



Neutral Citation Number: [2016] EWHC 1091 (Comm)

Case No: CL-2015-000836

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: 10/05/2016

Before :

MR JUSTICE BLAIR

Between :

(1) FSL-9 PTE LIMITED
(2) NORDIC TANKERS TRADING A/S
- and -
NORWEGIAN HULL CLUB

Claimants

Defendant

John A. Kimbell Q.C. and Emily McCrea-Theaker (instructed by **Reed Smith LLP**) for the
Claimants
Charles Kimmins Q.C. and Thomas Corby (instructed by **Mills & Co**) for the **Defendant**

Hearing date: 28th April 2016

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE BLAIR

Mr Justice Blair:

1. The issue in this case is whether the claimant owners can apply to the court to require the defendant P&I club to increase the level of security available under a letter of undertaking issued by the club to the owners on 31 October 2013. In summary, the owners say that the use of the words “liberty to apply” in the LOU means that the court has power to make such a requirement. The club says that the court has no such power. The parties have each issued summary judgment applications against the other, and it is common ground that the case raises a question of construction and law suitable for disposition on a summary basis.
2. The case arises out of an incident in the Indonesian port of Padang on 9 October 2013 in which the chemical tanker, “FSL NEW YORK” was damaged during loading, and there was an escape of cargo. At the time, the vessel was on charter to ICOF Ship Chartering Pte Ltd. Both owners and charterers asserted claims against each other, owners threatening to arrest vessels owned by the group of which charterers are part.
3. The immediate impasse was resolved by the mutual provision of security by way of the issue of letters of undertaking. There were three of these. The defendant P&I club, Norwegian Hull Club, of which charterers are members, provided owners with an LOU in the sum of US\$3,500,000. This is the instrument which is the subject of these proceedings. The owners’ P&I club (the Standard Club) provided charterers with an LOU in the same amount. The Singapore law firm acting for the charterers, Rajah & Tann, provided owners with a separate LOU in respect of the freight claim in the sum of US\$1,235,712.10. Each of these instruments was dated 31 October 2013, and was subject to English law and jurisdiction.
4. Shortly afterwards, in December 2013 a London arbitration was commenced pursuant to the terms of the charterparty. As the arbitral process progressed (a two week hearing is fixed to begin on 16 May 2016), owners formed the view that further security was required. It is common ground that the arbitral tribunal has no power to order such security.
5. On 12 October 2015, owners asked charterers for an additional sum by way of security which was put at US\$4,000,000 (the figures have since come down considerably). This was on the basis that the LOU allowed for adjustment if the security proved to be inadequate. It did so in these terms: “*It is agreed that both Charterers and Owners shall have liberty to apply if and to the extent the Security Sum is reasonably deemed to be excessive or insufficient to adequately secure Owners’ reasonable Claims.*” This paragraph of the LOU and in particular the reference to “liberty to apply” is central to the argument.
6. To put the phrase into context, I shall set out the whole text of the LOU issued by the defendant P&I club in favour of owners. It is a brief instrument providing as follows:

“Ship: FSL NEW YORK (the “Vessel”)

Charterparty: Voyage Charter between ICOF as Charterers and
Nordic Tankers A/S as agents for Owners of the Vessel FSL-9
PTE Ltd (“the Owners”)

Claims: All your claims (excluding any claim(s) for freight and/or general average, and/or legal costs and/or interest arising out of any claim(s) for freight and/or general average) against the Charterers arising out of or in connection with the damage sustained to the Vessel during the line blowing operation (the “Incident”).

In consideration of your providing reciprocal security for Charterers’ Claims arising as a consequence of the above Incident and in further consideration of your releasing from arrest and/or refraining from arresting or re-arresting or interfering with any ships or assets belonging to or controlled by Charterers, and/or associated companies/entities of the aforementioned, and in consideration of your agreement that all Claims arising out of the Incident will be determined according to the law and jurisdiction provisions of the Charterparty, we hereby agree to pay to you such sum or sums as may be finally adjudged by a competent court or arbitration tribunal or agreed between us to be due in respect of the above Claims and arising as a direct consequence of the above Incident, provided always that our total liability hereunder shall not exceed the sum of USD\$ 3,500,000 (Three Million Five Hundred Thousand United States Dollars) inclusive of interest and costs (the “Security Sum”). This undertaking is given without prejudice to any rights or defences of Charterers (including their right to limit liability) and without any admission of liability.

This agreement shall be governed by and construed in accordance with English law and any dispute arising hereunder shall be subject to the exclusive jurisdiction of the High Court of Justice in London.

It is agreed that both Charterers and Owners shall have liberty to apply if and to the extent the Security Sum is reasonably deemed to be excessive or insufficient to adequately secure Owners’ reasonable Claims.

Proceedings before the High Court of Justice may be served upon us by being served on at Rajah & Tann ...”

7. Following an exchange of emails, owners’ request for further security was refused on 19 October 2015. This was stated to be on behalf of the club (which has common representation with the charterers and is funding their defence in the arbitration).
8. These proceedings were begun by owners against the club on 26 November 2015. On the basis of their reasonably arguable best case (see the test in *The Moschanthy* [1971] 1 Lloyd’s Rep 37 at p.44, Brandon J), the owners say that they are under-secured in the sum of US\$2,261,846.82. The club says that the figure should be US\$1,484,609.53. I shall return to the figures later but, applying the *Moschanthy* test, it is not in dispute that the owners are in fact under-secured. The dispute is whether

they are entitled to look to the P&I club direct under the terms of the LOU to make good the shortfall.

The parties' submissions

9. In support of its application to strike out the owners' claim alternatively for summary judgment (both applications raising essentially the same issue) the defendant club submits as follows:

- 1) Absent some kind of statutory power, it would be peculiar if this court could compel the club to increase the security. No case has been found in which such an order has been made.
- 2) Owners are at liberty to apply for further security from charterers by going through the normal hoops of arresting an asset of the charterers (in such jurisdictions as they are able), which in practice may well result in the defendant P&I club putting up increased security, and which would be much quicker than these proceedings in the court.
- 3) The liberty to apply is expressly granted to "Charterers and Owners". The club does not have liberty to apply against owners. The whole idea was that owners and charterers had liberty to apply against each other.
- 4) Owners have liberty to apply for further security against charterers, but charterers are not party to the LOU. This is consistent with the idea that owners can apply for additional security against charterers in the ordinary way (by, e.g., arresting in such jurisdictions as they are able).
- 5) If owners are correct as to the meaning of "liberty to apply", it would follow that the club accepted a potentially unlimited and unquantifiable liability to provide further security. That makes no sense because the LOU expressly states that it will put up the security "provided always that our total liability hereunder shall not exceed the sum of US\$ 3,500,000". Further, it is inherently unlikely that any insurer would accept such a liability.
- 6) The claim does not disclose a complete cause of action. Owners plead the existence of their liberty to apply in the LOU but fail to identify a term obliging the club to provide further security. There is no such express term, and one cannot be implied.
- 7) As a matter of construction, the "liberty to apply" was given to "Charterers and Owners". There is no justification for reading the reference to "Charterers" as a reference to their P&I club, or re-writing the clause to replace "Charterers" with the club.
- 8) Owners are wrong to contend that the effect of the LOU is that this court has exclusive jurisdiction to deal with adjustments to the security, since charterers are not parties to the contract, and can go to whichever forum they wish.
- 9) Contrary to owners' contentions, English Admiralty procedure is irrelevant to the construction of the LOU. There is no evidence to show that it formed part

of the relevant factual matrix. If the procedure of any jurisdiction was likely to have been relevant, it would have been that of Indonesia (as the jurisdiction where charterers' assets are located).

10. The claimant owners argue as follows:

- 1) The words 'liberty to apply' in the LOU should be given their most obvious meaning. When read in context they mean liberty to apply to court – i.e. the High Court of Justice in London. The liberty to apply provision in the LOU appears immediately after the words "High Court of Justice".
- 2) The practical intention of the clause is plain and its effect perfectly symmetrical. If as the arbitration proceeded, charterers (ICOF) formed the view that the security sum was now excessive (e.g. because one or more of owners' claims had become unsustainable) then they were entitled to have the security sum reduced. Though not a party, charterers would have such right by virtue of the Contracts (Rights of Third Parties) Act 1999. Owners' right to have the sum adjusted upwards if the security sum became insufficient is just the other side of the coin.
- 3) Even if 'liberty to apply' is not construed as meaning a right to apply directly to the court, it must in context mean that there is a right to an adjustment if circumstances change in such a way as to render the security sum either insufficient or excessive. If there is a disagreement about that, it is clear that the London High Court has jurisdiction to resolve the matter because of the dispute resolution clause. The words 'any dispute' in the LOU dispute resolution clause are self-evidently wide enough to cover a dispute arising under the liberty to apply provision.
- 4) There is nothing odd about a P&I Club agreeing to a possible future adjustment in the level of security (up or down) if circumstances change.
- 5) When construing the words "liberty to apply" in the LOU it is appropriate to consider the standard Admiralty court procedure under English law, which allows for this kind of application.
- 6) The liberty to apply provision does not render NHC's exposure "unlimited or unquantifiable". The overall aim of the LOU remains to secure owners' full reasonable claims plus interest and costs. If those claims were uncertain in 2013, why should the parties not build in the possibility of an adjustment in either direction?
- 7) The club's suggestion that 'liberty to apply' means 'liberty to arrest' is inconsistent with the wording of the LOU. Owners have irrevocably undertaken not to arrest or interfere with the assets belonging to or controlled by charterers. This promise formed part of the consideration for which the club has agreed to secure owners' reasonable claims in the first place.
- 8) If as the club submits the intention of the provision had been merely to permit re-arrest then (i) the words 'liberty to re-arrest' would have been used, and (ii)

the undertaking not to re-arrest earlier in the LOU would have been qualified in some way e.g. “*subject to the proviso below, Owners undertake to ...*”.

- 9) Owners’ interpretation provides a simple solution and preserves all the generally recognised advantages of an LOU over arrest proceedings.
- 10) In terms of remedy, Owners’ primary case is that the LOU gives them a right to apply to the court for an adjustment. The club has denied this and the main purpose of these proceedings is to resolve that dispute by seeking a declaration. The court can either simply make an appropriate declaration or make a declaration and order that security now be provided in a certain sum (with or without any residual claim being referred to the Admiralty Registrar).
- 11) If the liberty to apply provision is not a provision permitting direct application to the court but is instead ‘a right to adjustment’ clause, then owners have made out a contractual right to an upward adjustment. The club’s breach on this analysis is in not agreeing to increase the security to a level which corresponds to owners’ best reasonably arguable case plus interest plus costs and they are entitled to refer this dispute to this court under the dispute resolution clause.

Discussion and conclusion

11. In the context of disputes which may lead to the arrest of a vessel, a letter of undertaking issued by a P&I club is a convenient means of providing alternative security, and such letters are widely accepted internationally as such (see Hazelwood and Semark, *P&I Clubs: Law and Practice*, 4th ed, chapter 14). The letter is issued at the request of a member of the club to the party making a claim, but issue is a matter of discretion, and there is no obligation on the club to do so (Andrews and Millett, *The Law of Guarantees*, 7th ed, at 15-024). The purpose is to place the claiming party in no less a favourable position than if it had begun an action *in rem*, and arrested the vessel (*The “Oakwell”* [1999] 1 Lloyd’s Rep. 249 at 253). Subject to its particular terms, such an instrument will be treated as giving rise to a primary obligation undertaken by the issuer analogous to a bank guarantee (*The “Rays”* [2005] 2 Lloyd’s Rep 479 at [50]). In that case, the special principles of construction applicable to contracts of suretyship will not apply, since these are premised on the surety’s secondary liability. Letters of undertaking should be construed as commercial contracts having regard to their commercial purpose (*The “Elpis”* [1999] 1 Lloyd’s Rep 606 at 610).
12. There was substantial agreement as to the approach to construction which has been well settled by recent authority: see *Rainy Sky SA v. Kookmin Bank* [2011] 1 WLR 2900, *Arnold v Britton* [2015] AC 1619.
13. Against that background, my conclusions are as follows.
14. As the owners say, the words “liberty to apply” normally refer to liberty to apply to a court. As they point out, in the LOU the phrase comes between a clause giving exclusive jurisdiction to the London court, and a provision as to service. That is the force of the submission that read in context the liberty to apply must refer to liberty to

apply to the London court, which is to be treated as the exclusive venue in this respect.

15. As against that, the term “liberty to apply”, at least as used in the English jurisdiction, is normally to be found in a court order, and is there to give parties to existing proceedings the right to come back before the court in particular circumstances. The words are much less easy to give meaning to when contained in a contract, and furthermore in a contract in respect of which there were no proceedings at the time.
16. However, the words are there, and they must be given a meaning. Owners argue that the clause is symmetrical, giving charterers the right to reduce the security, and owners the concomitant right to increase it. In terms of the language used, this is correct. The argument is that both have the right to apply to the court to vary the security up or down.
17. However, there is this difficulty. As the club says, the charterers are not a party to the letter of undertaking. On the face of it, they have no rights under it. In oral submissions in reply, owners sought to meet that objection by reference to the Contracts (Rights of Third Parties) Act 1999. The club raises the further objection that the charterers are not party to the exclusive London jurisdiction clause, and hence any restriction on bringing claims could not be a “benefit” for the purposes of s.1(b) of the 1999 Act.
18. Further, whilst owners’ argument produces symmetry as between themselves and the charterers, it is asymmetrical as regards the owners. I agree with the club that the term “Charterers” in the LOU cannot be read as meaning “charterers and/or the club”. This point is supported by the references to “Charterers” elsewhere in the LOU which can only be a reference to the “Charterers, and/or associated companies/entities of the aforementioned”. I agree with the club that it is unlikely that it did not have liberty to apply against owners but that owners had liberty to apply against it.
19. The club’s interpretation of the clause underwent some refinement during the course of the hearing. It submits that on its proper interpretation the clause gives charterers and owners liberty to apply to each other to adjust the security, and specifically gives owners liberty to apply for further security to any court with jurisdiction to arrest an asset of the charterers, or possibly to the arbitral tribunal by way of declaratory relief. The term does not, it submits, invest this court with jurisdiction which it would not otherwise have. Specifically, it submits that whether viewed from the position of the owners, or viewed from the position of the charterers, the application to increase or reduce the secured amount must always be directed to the other party—it cannot be directed to the P&I club directly in an application to the court.
20. Owners object that a construction which interprets the “liberty to apply” as allowing them to seek additional security through the arrest of vessels or other assets of the charterers in the event that the sum secured proves to be inadequate runs contrary to the prohibition in the LOU by which owners agree to refrain “... from arresting or interfering with any ships or assets belonging to or controlled by Charterers, and/or associated companies/entities of the aforementioned...”.
21. Clearly this provision is necessary to enable the LOU to achieve its immediate purpose of lifting the threat of the arrest of the vessel. However, I agree with the club

that as a matter of construction, the “liberty to apply” provision can be read compatibly with this prohibition. Ordinarily, the standard terms of a P&I club letter of undertaking would prevent the beneficiary from arresting the assets of the party with which it was in dispute. As it is put in Meeson and Kimbell, *Admiralty Jurisdiction and Practice*, 4th ed, at 4.89: “where security has been taken out of court, the terms of the security provided will ordinarily be a contractual bar to any arrest or re-arrest of the vessel for the purposes of obtaining increased security”. But the parties can agree otherwise. There is much force in the club’s submission that they have done so in the liberty to apply provision, which can be read as qualifying the prohibition against arrest or re-arrest of charterers’ assets if the security provided proves to be inadequate. Although owners object that if this was so the words would refer to “liberty to *re-arrest*” rather than “apply” and the earlier prohibition would have been expressly qualified by a proviso, I do not think that these objections in themselves negate the club’s case in this regard.

22. This does seem to be a case falling within the well-known passage from *Rainy Sky*, *ibid*, at [21], calling for a construction which is consistent with business common sense:

“The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other.”

Of course, the parties take diametrically different positions as to what constitutes business common sense. In this regard, there seem to me to be three particular factors to weigh up.

23. First, owners maintain that it is appropriate in construing the words “liberty to apply” in the LOU to consider the default standard procedure under English law (see Meeson and Kimbell, *ibid*). If the appropriate amount of security cannot be agreed, the court can decide on a quick summary procedure carried out by the Admiralty Registrar. Similarly, if the security sum subsequently turns out to be excessive, an application may be made to the court to have the security reduced: see CPR 61.6(2)(a). If the security sum turns out to be insufficient, the claimant may apply to the court for permission to re-arrest. Thus, owners say, it is standard English admiralty practice for applications to the court to be made, meaning here that it is highly likely that the use of the term “liberty to apply” meant liberty to apply to the identified court, that is the London court.

24. The club objects that English admiralty procedure is irrelevant, and if the procedure of any jurisdiction forms part of the relevant factual matrix, it would have been that of Indonesia, where the charterers' assets are located.
25. In my view, that is a valid objection. But apart from the lack of connection with England, as the club points out, English admiralty procedure applies as between the parties to the particular dispute, here owners and charterers. The P&I club will not be a party to the court proceedings, any more than a bank would be a party if security had been given by way of a bank guarantee instead of an LOU. In other words, adjustment takes place between the parties which are in dispute. I do not think that the reference to English admiralty procedure assists the owners' case.
26. Second, the club says that owners cannot identify a term of the contract requiring the club to increase the level of security upon the owners' application. On that basis, it is submitted that they cannot identify any breach of contract by the club. The club's case is that it is impossible to construe any obligation placed upon it to increase the amount of the security from a "liberty to apply" given to charterers and owners.
27. I do not think it was ultimately argued that the obligation in question can be supplied by implication of a term. As has been said in this context, the court should be cautious of implying terms into letters of undertaking which are widely used internationally often by those whose first language is not English (*The "Tutova"* [2007] 1 Lloyd's Rep 104 at [23]).
28. Owners' response is that if the provision is a properly construed only as a "right to adjustment", then the club is in breach by not agreeing to increase the security to a level which corresponds to owners' best reasonably arguable case, and owners are entitled to refer the dispute to the court under the dispute resolution clause.
29. In my view however, this response fails to meet the basic objection. It is not a matter of identifying the court to which a dispute must be referred, which is provided for in the LOU. The reference to the court of a dispute between owners and charterers does not imply that the *club* has undertaken to increase security, should charterers fail to do so. Increasing the amount of an undertaking is a very different type of obligation from the obligation to make payment under the undertaking in accordance with the terms of the instrument. A claim for breach of that obligation would, of course, lie directly against the club as issuer of the instrument, and would fall within the exclusive jurisdiction of the English court, but owners are not making it, because the club is not refusing to pay.
30. That leaves the third, and in my view the most significant factor. Owners argue that there is nothing odd about a P&I club agreeing to a possible future adjustment in the level of security up or down if circumstances change. However, on owners' case there is no upper limit to the amount by which the club's exposure may be increased by the court upon application under the "liberty to apply". Owners say that in practice this should not be a matter of concern, since the scope for liability is relatively constrained, and that although (for example) there was an escape of cargo during the incident, this is not a case where environmental damage is alleged.
31. However, as the club points out, the initial claim for an increase in the security by US\$4m was more than double the amount secured by the LOU. As it is, owners seek

an order that the court require the club to increase security by US\$2.26m, which is a very substantial increase over the existing \$3.5m.

32. The club raises two further objections in this regard. The first is as to the limit of liability in the LOU. In the relevant passage it says, "... provided always that our [*that is the club's*] total liability hereunder shall not exceed the sum of USD \$3,500,000...". By this clause, the club capped its liability under the LOU.
33. Owners respond that the cap is subject to the "liberty to apply". I do not accept this contention. In my view, the LOU states the maximum sum which the club commits to pay the owners. They could of course ask for an increase, and an increase might be refused at risk to the charterers, but it is a different matter altogether to propose that the court could order the club to give it, which is the owners' case. This is powerful support to the view that the "liberty to apply" subsists as against charterers, and does not give a direct right against the club to require it to increase the security.
34. Further, I agree that it is inherently unlikely that a P&I club, or a bank, or other financial institution, would issue a financial instrument investing a court with the right to increase without limit its liability under the instrument upon the application of the beneficiary. This would, as touched upon in argument, have among other things possible implications for the institution's capital requirements or reserves. Furthermore, though I was told that charterers had not in this instance been required to give an indemnity, it is easy to conceive of a situation in which increase by court order would increase the club's exposure on an unsecured basis, which would be unacceptable.
35. Owners also argue that there is no objection to the court looking at pre-contractual communications for the object of ascertaining the "genesis and object" of the disputed term. The club disputes this as a matter of principle (on grounds set out in Lewison, *The Interpretation of Contracts*, 6th ed, at p.112-3). However, even if the court is entitled to look at the pre-contract material, the case as advanced in owners' skeleton argument shows the lawyers for owners and charterers envisaging "liberty to apply" for both their clients to the extent that the security figure agreed did not accurately reflect what the loss turned out to be. Nothing to which the court's attention has been drawn is to the effect that this was treated as being a liberty to apply to the court to require the club to increase its liability.
36. A case based on estoppel by convention was not pursued, which in any case would be impossible to make out on the facts.
37. In conclusion, I cannot accept owners' case on construction. The "liberty to apply" in the letter of undertaking does not give owners the right to apply to the court to require the defendant P&I club to increase the amount of its undertaking. I accept the club's construction that this provision enables owners to arrest charterers' assets if the security provided proves to be inadequate, and notwithstanding the prohibition against arrest or re-arrest provided for earlier in the instrument. The right to enforce an increase in the amount of the security lies against the charterers, and not against the P&I club direct. It is, as I have said, common ground that the court should decide this issue on the present applications, and it follows that the club is entitled to summary judgment.

Quantum

38. The owners' claim for security includes their projected costs to the end of the arbitration in the sum of US\$1,880,407, which is not disputed for these purposes. The first dispute is as to whether the claim for freight and loss of earnings for the same period is (as the club maintains) double recovery: owners say not, because the right to freight is an accrued right to which they are in any event entitled. The second dispute is as to owners' claims for freight and in respect of the cargo claim, which the club says are not covered by the LOU: owners say that it is covered and that the cargo claim arises separately.
39. On the basis of my finding as to the construction of the LOU, the quantum issue does not arise. It will be decided in the arbitration, and it would not be useful for the court to say anything more at this stage.

Conclusion

40. For the above reasons, the defendant P&I club is entitled to summary judgment. The parties can draw up an order, and I will hear them on any consequential matters. I am grateful to them for their assistance.