SHIPPING | JUNE 2022

WRONGFUL TO REFUSE A REASONABLY SATISFACTORY LOU OFFERED PURSUANT TO ASG2, HOLDS COURT OF APPEAL[1]

Summary

The Court of Appeal has found that if parties agree to a collision jurisdiction agreement (**CJA**) in the form proposed by the *Admiralty Solicitors Group* (ASG2), and if the party who is to be secured is tendered security which is objectively satisfactory, then the recipient is obliged to accept it; to refuse to do so is a breach of the CJA.

Background

In 2018 there was a collision in the Suez Canal involving three vessels – *PANAMAX ALEXANDER* (**PA**), *OSIOS DAVID* (**OD**), and *SAKIZAYA KALON*. PA and OD agreed to enter into a CJA in the ASG2 standard form. PA delayed offering security and OD arrested an associated vessel of PA, *PANAMAX CHRISTINA*, in South Africa. PA's club subsequently offered security by way of Letter of Undertaking (**LOU**) on an amended standard form ASG Collision Undertaking (**ASG1**) which included a sanctions clause (the amended **ASG1 LOU**). The sanctions clause was requested as PA was bound for Iran and PA's club wanted to avoid any risk of breaching sanctions if it paid out under the amended ASG1 LOU.

OD objected to the form of the sanctions clause; in particular, the provision whereby the club providing security would be relieved of any obligation to pay out under the amended ASG1 LOU "[...] *if any bank in the payment chain is unable or unwilling to make, receive or process any payment for any reason whatsoever connected with the Sanctions (including but not limited to a bank's internal policies).*"

OD argued this would appear to permit the club to avoid payment under the amended ASG1 LOU even if it were legal to do so, simply because of an overly-cautious internal bank policy. Accordingly, OD maintained its arrest in South Africa.

PA subsequently brought a claim for breach of the CJA before the English courts. PA argued that (1) it had offered reasonably satisfactory security; which therefore (2) OD was obliged to accept. This was pursuant to clause C of the CJA:

> "*Each party will provide security in respect of the other's claim in a form reasonably satisfactory to the other.*"

The High Court found (1) that the amended ASG1 LOU was reasonably satisfactory; but (2) that ASG2 does not, neither as a matter of construction, nor by implication, impose an obligation for either party to accept security which is reasonably satisfactory to it.[2]

PA appealed the second finding; OD, by respondent's notice, challenged the first.

Court of Appeal Decision

The Court of Appeal (the **Court**) allowed PA's and disallowed OD's appeal. The amended ASG1 LOU was satisfactory and OD had to accept it. Lord Justice Males set out the Court's approach at paragraph 39 onwards:

> "[It] *is clear in the present case, whether as a matter of construction or implication, that shipowners who enter into an agreement on the terms of ASG 2 agree that, if reasonable security is provided pursuant to clause C, it is not open to the receiving party to seek alternative or better security by means of an arrest; and that if a ship has been arrested, it must be released once reasonable security is provided.*"[3]

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[1] *M/V Pacific Pearl Co Ltd v Osios David Shipping Inc* [2022] EWCA Civ 798

[2] See HFW's commentary from 2021 on this decision: https://www.hfw.com/Sanctions-clauses-in-LOUs-and-Obligations-under-Collision-Jurisdiction-Agreements

[3] Supra 39

The Court reasoned that "*once reasonable security has been provided, there is no justification for an arrest*". To hold otherwise "*leaves a party which has been provided with reasonable security free to seek alternative or better security by arresting the ship* [...] *however unreasonable that may be and whatever the disruption to the ship's trading or the cost, delay and inconvenience of getting the ship released. This turns well established Admiralty practice on its head and is contrary to the clear purpose and, in my judgment, the language of ASG 2.*"[4]

The Court therefore held "*that the respondent was under an obligation to accept the security offered and that it was in breach of the Collision Jurisdiction Agreement for refusing to do so.*"[5]

As to the respondent's challenge to the lower court's conclusion that the amended ASG1 LOU offered by the appellant's club was in a reasonably satisfactory form, the Court held simply that this was a conclusion which the lower court was "*entitled to reach and with which* [it] *would not interfere*."

Practical implications and next steps

This is a positive decision for P&I clubs, insurers and other entities that may be obliged to provide security as it is now accepted that an LOU which includes a sanctions clause can in principle be reasonably satisfactory and the beneficiaries of such an LOU will be obliged to accept it under the CJA scheme provided by the ASG. This decision also reaffirms the English courts' stance on the suspensory nature of sanctions clauses – they do not extinguish the securing party's obligation to pay; rather they suspend it.[6] This confirmation should be of some comfort to an LOU recipient, although it may be that express wording is introduced into the standard form ASG1 affirming this, or by a recipient of an LOU to avoid any future debate.

Recipients of an LOU who are concerned that this decision may encourage clubs to try to introduce further amendments to the standard form ASG1 will perhaps only agree in the future to enter into a CJA on ASG2 terms on condition that ASG1 in its unamended form is agreed to at the same time. Parties might also be potentially slower to agree English law and jurisdiction for tortious claims, or prior to agreeing security seek to arrest for security elsewhere where sanctions wordings and/or P&I LOUs are not generally accepted.

Given sanctions regimes may remain in place for an uncertain, often lengthy durations, LOU recipients might require security to be provided on a lump sum basis exclusive of interest, with interest accruing at an agreed rate per year, as opposed to simply an all-inclusive figure. Such a wording could be justified on the basis of avoiding the risk of interest accruing over several years on the secured amount, such that the amount ultimately due under the LOU exceeds the all-inclusive figure.

Commentary

This is an unsurprising decision by the Court; if one accepts that the amended ASG1 LOU which was tendered was objectively reasonable then it should follow that to reject it is a form of repudiatory breach of the CJA.

Having said this, this decision may have the effect of stultifying a regime which was intended to encourage parties to agree quickly to concise, well-known terms, and to avoid the costs and delays which are caused by arrests.

It is also worth pointing out that the Court did not approve the specific wording of the sanctions clause in this case – it merely upheld the finding by the lower court that as a matter of principle an LOU with a sanctions clause can be objectively satisfactory to the beneficiary, and that it was not its place to second guess a finding of fact of the lower court.

Finally, it should be said that it is unsurprising that the International Group (**IG**) of P&I clubs, who are usually guarantors and rarely beneficiaries in these schemes, have endorsed this wording. Whether, for example, the Lloyds cargo insurance market would have proffered a similar view is perhaps more questionable, and consequently, while the IG endorsement is not surprising, the weight given to the IG endorsement by the Court, whilst welcome, is perhaps a little surprising.

Case Details

Court:	Court of Appeal
Judges:	Lord Justices Lewison, Males and Snowden
Date of judgment:	14 June 2022

HFW represented the owners of *SAKIZAYA KALON* in *Sakizaya Kalon & Osios David v Panamax Alexander* [2020] EWHC 2604 (Admlty).

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[4] Supra 41

[5] Supra 52

[6] See *M/V Pacific Pearl Co Ltd v Osios David Shipping Inc* [2021] EWHC 2808 (Comm) paragraphs 70-71 and *Mamancochet Mining Limited v Aegis Managing Agency Limited and others* [2018] EWHC 2643 (Comm).

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