and P Samuelson, 'Probability, Utility, and the Independence Axiom' (1952) 20 *Econometrica* 670–678. In 1954, Savage proposed a model of subjective expected utility (see L Savage, *The Foundations of Statistics* (1st edn, John Wiley and Sons 1954; Revised and Enlarged Edition, Dover Publications 1972)). He obtained his characterisation of subjective expected utility and subjective probability by means of axioms on a decision maker's preferences over subjective acts, including what is known as 'the sure thing principle', which states that events that do not affect payoffs do not affect choices. Ellsberg challenged Savage's axioms, in particular the sure thing principle in his 1961 paper (Ellsberg (n 20)). Many studies on expected utility were built on or inspired by Ellsberg's work. For a general discussion see D Weisbach, 'Legal Decision Making under Deep Uncertainty' (2015) 44 (Supplement 2) *Journal of Legal Studies* 319-336. A comprehensive account of the economic theory may be found in MJ Machina and W Kip Viscusi (eds), *Handbook of the Economics of Risk and Uncertainty* (Elsevier 2014).

25 See discussion in ST Trautmann, FM Vieider and PP Wakker 'Causes of Ambiguity Aversion: Known versus Unknown Preferences' (2008) 36 *Journal of Risk and Uncertainty* 225, 227.

26 Trautmann et al (n 25) 227–228.

The same authors showed that making the decision-maker's preferences unknown completely eliminated ambiguity aversion.[27]

Interestingly, by applying evolutionary psychology and studying the ambiguity avoidance effect within the framework of risk-sensitive foraging theory, Rode and Wang[28] demonstrated that humans take into account three things to arrive at a decision: the mean outcome of an option, the variability of the outcome and their current goal. While humans were evolving, the goal of foraging would have been to obtain sufficient calories to survive. This explains why the option with the lower variance is preferred — if, in expected utility terms, both options available will provide the minimum number of calories required for survival (the 'minimum requirement' or 'goal'), the option with the lower variance (the risky option) will be chosen, as the option with the higher variance (the ambiguous option) may be viewed as less reliable. Conversely, one would expect that while there is an aversion to ambiguity, if the person's goal is to obtain X and the outcome of either option in expected utility terms is less than X, the person may go for the higher variance option (option B), as the precise information about option A gives a clear indication of the likelihood that the goal will not be met. Thus, Rode and Wang observed:

> If people understand that the payoff of options with missing probability information is more variable than that for which the probability information is known, then, according to risk-sensitive foraging theory, the two options are not equivalent, even when they have the same mean payoff. Risk-sensitive foraging theory predicts that a decision maker will choose the option with lower payoff variance *unless the minimum requirement in the given situation exceeds the expected payoff of this option*.[29]

Thus '[a]mbiguity seeking is expected for situations in which a minimum requirement exceeds the expected payoff of a low-variance option'.[30] This was borne out by an experiment undertaken by Rode

---

27 Trautmann et al (n 25).

28 C Rode and XT Wang, 'Risk-Sensitive Decision Making Examined Within an Evolutionary Framework' (2000) 43 *American Behavioural Scientist* 926.

29 Rode and Wang (n 28) 930. Emphasis added.

30 Rode and Wang (n 28) 930.

and others in 1999.[31] Thus, if the probable payoff of the risky option (option A) does not meet the decision-maker's goal the ambiguous option (option B) is more likely to be chosen.

In our case study, Gunvor's goal (or 'minimum requirement') appears to have been to obtain the amount of the credit, which, as explained, would have been higher (perhaps considerably higher) than the value of the goods. So Gunvor chose option B (leaving the documents with SCB and continuing to insist on full payment) rather than option A (retrieving the documents and using them to recover the goods, then claiming damages from SCB), even though option B was surrounded by ambiguities. Indeed, leaving the documents with SCB gave rise to multiple questions, such as, were the documents being held by SCB for itself or for Gunvor? Did this make a difference to SCB's obligation to pay out on the credit? Could Gunvor determine what SCB's obligations were (to pay out on the credit or to pay damages for breaching its obligations under it) simply by omitting to retrieve or give SCB instructions with respect to the documents?[32] What was the effect of Gunvor's decision to order the release of the goods while SCB was in possession of the bill of lading? While these questions would have increased the variance of possible outcomes to option B, Gunvor's lawyers would have been mindful of the obligations triggered by a compliant presentation and SG would have been well aware of the reputational risks SCB faced if it adhered to its refusal to pay out, making the gamble seem worthwhile. The ambiguities arose as a result of the fact that upon rejection the documents entered a sort of limbo, giving rise to option B (which, had there been a mechanism for returning them definitively to Gunvor, would not have been available at all). Had measures been in place to effect a physical return of the documents, then option A would have been the only possible option (aside from re-presenting, which would not have been possible in any case following the expiry of the credit) and Gunvor would not have been tempted to gamble on the high-variance option which, as it turned out, led to a final outcome falling well short of its goal.

---

31 C Rode, L Cosmides, W Hell and J Tooby, 'When and why do people avoid unknown probabilities in decisions under uncertainty? Testing some predictions from optimal foraging theory.' (1999) 72 *Cognition* 269–304.

32 The Court of Appeal decisions appears to suggest it could. See *Erin Schulte* CA (n 5) [52]. See also comment in J Hjalmarsson, 'Lawful holder of bill of lading: new and improved' [2014] Nov *Shipping & Trade Law* 6–8: '[U]nder the propounded paradigm there is a difficulty in identifying the exact position of the parties at any given time. When the presentation originally resulted in rejection, the bank nevertheless retained the right to pay the debt with absolving effect until after the expiry of the letter of credit and therefore probably for the foreseeable future, apparently as a result of silence from [Glencore] or perhaps a failure to physically retrieve the presented documents.'

4.3 Regret theory and the status quo bias

One seemingly inexplicable decision that Gunvor took was to order the release of the cargo by Dorchester to UIDC's new buyers in the context of its burgeoning dispute with UIDC and SCB. Gunvor's decision to order the release of the cargo to the final buyers at the end of a string, in the absence of the bill of lading, is by no means an unusual one. Indeed, in modern sea carriage of certain kinds of cargo it may legitimately be described as ubiquitous. Such delivery is a high-risk decision for the carrier (usually the shipowner) as it leads to the loss of Protection and Indemnity (P&I) cover, in that it is a deliberate breach of contract and P&I Clubs are not prepared to bear the risk of liability for it.[33] The reason the practice is so widespread in spite of this, is that negotiable bills of lading (used mainly where goods are traded while in transit, or where banks finance the transaction, in order to transfer constructive possession from seller to bank and from bank to buyer), rarely reach the discharge port in time to be used as contractually intended (ie to demonstrate entitlement to delivery). [34] If the vessel were simply to delay discharge until the arrival of the bill of lading, the costs of the delay would be borne by the charterer, either in the form of hire payments while the ship stands idle (in the case of a time charter) or in the form of demurrage (in the case of a voyage charter).[35] As a result, charterers regularly require the inclusion of provisions in charterparties whereby the shipowner agrees to deliver the cargo in the absence of the bill of lading if ordered by the charterer to do so, against a letter of indemnity issued by the charterer[36] (at times also requiring counter-signature by a bank).[37] The letter of indemnity is designed to replace the P&I Club cover that is lost as a result of following the order, and P&I Clubs have drafted standard wordings which may be used by their members to draft these letters, so as to ensure that the indemnity provides appropriate cover. [38] While, provided the instructions contained in it are properly followed,[39] the letter of indemnity is likely to protect the carrier, the charterer remains exposed to the risk that the cargo is delivered to the wrong person.

---

33 The Rules of all thirteen P&I Clubs in the International Group exclude from the scope of standard P&I cover claims arising out of the delivery of cargo carried on an entered ship without the production of the relevant bill of lading, subject always to the exercise of discretion by the Board of the relevant Club to allow claims.

34 See for example *Hansen-Tangens Rederi III A/S v Total Transport Corp (The Sagona)* [1984] 1 Lloyd's Rep 194, 201, where the master of the vessel who had been in command of oil tankers for 14 years, when asked how often an original bill of lading had been presented to him prior to discharge, declared 'I have never seen it'.

35 See eg the facts in *Glencore Grain Ltd v Flacker Shipping Ltd (The Happy Day)* [2002] EWCA Civ 1068, [2002] 2 Lloyd's Rep 487.

36 See eg charterparty form BPVOY4 cl 30.3. See also the facts in *Enichem Anic SpA v Ampelos Shipping Co Ltd (The Delfini)* [1990] 1 Lloyd's Rep 252.

37 See eg the facts in *Pacific Carriers v BNP Paribas* [2004] HCA 3, (2004) 218 CLR 451.

38 See International Group of P&I Clubs, forms A and AA: http://www.ukpandi.com/knowledge/industry-developments/international-group-standard-letters-of-indemnity/.

39 For an example where instructions were not deemed to have been followed, see *Farenco Shipping Co Ltd v Daebo Shipping Co Ltd (The Bremen Max)* [2008] EWHC 2755 (Comm), [2009] 1 Lloyd's Rep 81.

One possible means of dealing with this risk is for the charterer to take delivery of the goods itself and put them in storage pending the presentation and surrender of the bill of lading. Storage also entails costs, however, which may be considerable.[40] These costs are just as likely to be perceived by the charterer as sunk costs as the costs of delaying the ship in the port. In this situation, and in line with prospect theory, it would appear that charterers are risk-seeking in the face of a perceived loss. They prefer not to defray costs which they view as avoidable. The letter of indemnity is therefore a means used by the charterer to avoid the costs of either: (i) paying hire or demurrage for delays in the discharge port; or (ii) paying the costs of warehousing the goods pending the arrival of the bill of lading.

The decision not to defray these costs, in spite of the risks associated with delivering in the absence of the bill of lading, may also be explained by reference to behavioural psychology, and in particular regret theory,[41] which posits that individuals either rejoice or experience regret after making a decision, and that the anticipation of these feelings influences the decision. Further, 'the fear of regret (a loss) looms larger than then anticipation of the gains associated with rejoicing'.[42] Thus regret theory posits that the value of a given alternative to a decision-maker is a function not just of its own outcomes but of how its outcomes compare to the outcomes of other alternatives. The available alternatives to Gunvor were: (A) delay release of the cargo until the resolution of the burgeoning dispute with SCB and UIDC, paying the related costs, (which may or may not be recoverable); or (B) issue a letter of indemnity so as to secure the release of the cargo to UIDC's buyers, who were as yet unable to demonstrate their entitlement to it as the bills of lading were still with SCB, avoiding such costs. Had Gunvor chosen option A, a certain loss would have ensued (in the form of storage or demurrage costs), so Gunvor would have anticipated regret when contemplating the outcomes of option A in comparison with the outcomes of option B (which would not have entailed these costs).

In addition, release of the cargo against a letter of indemnity is a very widespread practice in circumstances where the final buyer is known but the bill of lading has not yet made its way through

---

40 The kind of cargo on the *Erin Schulte* (gasoil) would have fallen under the category Conventional Cargo: Dangerous Goods Group II (which includes flammable liquids) in the port of Takoradi Ghana. The storage charges *per ton* for this kind of cargo, as quoted for 2015, are as follows: for days 1-5: free; for days 6-12 GHC 3.60; for days 13-19: GHC 7.20; for days 20 and thereafter: GHC 14.40. Figures for 2010 were not available for reference. The average exchange rate between the Ghanaian Cedi and the US Dollar in 2015 was GHC 1 = USD 0.25.

41 This was first propounded by D Bell, 'Regret in Decision Making Under Uncertainty' (1982) 30 *Operations Research* 961 and (independently) by G Loomes and R Sugden, 'Regret Theory: An Alternative Theory of Rational Choice Under Uncertainty' (1982) 92 *Economics Journal* 805.

42 GB Gelberg, 'Regret Theory — Explanation, Evaluation and Implications for the Law' (2002–2003) 36 *University of Michigan Journal of Law Reform* 183, 187.

the banking system, and would have been perceived as the default option by the decision-makers at Gunvor. Acting otherwise would have constituted a departure from the status quo, and would have required them to overcome what is known as the status quo bias.[43] There is a link between regret theory and the status quo bias as it has been shown that action is regretted more often than inaction. As aptly noted by Gelberg:

> Combined with the knowledge that regret looms larger than rejoicing, regret associated with action may give rise to a substantial premium. An individual must overcome this premium in order to deviate from the status quo.[44]

A final study on status quo bias to which it is worth referring is a 2006 paper by Roca and others[45] which found that when individuals were asked to exchange an ambiguous alternative in their possession for an unambiguous one, they preferred to retain the former.[46] The bias towards the status quo, combined with the endowment effect, is therefore strong enough to overcome ambiguity aversion (which, as indicated under heading 4.2, appears to have been overcome in Gunvor's case).

Thus, even though, as it turned out, option B was the riskier choice, Gunvor opted for it as it was in line with common practice (the status quo) and the level of anticipated regret to which it gave rise was less than that of the safer option A.[47] This effect would have been intensified through the anchoring effect, which would have established the *financial* status quo (what

---

43 First proposed by W Samuelson and R Zeckhauser, 'Status Quo Bias in Decision Making' (1988) 1 *Journal of Risk and Uncertainty* 7. For a discussion of the link with the endowment effect and loss aversion, discussed under heading 4.1, see D Kahneman, JL Knetsch and RH Thaler 'Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias' (1999) 1 *The Journal of Economic Perspectives* 193.

44 Gelberg (n 42) 190.

45 M Roca, RM Hogarth and AJ Maule, 'Ambiguity seeking as a result of the status quo bias' (2006) 32 *Journal of Risk and Uncertainty* 175.

46 Roca et al (n 45) 187: 'In all three experiments, there was evidence suggesting that participants were more likely to retain an ambiguous alternative over its unambiguous counterpart when they had previously been endowed with it, in comparison to a neutral situation without prior endowment. This effect occurred both within- and between subjects, with hypothetical and real incentives, and in experimental situations involving choices between both gambles and investments.' See also M Roca and AJ Maule, 'The effects of endowment on the demand for probabilistic information' (2009) 109 *Organizational Behavior and Human Decision Processes* 56.

47 M Zeelenberg and J Beattie, 'Consequences of Regret Aversion 2: Additional Evidence for Effects of Feedback on Decision Making' (1997) 72 *Organizational Behavior and Human Decision Processes* 63, 74–75 showed that 'both the anticipation of regret caused by the manipulation of expected feedback, and the experience of regret caused by actual feedback, have a profound influence on decisions in several contexts'.

Gunvor expected to make out of the transaction, or its reference point, as explained above). Moving away from this status quo by incurring what would have been viewed as unnecessary costs would have required overcoming an anticipated regret premium.

The decision made by Gunvor's representatives to order the release of the goods in the absence of a bill of lading is therefore not surprising when analysed on the basis of bounded rationality. What remains unexplained, however, is Gunvor's failure themselves to require a letter of indemnity from receivers as a condition precedent to delivery. This practice does appear to exist: there are indications in the case law that cargo receivers who are unable to present and surrender a bill of lading are sometimes required to issue a letter of indemnity in favour of the charterer or shipper who issues a letter of indemnity to the carrier in exchange for delivery in the absence of the bill.[48] It is unclear why this was not done in this case. Had this been done, Gunvor would in its turn have had a remedy against the person who ultimately got the cargo (or its value).

4.4 The optimism bias

In combination with the status quo bias, the optimism bias may also have had a hand in Gunvor's decision-makers' willingness to issue a letter of indemnity at a time when a dispute with UIDC was unfolding and when it should have been aware that SCB was considering exercising the rights of a bill of lading holder.[49] The optimism bias is one of the biases affecting decision-making that has been most widely discussed by behavioural economists. It 'refers to the tendency of people to believe that their own probability of facing a bad outcome is lower than it actually is'.[50] In issuing the letter of indemnity when it did, Gunvor must have

---

48 See for example, the facts of *Laemthong International Lines Co Ltd v Artis (The Laemthong Glory) (No 2)* [2005] EWCA Civ 519, [2005] 1 Lloyd's Rep 688.

49 See *Erin Schulte* HC (n 1) [21]: 'On 18 June 2010 SCB wrote to Ince & Co [Gunvor's legal advisers] seeking a meeting and clarification as to various matters. SCB said in particular: "One of the specific issues we would like to discuss is whether and if so the basis upon which Gunvor has instructed the carrier to split the gasoil cargo and discharge the same apparently without reference to [SCB] as the rightful holder of the Bill of Lading."' See also ibid [23]: 'But Ince & Co replied on the same day, saying that the position remained the same, that SCB ought to have paid Gunvor and that there was nothing to discuss.'

50 C Jolls and CR Sunstein, 'Debiasing through Law' (2006) 35 *Journal of Legal Studies* 199, 204. See also summary in C Jolls, 'Behavioral Economic Analysis of Redistributive Legal Rules' (1998) 51 *Vanderbilt Law Review* 1653, 1659; and D Armour and SE Taylor, 'When Predictions Fail: The Dilemma of Unrealistic

optimistically underestimated SCB's chances of success in suing the carriers for breach of the bill of lading contract and conversion of the cargo. In line with the optimism bias also, Gunvor must have been optimistic about the bill of lading eventually reaching the receivers to whom the goods were actually delivered (hence their failure to require back-to-back letters of indemnity from such receivers).

The dispute between Gunvor and UIDC (concomitantly with SCB's loss of right of recourse) was significant to Gunvor's position: the court found that UIDC attempted to liaise with Gunvor following the discovery that the cargo was not of the contracted quality and following the identification of new buyers. While Gunvor was within its strict legal rights in insisting on payment under the transfer letter of credit, UIDC seems to have taken the position that, as Gunvor had 'failed to honour' the original contract of sale, the right thing for it (Gunvor) to have done would have been to come to a commercial agreement rather than continue so to insist, and that it (UIDC) would not reimburse SCB if SCB were forced to pay out.[51]

Thus, through what appears to have been an incomplete appreciation of its overall legal position (in all likelihood spurred by the optimism bias), Gunvor put itself in a worse position financially than it would have been in had it sought a commercial solution (ie a new letter of credit issued on application of the cargo's new buyers). In any case, as already mentioned, there would have come a point in time when it would presumably have had to compensate UIDC for any breach of the underlying contract of sale that it may have committed.

The end result was that Gunvor lost both the goods and their monetary value, UIDC (who was paid by the receivers) having washed its hands of the whole business. Indeed, UIDC seems to have taken the position that, since Gunvor was using legal means to obtain full payment in spite of having, in UIDC's view, breached the contract of sale, UIDC would do exactly the same and also rely on its legal position: having returned the value of the goods to SCB under the indemnity, Gunvor could no longer claim against UIDC in contract for payment of the amount due for the *Erin Schulte* cargo, even minus any amount due in damages for Gunvor's breach

Optimism' in T Gilovich, D Griffin and D Kahneman (eds), *Heuristics and Biases: The Psychology of Intuitive Judgment* (CUP 2002) 334–347.

[51] *Erin Schulte* HC (n 1) [18].

of contract, as Gunvor had been paid under the letter of credit, which constitutes payment under the contract of sale.[52]

5 Countering cognitive biases: law and practice

5.1 Legal Advice

The way in which the client's legal position is conveyed can counteract biases in operation. It is submitted that it is important for legal advisers to understand the processes whereby clients make decisions (usually with bounded rationality), and to be aware of these processes when giving advice. The client may be influenced by cognitive biases, and, as a result, may not be giving proper weight to certain aspects of its position. If the client is influenced by the endowment effect so as to perceive the outcome of settlement as a loss, the client is unlikely to view settlement as an attractive option, even if settling may lead to the better outcome in utility-maximisation terms.[53] Similarly if the client is in the midst of a dispute it may act in such a way as to worsen its position if, as a result of the operation of the optimism bias, it underestimates the remedies that may be open to the other party. Of course, a lawyer can only be involved to the extent that he or she is asked for advice, but where such advice is sought, the adviser would do well to be aware of the biases that might be driving the client's persistence one way or another, and to ensure that the client's true legal position (including any uncertainties and attendant risks) is conveyed to it with full clarity.[54]

Empirical research has demonstrated that one possible way of countering the optimism bias is to bring into play the availability heuristic.[55] According to the availability heuristic, 'the probability of an event is estimated after an assessment of how easily examples of the event can be called to mind'.[56] Jolls and Sunstein observe that:

---

52 *W J Alan & Co v El Nasr Export and Import Co* [1972] 2 QB 189, 212 (Lord Denning). It is not known to the author whether suit on any other basis (eg unjust enrichment and restitution) was attempted or (if yes) whether it was successful.

53 See DiPippa (n 12) esp 96–115.

54 In this regard see the discussion in R Korobkin and C Guthrie, 'Psychology, Economics and Settlement: A New Look at the role of the Lawyer' (1997) 76 *Texas Law Review* 77.

55 Jolls and Sunstein (n 50) 209–211.

56 Jolls and Sunstein (n 50) 203–204.

> One prominent method of making an occurrence available to individuals is exposing them to a concrete instance of the occurrence … . Concrete information appears to render the incident in question available in a way that can successfully counteract optimism bias.[57]

In other words, cautionary tales do work, and when giving legal advice recounting to a client the facts and outcomes of actual cases (such as *The Erin Schulte*) may be more effective in bringing home the risks than simply setting out their position in abstract terms. This could lead to clients taking decisions on whether to issue a letter of indemnity with more caution.

This point may be illustrated by reference to the facts of another recent case on letters of indemnity, that of *The Zagora*,[58] which featured a string of charterparties whereby the party in the position of shipowner in each case undertook to release cargo in the absence of the bill of lading, should the latter be unavailable at the port of discharge, in exchange for a letter of indemnity from party in the position of charterer.[59] When charterers asked the shipowners to deliver the cargo in the absence of the bill, the shipowners provided them not only with the LOI wording which they wished them to use but also requested 'a letter of authorisation identifying the person (name and ID number) authorised to take delivery on behalf of the notify party'.[60] The charterers initially refused the latter request stating that it was not an express requirement of the charter. Indeed, it was not. However, the explanation for the making of this request may be found in an earlier case providing a cautionary tale, namely *The Bremen Max*[61] where it was held that the shipowner was unable to enforce an LOI, as it had failed to verify, when delivering the cargo in the absence of the bill of lading and against the LOI, that the person claiming delivery was the same person to which the charterer had instructed that delivery be made in the LOI. Mr Justice Teare held as follows:

> It is of course correct that the shipowner will not, in the typical case, have had any dealings with the person to whom the charterer requests the shipowner to make delivery. He may well not know that person. It is the charterer who is likely to know that person. But the

---

57 Jolls and Sunstein (n 50) 210.

58 *Oldendorff GmbH & Co KG ('Oldendorff') v Sea Powerful II Special Maritime Enterprises ('Head Owners') and others (The Zagora)* [2016] EWHC 3212 (Comm), [2017] 1 Lloyd's Rep 194.

59 *The Zagora* (n 58) [3], [4], [36].

60 *The Zagora* (n 58) [5].

61 *The Bremen Max* (n 39).

> shipowner need not enquire into whether that person is entitled to possession of the goods. He only needs to know that the person to whom he delivers the good is the person to whom the charterer has requested that delivery be made. *If the shipowner is in doubt as to that he may ask the charterer to identify the intended receiver*. If the shipowner then complies with such representations as the charterer makes as to the identity of the person to whom delivery is to be made the charterer will be estopped from denying that the shipowner delivered the cargo to the person to whom the charterer requested the shipowner to make delivery.[62]

The court's guidance in *The Bremen Max* appears to have been taken to heart by shipowners,[63] judging by the request made in *The Zagora* (which, as indicated, met with resistance, but to which, ultimately, charterers had to accede[64]).

5.2 Commercial practice

It is argued above[65] that the ambiguity effect played an important part in the unfolding of the facts in *The Erin Schulte*. Indeed, the possibility that the person in whose hands a bill of lading is (in this case, SCB) may or may not be holding it for itself or for another makes it potentially very difficult to determine who may or may not have rights over the relevant goods at any one time.[66] Arguably the situational ambiguity that has the potential to arise when a bank rejects documents but remains in possession of them may be remedied by the use of platforms for the electronic presentation of documents. Two such systems are the Bills of Lading Electronic Registry Organisation (Bolero)[67] and essDOCS (formerly known as Electronic

---

62 *The Bremen Max* (n 39) [35]. Emphasis added.

63 See the circular published by the International Group of P&I Clubs following the *Bremen Max* decision on 20 December 2010, which 'inform[ed] Members of the decision in the English Commercial Court in the case of … the 'Bremen Max' … and the Group's recommendations that Members take two further precautions if they choose to accept a Letter of Indemnity for delivery of cargo without production of the original bill of lading'. See http://www.igpandi.org/article/ig-standard-form-letter-of-indemnity-delivery-of-cargo-without-production-of-bills-of-lading.

64 *The Zagora* (n 58) [7], [32].

65 Heading 4.4 above.

66 The same observation is made by M Spanjaart, 'Endorsement, delivery, possession and holdership' (2015) 21 *Journal of International Maritime Law* 18, 21–22.

67 See http://www.bolero.net.

Shipping Solutions or ESS). [68] Both of them provide commercially available electronic bill of lading (EBL) and electronic trade documentation services which have been granted the stamp of approval of the International Group of Protection and Indemnity (P&I) Clubs.[69] P&I Clubs now provide cover for typical P&I Club liabilities arising under any electronic bill of lading to the extent that these liabilities would also have arisen had a paper bill of lading been used. Had the particular liability *not* have arisen had a paper bill been used, the liability will still be covered by the Club; however, cover is discretionary unless the electronic system used was one approved by the International Group of P&I Clubs.[70]

Banks are also included among the systems' users, the system acting as a conduit for electronic presentation in accordance with the Uniform Customs and Practices on Documentary Credits: Supplement on Electronic Presentation version 1.1, 2007 (eUCP) or the Uniform Rules on Bank Payment Obligations 2013 (URBPO). The systems' operational rules include provisions on what is to happen where a bank rejects a documentary presentation. In the Bolero system, such a bank would usually be designated[71] as a Pledgee Holder. The Bolero Rulebook provides:

> Where a Designated Pledgee Holder *rejects* the Bolero Bill of Lading by returning Holdership to the immediately preceding Holder, the Carrier shall cease to hold the goods to the order of such Designated Pledgee Holder and *the constructive possession of the goods will automatically revert to the immediately preceding Holder-to-order*, Bearer

---

68 See http://www.essdocs.com/.

69 Fear of liability slowed down the uptake of electronic systems by carriers for a long time (see discussion in M Goldby, 'Electronic Bills of Lading and Central Registries: What is Holding Back Progress?' (2008) 17 *Information and Communications Technology Law* 125, 137–140), but P&I Clubs have recently agreed to cover the liability risks arising from the use of certain systems, including these two (see UK P&I Club Circular Ref. 6/13, *Electronic (Paperless) trading systems — Electronic Shipping Solutions & Bolero International Ltd. — Updated ESS DSUA Version 2013.1*, March 2013, available electronically from http://www.ukpandi.com/), which has increased their popularity and uptake in the shipping community.

70 See UK P&I Club, *Paperless Trading (Electronic Bills of Lading) — Frequently Asked Questions*, available electronically from http://www.ukpandi.com/, Question 2. The liabilities which might remain uncovered if an unapproved system is used include those arising from a successful legal challenge to the system's ability to transfer rights over the goods as intended, or from the ineffective incorporation of the Hague or Hague-Visby Rules (which may not apply automatically where a paper bill of lading is not used). Ibid, Question 5. See also discussion in M Goldby, *Electronic Documents in Maritime Trade: Law and Practice* (OUP 2013), [6.14]–[6.18].

71 The Bolero System works on the basis of user designations: the designation given to any particular system user in relation to a Bolero bill of lading (BBL) will depend on where that user stands in relation to the bill. A bank will usually have the bill on a pledge basis.

> Holder, Pledgee Holder or, if none, to the Shipper.[72]

This seems to suggest that where a bank to whom a BBL has been presented and who is holding it as pledgee actively rejects the BBL it will automatically revert to the person who transferred it to that user. Similarly, for the essDOCS system, the Databridge Services User Agreement (DSUA) provides:

> In the event of the new Holder having [a] right to reject an eDoc, the new Holder may exercise that right by Transferring the eDoc back to the User from whom he received it.[73]

In *The Erin Schulte*, the Court of Appeal held that 'once SCB had unequivocally rejected the bill of lading it could not unilaterally change its mind and decide to take it up'[74] but that it was possible for Gunvor to consent to SCB's taking up the bill of lading by making it 'clear that it was willing for SCB to take up the documents and accept liability for payment of the amount stipulated in the letter of credit'[75] after the rejection. This, the court found, Gunvor had done because:

> It did not ask for the documents to be returned and by accepting payment of the face value of the credit necessarily accepted that SCB was entitled to take them up. Whether that is characterized as a further presentation or merely an insistence that SCP accept the document pursuant to the original presentation seems to me not to matter.[76]

Had an electronic system designed as described above been used, SCB would not have remained in control of the bill of lading upon rejection: it would have reverted to the previous holder (ie Gunvor). So, in order to claim the full amount of the credit, Gunvor would have had to transfer it back to SCB. However, it is also possible that, by this time, the bill would have been used to obtain delivery of the goods (precluding the need for a letter of indemnity). Thus, SCB would not have had the bill (and therefore would not have had a claim against Dorchester

---

72 Bolero Rulebook, Rule 3.4.1(6): Rejection by Pledgee. Emphasis added.
73 DSUA, cl 7.9.2.
74 *Erin Schulte* CA (n 5) [33].
75 Ibid.
76 *Erin Schulte* CA (n 5) [52].

LNG), however neither would it have been liable to pay out on the credit. As the court held: 'Since the contract provides for payment against documents, the beneficiary is not entitled to recover the full value of the credit otherwise than on surrender of the documents.'[77] The only claim Gunvor would then have had against SCB would have been for wrongful failure to honour the credit,[78] and the extent of this would have depended on the loss caused by such breach of contract.[79] Therefore SCB would have ended up paying Gunvor what it actually ended up paying it in any case: the difference between the letter of credit amount and the actual value of the goods. However, as the circumstances actually unfolded, thanks to the letter of indemnity it issued, Gunvor ended up never obtaining the actual value of the goods themselves, which it would have done had it recovered the bill of lading from SCB, sold the goods and claimed damages from the bank.

This analysis therefore demonstrates two things. First, the argument that a seller can have it both ways (ie be paid the full amount due under a letter of credit *and*, where a document of title is one of the documents required to be presented, retain the right to dispose of the goods independently of such payment) is bound to fail. It reflects neither the nature of a letter of credit undertaking nor commercial reality. Secondly, a letter of indemnity issued by a seller in order to enable it to effect such a disposal opens it up to a risk that can significantly reduce or even wipe out the value that it is supposed to obtain from the contract of sale: the risk that it is effectively disposing of the goods twice in breach of its contractual obligations. An electronic system which gives control over the goods to a single person gives more clarity as to who may have rights over the goods at any point in time (allowing the probability that such rights will be exercised to be assessed) and, although it is unlikely to put a complete end to letter of indemnity practices, it is likely to reduce dramatically the extent to which they are used,[80] and may also ensure that when they are used, they are entered into with more caution.

---

77 *Erin Schulte* CA (n 5) [51].

78 *Seaconsar Far East v Bank Markazi Jomhouri Islami Iran* [1999] 1 Lloyd's Rep 36, 38.

79 *Fortis Bank v Indian Overseas Bank* [2011] EWHC 538 (Comm), [2011] 2 Lloyd's Rep 190.

80 See Bolero, *Electronic Bill of Lading for Carriers: Frequently Asked Questions (FAQs)*, available electronically from http://www.bolero.net, 2: 'Q. What impact does the eBL have on Letters of Indemnity (LOIs)? A. An eBL significantly reduces the likelihood of goods having to be discharged prior to surrender of the BL therefore reducing the requirement for LOIs. For example, a Bolero customer has seen a 90% reduction in LOIs in the 6 months since going live with their first eBL.'

6 Concluding Remarks

This paper argues that the unfortunate decisions taken in *The Erin Schulte* were taken as a result of cognitive biases which may regularly be displayed even by sophisticated business people. In addition, it argues that the decision itself will potentially have a positive effect in terms of addressing the shortcomings of bounded rationality in the future because it dispels the myth that the letter of credit undertaking is wholly disconnected from the contract of sale, and provides a marked illustration of two important connections. First, payment under the letter of credit is against the documents required under it to be presented, among which will usually be included a document of title representing the goods which are the subject of the underlying sale contract. In other words, in order to be paid, the seller must, in effect, hand over the goods. Secondly, if the seller receives payment under the letter of credit, the payment obligation under the contract of sale will be deemed performed. Thus, should the bank have recourse against the carrier for misdelivery of the goods, and should this trigger the seller's obligation under a letter of indemnity to cover the carrier's liabilities, the seller cannot then have recourse against the buyer unless a separate indemnity has been obtained from the buyer at the time of releasing the goods to it (or its sub-buyers). It is therefore the letter of indemnity that is completely independent and autonomous from the contract of sale and not the letter of credit.[81] Gunvor must have failed to appreciate these possible consequences of its decision to issue the letter of indemnity, and (optimistically but) mistakenly believing that the negative outcome would not befall it, it proceeded to do what it did.

Behavioural economics also tells us that the *Erin Schulte* case itself may be a means whereby the availability heuristic can counter the optimism bias as it provides a striking illustration of both the two important connections between contracts of sale and letters of credit, and the

[81] In this regard see *Mauri Garments Trading and Marketing Ltd v Mauritius Commercial Bank Ltd* [2015] UKPC 14 (Mauritius).

importance of structuring indemnities more thoughtfully with an eye to the other obligations that relevant parties might have undertaken.

By striking a note of caution when it comes to letters of indemnity, the case could also encourage the more widespread use of electronic alternatives to bills of lading. Buyers and sellers of commodities can also often be the charterers of the ships carrying those commodities, and recently drafted standard terms suggest that contractually an obligation may be placed on shipowners to issue electronic rather than paper bills of lading, at charterer's request.[82] Electronic bill of lading systems, as seen above, may be designed so as to provide clarity as to who is in control of the goods (and therefore entitled to demand delivery of them) at any point in time. Thus, if a confirming bank that has lost its right of recourse to the issuing bank and applicant is designated as pledgee holder one may reasonably expect that it will exercise its pledge.

[82] See Baltic and International Maritime Council (BIMCO), *Electronic Bills of Lading Clause for Charterparties*, BIMCO Special Circular No 3, 20 May 2014. See para (a) of the model clause: 'At the Charterers' option bills of lading, waybills and delivery orders referred to in this Charter Party shall be issued, signed and transmitted in electronic form with the same effect as their paper equivalent.' See also cl 30, paras 30.3–30.6, of the BP VOY 5 standard form charterparty adopted in 2016.