The Iranian Nuclear Issue – War Risk, Unsafe Port And Frustration

February 2012

1 Introduction

The European Council decision 2012/35/CFSP adopted on 23 January 2012 operates as an embargo of the import, purchase and transport of Iranian crude oil and petroleum products. This represents perhaps the most significant sanctions taken against Iran to date and raises an important question for shipping. What issues arise in relation to Iran’s threats to block the Strait of Hormuz, or in the event of military strikes or other hostile action?

Prior to the EU decision statements had been made by members of Iran’s legislature that the Strait would be blocked if sanctions were adopted. After the decision was made, another senior official said that the Strait would be blocked if Iran’s oil trade was disrupted. Iran’s ambassador to the U.N. had said that there is no decision to block the Strait unless Iran is threatened. A flotilla of warships including a U.S. carrier has sailed through the Strait in a clear demonstration of intent to resist any action against the bottleneck by Iran. Most recently, on 28 January, Iran’s Vice-President warned that no oil will pass through the Strait if sanctions are widened.

The possibility of Iran adopting retaliatory responses to the sanctions would have an impact on contracts of carriage, contracts of sale and marine war risks insurance. The Strait of Hormuz is a narrow strait in the region connecting the Persian Gulf with the Gulf of Oman and the Arabian Sea. In 2011, a daily flow of almost 17 million barrels of oil flowed through the Strait of Hormuz. This reportedly accounted for about 35 percent of all seaborne traded oil and more than 50 percent of these crude oil exports were destined for the Asian markets, mainly Japan, India, South Korea, and China.

This article provides an overview of the issues facing Members letting or taking vessels on time or voyage charter terms which may be ordered to the region, specifically compliance with charters’ orders, port safety, frustration and consequential matters.

2 War Risks Clauses

Most time and voyage charters nowadays incorporate fairly detailed war risk clauses that aim to safeguard owners and vessels’ interests in circumstances where the owner or master considers that proceeding to a port would expose the vessel and crew to war risks. These are commonly on BIMCO’s CONWARTIME 2004 or VOYWAR 2004 terms or their previous, 1995 versions or similar. It is relatively rare to find charters fixed on the basis only of older, more narrowly drawn clauses or only a great power war cancellation clause.

CONWARTIME 2004 provides that:

“War Risks shall include any actual, threatened or reported:

War, act of war, civil war, hostilities, revolution, rebellion, civil commotion, warlike operations, laying of mines, acts of piracy, acts of terrorists, acts of hostility or malicious damage, blockades (whether imposed against all vessels or imposed selectively against vessels of certain flags or ownership, or against certain cargoes or crews or otherwise however), by any person, body, terrorist or political group, or the Government of any state whatsoever, which, in the reasonable judgement of the Master and/or the Owners, may be, or are likely to be or to become dangerous to the Vessel, her cargo, crew or other persons on board the Vessel.”

VOYWAR 2004 contains an identical definition.

Under older, narrow clauses it has been necessary to consider whether a situation amounts to war. The leading English authority, Spinney’s Case (1981), determined that the main characteristics of war included considerations of: (i) conflict between opposing sides with territorial, political or other identifiable objectives of domination; and (ii) the character and the amount/manner of armaments’ conflict. War like operations will trigger a war risks clause regardless of whether or not there has been a formal declaration of war. “Warlike operations” and hostilities are wider than “war” and do extend to belligerent acts, although Spinney’s Case suggests that they may require to be done in the context of war or similar.

A blockade requires the use of force to cut off access of vessels and must be effectual and constantly enforced.

In the context of the current developments involving Iran, a number of the other categories of War Risks short of war could potentially apply, such as laying of mines or blockades, depending on what further threats or actions emanate from Iran; see further below.

3 Orders to a War Risks Area

CONWARTIME 2004 provides that:

“The Vessel, unless the written consent of Owners be first obtained, shall not be ordered to or required to continue to or through, any port, place, area or zone (whether on land or sea) or any waterway or canal, where it appears that the Vessel, her cargo, crew or other persons on board the Vessel in the reasonable judgement of the Master and/or the Owners, may be, or are likely to be exposed to War Risks .... The Vessel shall not be required to pass through any blockade.”

A war risks clause such as CONWARTIME 2004 would permit Owners to refuse orders to proceed to the Gulf if in the reasonable judgement of the Master or Owners the Vessel would be exposed to war risks. The test is objective reasonableness. In the recent case of The “Trinta Lanka” (2011) [iv], it was held that the Owners would have to establish that they had formed a reasonable judgment (this would require evidence of the decision making process) that there was a “real likelihood” that the vessel would be exposed to war risks (in that case piracy). “Real” means that there must be some evidence, not for example mere speculation. The Judge also held that “likelihood” did not mean more likely than not. It could include an event which had a less than even chance of happening but it required a degree of probability greater than a bare possibility.

In a further judgment in the same case on 25 January 2012, the Judge observed that what is dangerous in the context of exposure to war risks will depend on the facts of the case and will include the degree of likelihood that a particular peril might occur and the gravity or other consequence should that event occur.
Considering the war risks in CONWARTIME 2004, threatened or hypothetical action by Iran (or counter measures) might fall under a number of the itemised risks. Whilst threatened war may require a formal statement, albeit falling short of a formal declaration, and that may not yet have occurred, it may be arguable that the various statements made up to 28 January, whether considered official or unofficial, emanating from various individuals within the Iranian government or authorities could already satisfy the various categories of threatened lesser war risks within the 2004 BICMC clauses, at least that of a threatened blockade. It should be noted however, that they do not all appear consistent or clear.

However, whether qualifying as war risks or not, it would probably be a brave Owner who relied on the various differing statements to date and/or the U.S. and other countries’ shows of force to justify a judgement that they posed a danger to the vessel or were likely to do so, without positive evidence that there were serious threats and/or of acts or preparations by Iranian forces.

Future development may need to be monitored carefully to judge whether the situation has or will become dangerous and, of course, there is the possibility that discriminating action by Iran (contrasted with non-discriminating actions such as the laying of mines) might make passage appear dangerous for some and not other vessels.

If the standard war risks clauses are triggered, they make provision for discharge of the cargo elsewhere if loaded already. In the case of the SHELLTIME 4, if no cargo is loaded and charterers give no substitute orders within 48 hours then the charter is automatically terminated. In any event, if the clause provides an option to cancel, it must be exercised promptly. Such clauses are often construed strictly against the party with the option to terminate.

4 Remedies for loss and damage and Unsafe Ports

If a vessel suffered damage from action by Iran or hostilities as a result of passing through into the Strait of Hormuz, an Owner may have limited recourse against the charterer for damages in the context of an unsafe port unless, perhaps, the nature of the threat changes. A safe port warranty, whereby the Charterer warrants at the time of nominating a port that it will be safe during the vessel’s approach, call and departure without being exposed to danger in the absence of an abnormal occurrence, is limited to those ports of the approach to the port which are characteristic of that port, not all those in a region. The Strait is a waterway through which access to all the ports of the Persian Gulf is obtained from those outside.

However, it is still possible that a Charterer could be in breach of an obligation such as that in CONWARTIME 2004 not to order the vessel to or through a waterway reasonably considered to be dangerous. Accordingly, where, for example, an Owner has stated its position that it was unsafe to proceed and a Charterer affirmed its order or, with knowledge of the situation, did nothing to prevent the vessel from continuing, the Charterer may be in breach and held liable in damages to the Owner (see “The Eugenia” 1960)[v] where, under an older version of the Baltic war risks clause, Owners objected to the vessel proceeding via the customary route to the discharge ports through the Suez Canal after the Israeli invasion of 1956 and the Charterers, having done nothing to stop the vessel, were held to have impliedly ordered her into the Canal and were liable for damages resulting from her being subsequently blocked there.

It is important to note that, while the acceptance by Owners of the Charterers’ orders or their failure to refuse to proceed with the voyage will amount to a waiver of the right to do so, at least absent a change in circumstances, if the vessel or Owners suffer damage as a result and it is shown that the Charterers were in breach, Owners’ acceptance will not prevent them from claiming damages, see “The Kannenjunga” (1987)[vi]

However, there are circumstances whereby an Owners’ acceptance of a charterers’ nomination has been held to constitute a waiver of a claim for damages. In The “Chemical Venture” (1991)[vii] the crew refused to comply with Charterers’ orders to proceed to Kuwait despite Owners’ orders to the crew to comply with them. At Owners’ suggestion, charterers negotiated directly with the crew who finally agreed to proceed to Kuwait after charterers agreed to pay them a significant bonus. The Court held that owners had waived their right to claim damages on a proper construction of correspondence exchanged with Charterers. Care should therefore be taken over any negotiations to proceed with or continue a voyage.

Charterers’ orders, or navigation?

The implied indemnity arising out of the master’s duty to obey Charterers’ orders as to employment under a time charter provide an alternative basis upon which an owner may recover damage caused by compliance with charterers’ orders. If a matter is dealt with fully by express terms of the charter, there may be no reason to imply an indemnity. Furthermore, this subject often gives rise to issues over whether the risk of damage was on, a proper construction of the charter, assumed by the Owner such that there is no indemnity or to causation issues such as whether the damage was caused from compliance with charterers’ orders or by the master’s navigation.

In the context of Iran, arguments as to whether damage was caused from compliance with orders or the master’s navigation may be unlikely to arise given the narrow confines of the Strait unless it is a case of transiting via area declared unsafe, rather than one declared to be safe, or deliberately proceeding through an area known to be mined.

The War Risks clause is therefore likely to provide the simplest answers to the issues that arise. Owners’ obligations under the charter are also likely to be affected by the Owners and master’s responsibility for the navigation of the vessel given the House of Lords decision in The Hill Harmony [2001][viii] that the choice of ocean route as a matter of the vessel’s employment. However, it could provide some operational flexibility, for example to deviate or delay for the vessel’s safety without being held in breach of charter.

5 Frustration

The doctrine of frustration often arises in the context of hostilities. In the words of Lord Justice Bingham, the effect of frustration is “…to kill the contract and discharge the parties from further liability under it.” “The Super Servant Two” (1960)[ix]. It can be said that a charter is frustrated and brought to an immediate end if, during its performance, a fundamentally different situation arises through no fault of either party, and for which the parties have made no provision in the charter, so that it would be unfair in the new circumstances to require them to perform the balance of their obligations. Clearly, in the context of the Iranian sanctions and nuclear issues, it is more likely to arise in relation to a voyage charter or time charter trip than a longer period hire charter with wide trading limits.

Will War or Threats of Hostilities Frustrate a Charter?

No. This was made clear by Mustill J in The Chrysalis” (1953)[x]

“Except in the case of supervening illegality, arising from the fact that the contract involves a party trading with someone who has become an enemy, a declaration of war does not prevent the performance of a contract: it is the acts done in furtherance of war which may or may not prevent performance depending on the individual circumstances of the case.”

Cases dealing with issues of frustration in the context of hostilities arose from the nationalisation of the Suez Canal by the Government of Egypt in 1956 and the subsequent blocking of the waterway. This resulted in vessels having to undertake a longer passage around the Cape at considerable expense. In “The Eugenia” (1963)[xi] Lord Denning held that this did not amount to a fundamentally different situation so as to frustrate chartermanship in question.
“To see if the doctrine applies, you have first to construe the contract and see whether the parties have themselves provided for the situation that has arisen. If they have provided for it, the contract must govern. There is no frustration. If they have not provided for it, then you must compare the new situation with the situation for which they did provide. Then you must see how different it is. The fact that it has become more onerous or expensive or one party more thought is not sufficient to bring about a frustration. It must be positively unjust to hold the parties bound.”

Having said that, the presence of war risks clauses in the charter does not necessarily prevent the charter being frustrated.

Of course there is no possibility of an alternative route in relation to trade into and out of the Persian Gulf. The issue would be delay until passage through the Strait of Hormuz was no longer considered to be dangerous.

Generally, delay can be a frustrating event but is a question of fact whether or not the period of delay is sufficient to constitute frustration; see Universal Cargo Carriers v Pedro Citali (1957)[xiii].

The question is at what time should the actual and/or anticipated interruption of the charter be assessed? The view appears to be that the court should go back to the time when the parties claimed that the charter had been frustrated and to ascertain what moment of time a reasonable businessman standing in their shoes would have anticipated, see Anglo Northern v Jones (1917)[xvi]. In the context of the current situation, the U.S. has stated its commitment to keeping the Strait open. Depending upon what action was taken by Iran, it may be that further direct threats or even positive action by Iran were insufficient to frustrate immediately contracts of carriage to or from the Persian Gulf and the situation may need to be assessed over a longer period taking into account the reaction to the international community to determine its effect.

It is worth noting that the availability or otherwise of hull or P&I insurance is not itself a factor making a place more or less dangerous for the purposes of triggering a war risks clause and, likewise, is unlikely to determine whether or not a charter is frustrated. The underlying reasons why such insurance is not available may themselves allow Owners to form a reasonable conclusion that passage through the Strait of Hormuz or a voyage to Iran is dangerous and/or they may permit rejection of orders under sanctions provisions or on the basis of illegality according to an applicable law.

Conclusion

If Iran retaliates to the latest sanctions by blocking the Strait of Hormuz, launching military strikes or by taking some other hostile action, the English courts and arbitral panels have a great deal of previous authority guiding the approach to the resolution of disputes arising under charters. Members should be paying close attention to the war risks and sanctions clauses which will determine the economic consequences of serious developments in relation to the Strait of Hormuz. In doing so, owners and charterers may consider tailoring their war risks clauses to their particular needs and interests.

With thanks to Stephen Kirkpatrick and Jacqueline Zalapa of Reed Smith for preparing this article.


[xiii] Anglo Northern v Jones [1917] 2 KB 78