Neutral Citation Number: [2010] EWHC 2661 (Comm)

Case No: FOLIO NO. 178 OF 2010

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

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 26/10/2010

Before :

THE HONOURABLE MR JUSTICE BEATSON

- -

Between :

Islamic Republic of Iran Shipping Lines	**Claimant**
- and -	
Steamship Mutual Underwriting Association (Bermuda) Limited	**Defendant**
-and-	
HM Treasury	Interested Party

- -
- -

Christopher Butcher QC and Peter de Verneuil Smith (instructed by **Holman Fenwick and Willan LLP**) for the Claimant
Jonathan Hirst QC and Richard Eschwege (instructed by **Reed Smith LLP**) for the Defendant
Jonathan Swift QC and Ben Olbourne (instructed by **The Treasury Solicitor**) for the **Interested Party**

Hearing dates: 26-28 July 2010

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Judgment

The Hon. Mr Justice Beatson :

I. Introduction

1. This case concerns the effect of measures taken by HM Treasury pursuant to powers conferred by the Counter-Terrorism Act 2008 (the "2008 Act") on a contract of insurance between the claimant and the defendant, and, in particular, on cover in respect of liabilities in respect of bunker oil pollution. Such cover (or similar security) is required by the International Convention on Civil Liability for Bunker Oil Pollution

Damages 2001 ("the Bunkers Convention"[1]) in order for a ship to trade in the territorial waters of States which are parties to the Convention. The defendant, Steamship Mutual Underwriting Association (Bermuda) Ltd. (the "Club") provides marine P & I insurance to its members on a mutual basis against a wide range of risks including pollution. Prior to the events giving rise to these proceedings, the claimant, Islamic Republic of Iran Shipping Lines ("IRISL") was a member of many years standing.

2. In 2009 twenty-eight ships owned by IRISL or otherwise part of its fleet were entered with the Club with effect (see Rule 14(i)) from noon GMT on 20 February 2009 until noon GMT on 20 February 2010. The "ZOORIK" was one of the ships owned by IRISL which was so entered. It was entered for Class 1 Protection and Indemnity insurance. On 31 October 2009 it suffered a casualty in the territorial waters of the People's Republic of China causing bunker oil pollution and rendering it a constructive total loss. Less than 24 hours earlier, the Club had terminated cover in respect of all the ships entered by IRISL with the Club with effect from midnight GMT time on 30 October. It did this on the ground that the contract of insurance between it and IRISL had been discharged by reason of frustration or supervening illegality as a result of the measures taken by the government of the United Kingdom.

3. Those measures taken were the promulgation of the Financial Restrictions (Iran) Order 2009 SI No 2725 of 2009 ("the Order") and a number of associated licences issued by HM Treasury. The Order, which was made on 9 October 2009 and came into effect on 12 October, prohibited transactions and business relationships between persons operating in the financial sector ("relevant persons") and two designated Iranian entities, IRISL and Bank Mellat. HM Treasury was empowered to exempt specified acts from the Order by issuing licences. It issued two licences authorising the Club to continue to provide insurance cover under an existing contract with IRISL for specified periods. The second of these periods expired on 30 October. On that day HM Treasury issued a further licence but it was in different terms to the previous licences about the arrangements between the Club and IRISL. The Club terminated cover because it took the view that the terms of the Licence issued on 30 October meant that it was no longer permitted to provide insurance cover to IRISL.

4. Was the contract of insurance discharged by frustration or supervening illegality, or did the terms of the Licence issued on 30 October 2009 mean that it was not and that the Club remains liable to IRISL in respect of certain liabilities incurred by it as a result of the casualty to the "ZOORIK"? The liabilities in question are those imposed on State Parties by the Bunkers Convention, which *inter alia* provides for State Parties to require compulsory insurance to be taken out by the owners of ships of over 1,000 gross tons. The gross tonnage of the "ZOORIK" was 16,173 tons and this provision of the Convention thus applied.

5. The statutory authority for the Order is contained in section 62 of, and Schedule 7 to, the 2008 Act (hereafter "Schedule 7"). Schedule 7 empowers HM Treasury to "give a direction" to (see paragraph 3(1)) a person operating in the financial sector (a "relevant person") if, *inter alia*, (see paragraph 1(3) & (4)) it reasonably believes that

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[1] Reflecting the term in the Merchant Shipping (Oil Pollution) (Bunkers Convention) Regulations, 2006 SI No. 1244.

"the development or production of nuclear, radiological, biological or chemical weapons" in a country or the doing in that country of anything that facilitates the development or production of any such weapons poses a significant risk to the national interests of the United Kingdom.

6. In the present case the Explanatory Memorandum to the Order, the other documents issued with it, and the written ministerial statement about it stated that the Secretary of State believed that Iran had ballistic missile and nuclear programmes which posed a risk to the United Kingdom. The documents also stated that the provision of services by IRISL and Bank Mellat, in the case of IRISL by transporting goods for both programmes, contributed to those programmes and that risk.

7. A direction in an Order may impose requirements ranging from "customer due diligence" and "ongoing monitoring" to requiring a relevant person to limit or, as it did in this case, to cease business with a designated person: see paragraphs 9(4) and 13 of Schedule 7. A direction must (see paragraph 14(2)) be contained in an Order subject to an affirmative resolution of each House of Parliament and (see paragraph 16(4)) the Order ceases to have effect one year after it was made.

8. HM Treasury's power to grant a licence to exempt acts specified in the licence from the requirements contained in a direction is contained in paragraph 17 of Schedule 7. On 12 October when the Order designating IRISL and Bank Mellat came into force the Treasury issued an interpretative note and three general licences ("the General Licences") pursuant to the power conferred by paragraph 17. The material terms of these licences are set out at [30-32]. The third General Licence allowed "relevant persons" to "continue to provide insurance cover under an existing contract with a designated person [i.e. with IRISL] for a period of seven days". This was extended by a licence made on 19 October which permitted the Club to "continue to provide insurance cover under an existing contract with" IRISL until 30 October 2009. A further licence (hereafter "the Licence" and "the 30 October Licence") was made on 30 October which provided *inter alia* that "[the Club] may continue to provide insurance cover in accordance with the Blue Cards issued to IRISL for a period of three months starting on 30 October 2009…". The reference to "Blue Cards" concerns the compulsory insurance required by Article 7(1) of the Bunkers Convention. A Blue Card is the document issued by the Club evidencing that the insurance required is in place, although (see [33]) the cards were not issued "to IRISL".

9. Initially IRISL commenced proceedings against HM Treasury under section 63 of the 2008 Act challenging the legality of the Order. The grounds of the challenge are that IRISL had not provided the services relied on by the Secretary of State, and there was no evidence demonstrating that it had. IRISL claims that the decision to make the Order was irrational because of the absence of evidence demonstrating that IRISL transported goods for Iran's ballistic missile and nuclear programmes. It also claims that the decision was in breach of the requirements of procedural fairness, and an infringement of the UK's obligations under the Bunkers Convention. On the assumption, contrary to its position in these proceedings, that the 30 October Licence rendered it unlawful for the Club to provide an indemnity to it, IRISL also challenged the legality of the Licence. The grounds in respect of the Licence are similar to those in respect of the Order, but there is also one based on IRISL's legitimate expectations.

10. It, however, became apparent that the first issue that needed to be determined was whether the Order and the Licence did in fact render it unlawful for the Club to provide an indemnity to IRISL in respect of the liabilities arising from the casualty to the "ZOORIK". The Club indicated that it was willing to participate in proceedings in the Commercial Court rather than insist upon arbitration under Rule 47(ii)(a) of its Rules. Following a Directions Hearing before Gross J on 9 February 2009 at which the section 63 proceedings were stayed, on 15 February 2010 these proceedings were instituted. Accordingly, while IRISL does not accept the validity of the Order, these proceedings are not concerned with that question.

11. The parties have agreed a statement of facts, and the issues for the court are ones of the proper construction of the Order and the 30 October Licence and as to the law on the basis of those facts and that construction. The Club's position is that the correct interpretation of the Licence means that it is not permitted to provide insurance cover and thereby to indemnify IRISL in respect of claims made by third parties against IRISL for pollution damage. Mr Hirst QC, on behalf of the Club, submitted that the entire contract of insurance between it and IRISL in respect of the "ZOORIK" was discharged by frustration and/or supervening illegality. He also submitted that IRISL is obliged to indemnify the Club in respect of liability to any third parties for pollution damage in accordance with its obligations under the Bunkers Convention.

12. IRISL accepts that what was permitted by the 30 October Licence is narrower than what was permitted by the earlier licences. But its position is (see Skeleton Argument paragraph 33) that, whatever the legality or otherwise of the Order, it is clear from the terms of the 30 October Licence that the provision of insurance cover in respect of its losses arising from the casualty from pollution damage in accordance with its obligations under the Bunkers Convention was not rendered illegal. It also maintains (see its Skeleton Argument paragraph 81) that the contract of insurance was not discharged by frustration or supervening illegality. HM Treasury, the defendant in the section 63 proceedings, is an Interested Party in these proceedings. Although it takes a different position on a number of specific points, it broadly supports IRISL's submissions both in relation to the construction of the Licence and in relation to frustration.

II. The Issues

13. The issues for determination are:

    1. On the true construction of the Order and the 30 October Licence what, if any, insurance cover was the Club permitted to continue to provide to IRISL?
    2. Was the effect of the Order and the 30 October Licence to discharge the insurance by reason of frustration?
    3. Is IRISL entitled to be indemnified in respect of its costs and liabilities arising out of the casualty?
    4. Is the Club entitled to an indemnity and/or reimbursement from IRISL in respect of any liabilities that it incurs to third parties under Article 7(10) of the Bunkers Convention as a result of the casualty?

14. Before turning to these, I summarise the Club's rules, and set out the relevant provisions of the Bunkers Convention, the Order, the various licences made by HM Treasury, and the remainder of the material facts.

III. The Club's Rules

15. The contractual relationships between the Club and its members, including IRISL, and between one member and other members, are principally determined by the Club's rules. In this case they are the Club's Class 1 Protection and Indemnity Rules which provide cover for a wide range of risks (summarised at [19]).

16. The policy of marine insurance which is formed when an owner enters a ship in the Club is (see Rules 3(ii) and (iii), and 8) governed by those rules. It is thus subject to the conditions and limitations in them and any special terms agreed. Those conditions and limitations include familiar terms and conditions (see Rule 28) which operate as conditions precedent to liability, including giving notice of claims within 12 months of the time the member might reasonably to be aware of them, and that there be no admission of liability without the prior consent of the Club. They also include the provision in Rule 26(iii)(a) that there shall be no right of recovery against the Club if the member fails to make a ship available for survey when required by the Managers or to carry out recommended repairs.

17. The mutual nature of the obligations is evident from a number of the Club's rules. These include Rule 11 permitting initial calls and Rule 12 permitting additional premiums, but the primary source of mutuality is rule 10. Rule 10 provides that, unless entered as a fixed premium entry or upon special terms, members who have entered ships for insurance:

> "shall severally and not jointly mutually insure each other... against liabilities, costs and expenses which they or any of them may become liable to pay or may incur in respect of any entered ship, and for this purpose each such member… shall contribute to the funds or other obligations of the Club as required:
>
> (a) to meet all such claims, liabilities, costs, expenses and other outgoings…as the Board of Directors determine necessarily and properly fall on the Club."

18. Rule 11 provides that the premium is to be determined at the beginning of each Policy Year and levied on and paid by the member during that year and in subsequent years. Rule 12 gives the Managers power to levy additional premiums during or after that year until it has been closed.

19. A member is (see Rule 3(v)) only insured against loss, damage, liability or expense incurred which arose out of events occurring during the period of entry of a ship in the Club. The cover is in respect of the 21 categories of risk set out in Rule 25. Rule 25(xxii) concerns deductibles. The categories of risk include liability for damages or compensation for loss of life by crew and passengers (Rule 25(ii) and (iii)), collision liability (Rule 25(v)), damage to fixed and floating objects (Rule 25(vii)) and to

vessels without collision (Rule 25(viii), towage (Rule 25(ix)), wreck removal (Rule 25(xi), cargo liabilities (Rule 25(xiii)), cargo's and ship's proportion of general average (Rule 25(xiv) and (xv)), fines and confiscation (Rule 25 (xvi) and (xvii)), legal and other expenses (Rule 25 (xx)), and loss of or damage to containers (Rule 25(xxi)).

20. Rule 25(vi) provides for the following cover against liability for pollution:

Pollution	**vi**	Liabilities, losses, damages, costs and expenses caused by or consequent on the escape or discharge or threatened escape or discharge of oil or any other substance from the entered ship as follows:
Actual Escape of Pollutants	**a**	Liability for loss, damage or contamination.
Clean up Costs	**b**	Costs of any measures reasonably taken for the purpose of avoiding, minimising or cleaning up any pollution, any imminent danger of pollution, or any resulting loss, damage or contamination, together with any liability for any loss of or damage to property caused by any measures so taken.
Prevention Costs	**c**	Costs of any measures reasonably taken to prevent an imminent danger of discharge or escape from the entered ship of oil or any other substance which may cause pollution.
Costs Pursuant to Government Directions	**d**	Liabilities, costs or expenses following a casualty to the entered ship incurred as a result of compliance with the order or direction of any government or authority (other than in respect of repair or salvage or any permanent structural alteration to the entered ship) for the purpose of avoiding or minimising pollution or the imminent danger of pollution *provided always that:* (i) such liabilities, costs or expenses are not recoverable under the Hull Policies of the entered ship and (ii) there shall be no recovery under this Rule in respect of liabilities that would be recoverable under such Hull Policies but for the conduct of the Member.

21. It is to be noted that under Rule 25(vi) cover is given for pollution caused by the discharge or escape of any substance, and thus for a wider range of events than those dealt with in the Bunkers Convention. The Bunkers Convention only deals with pollution from the escape of bunker oil from a ship. It is also to be noted that the

cover under rule 25(vi)(b)-(d) does not only concern liability to third parties, but includes the cost of measures to prevent or minimise pollution.

22. The range of risks covered is wide and there may be overlap between the risks covered by different rules. Mr Hirst gave the example of an overlap between Rule 25(vi) and Rule 25(xi) which provides cover for the costs of removing or attempting to remove a wreck. The overlap will occur where the removal or attempted removal of a wreck causes additional pollution and thus falls within Rule 25(vi).

23. Many of the types of cover (e.g. that for collision) are not subject to a limit. The cover for oil pollution is (see the note to Rule 18(ii)) US $1 billion in respect of each vessel and any one accident or occurrence, and that for passengers and crew (see Rule 18(iv)(b)) is US $3 billion.

24. Rule 17 deals with recoveries. It contains the Club's "pay to be paid" provision. The effect of such provisions is (see *The Fanti and the Padre Island* [1991] 2 AC 1) that payment by the member to the third party is generally a condition precedent to payment by the club to the member (although see Rule 17(ii) obliging the Club to discharge the member's liability to a seaman where the member has failed to do so).

25. A number of rules give the Managers power to remove or terminate the entry of a ship or to vary its terms. These include: the power under Rule 6(v)(a) to terminate from the commencement of the Policy Year, where the Managers determine that the nature of the risk has materially changed since the ship was entered; that for non-compliance with the Managers' requirements under Rule 26 (see [16] above) where termination may be "forthwith"; that under Rule 37 for non-payment of premium or other sums due; and the power of termination under Rule 14(ii)(a) where notice has been given that the insurance is to cease at the end of the then current Policy Year, or under Rule 14(ii)(c), which provides for termination by 30 days' notice in writing.

IV. The Bunkers Convention

26. The Bunkers Convention came into force on 21 November 2008. The State Parties to the Convention include the United Kingdom and the People's Republic of China. The Islamic Republic of Iran is not a State Party to it. Its material provisions are:

> "**Article 1 Definitions**
>
> 9 "**Pollution damage**" means:
>
> (a) loss or damage caused outside the ship by contamination resulting from the escape of bunker oil from the ship, wherever such escape or discharge may occur, provided that compensation for impairment of the environment other than loss of profit from such impairment shall be limited to the costs of reasonable measures of reinstatement actually undertaken or to be undertaken; and
>
> (b) the costs of preventative measures and further loss or damage caused by preventative measures.
>
> **Article 3. Liability of the shipowner**
>
> 1. Except as provided in paragraphs 3 and 4, the shipowner at the time of an incident shall be liable for pollution damage caused by any bunker oil on board or originating from the ship,

provided that, if an incident consists of a series of occurrences having the same origin, the liability shall attach to the shipowner at the time of the first of such occurrences.

…

No claim for compensation for pollution damage shall be made against the shipowner otherwise than in accordance with this Convention.

Article 6. Limitations of liability

Nothing in this Convention shall affect the right of the shipowner and the person or persons providing insurance or other financial security to limit liability under any applicable national or international regime, such as the Convention on Limitation of Liability for Maritime Claims, 1976, as amended.

Article 7. Compulsory insurance or financial security

1. The registered owner of a ship having a gross tonnage greater than 1,000 registered in a State Party shall be required to maintain insurance or other financial security, such as the guarantee of a bank or similar financial institution, to cover the liability of the registered owner for pollution damage in an amount equal to the limits of liability under the applicable national or international limitation regime, but in all cases, not exceeding an amount calculated in accordance with the Convention on Limitation of Liability for Maritime Claims, 1976, as amended.

2. A certificate attesting that the insurance or other financial security is in force in accordance with the provisions of this Convention shall be issued to each ship after the appropriate authority of a State Party has determined that the requirements of paragraph 1 have been complied with. With respect to a ship registered in a State Party such certificate shall be issued or certified by the appropriate authority of the State of the ship's registry; with respect to a ship not registered in a State Party it may be issued or certified by the appropriate authority of any State Party….

3. (a) A State Party may authorize either an institution or an organization recognized by it to issue the certificate referred to in paragraph 2. Such institution or organization shall inform that State of the issue of each certificate. In all cases, the State Party shall fully guarantee the completeness and accuracy of the certificate so issued and shall undertake to ensure the necessary arrangements to satisfy this obligation.

…

(c) The institution or organisation authorised to issues certificates in accordance with this paragraph shall, as a minimum, be authorised to withdraw those certificates if the conditions under which they have been issued have not been maintained.

…

5. The certificate shall be carried on board the ship and a copy shall be deposited with the authorities who keep the record of the ship's registry or, if the ship is not registered in a State Party, with the authorities issuing or certifying the certificate.

6. An insurance or other financial security shall not satisfy the requirements of this article if it can cease, for reasons other than the expiry of the period of validity of the insurance or security specified in the certificate under paragraph 2 of this article, before three months have elapsed from the date on which notice of its termination is given to the authorities referred to in paragraph 5 of this article, unless the certificate has been surrendered to these authorities or a new certificate has been issued within the said period…

…

> 9. Certificates issued or certified under the authority of a State Party shall be accepted by other State Parties for the purposes of this Convention and shall be regarded by other State Parties as having the same force as certificates issued or certified by them even if issued or certified in respect of a ship not registered in a State Party…
>
> 10. Any claim for compensation for pollution damage may be brought directly against the insurer or other person providing financial security for the registered owner's liability for pollution damage. In such a case the defendant may invoke the defences (other than bankruptcy or winding up of the shipowner) which the shipowner would have been entitled to invoke, including limitation pursuant to article 6. Furthermore, even if the shipowner is not entitled to limitation of liability according to article 6, the defendant may limit liability to an amount equal to the amount of the insurance or other financial security required to be maintained in accordance with paragraph 1. Moreover, the defendant may invoke the defence that the pollution damage resulted from the wilful misconduct of the shipowner, but the defendant shall not invoke any other defence which the defendant might have been entitled to invoke in proceedings brought by the shipowner against the defendant. The defendant shall in any event have the right to require the shipowner to be joined in the proceedings."

27. The provisions of the Bunkers Convention were implemented into English law by amendments made to the Merchant Shipping Act 1995 by the Merchant Shipping (Oil Pollution) (Bunkers Convention) Regulations, 2006 SI No. 1244. The liability for pollution by bunker oil in section 153A of the 1995 Act and the right of third parties to proceed directly against the insurer in section 165 is for incidents in the territorial waters of the United Kingdom. The direct right of action in section 165 is in respect of any discharge or escape of oil or bunker oil "occurring … while there was in force a contract of insurance" satisfying the requirements of Article 7 of the Bunkers Convention.

28. The provisions in section 163A requiring compulsory insurance against liability for pollution by bunker oil and certification that there is such insurance apply to United Kingdom registered ships and ships entering or leaving a port in the United Kingdom. However, section 164(1A) requires the Secretary of State to issue a certificate in respect of a ship registered in a State which is not a party to the Bunker Convention in response to an application for one if he is satisfied that there will be in force throughout the period for which the certificate is to be issued a contract of insurance or other security satisfying Article 7 of the Bunkers Convention. Without such a certificate, which (see Article 7(5)) must be carried on board, the ship is not permitted to enter the territorial seas of states which are party to the Convention.

V. The Order and the Licences

29. The Order (SI 2009 No 2725) contains a direction (paragraph 4) prohibiting all relevant persons (paragraph 2) from entering or continuing to participate in any transaction or business relationship with (paragraph 3) two designated persons, IRISL and Bank Mellat. Paragraph 23 of the statement of agreed facts states "unless it is revoked at an earlier date the Order will expire on 11 October 2010", but paragraph 16(4) of Schedule 7 to the 2008 Act states that the period is "one year beginning with the date on which [the Order] was made", that is 8 October 2010.

30. The material provisions of the three general licences issued by HM Treasury on 12 October 2009 when the Order came into force are:-

(a) "**General Licence 1 – "Accounts and Funds of a Designated Person**": Relevant persons may receive and hold funds from or on behalf of a designated person and (at paragraph 8) that any funds received from a designated person must be paid into a restricted account and the Treasury notified of the amount and the source (paragraph 6).

(b) "**General Licence 2 – "Payments to a Designated Person**": Relevant persons may make a payment into a restricted account where the payment is due to a designated person under an agreement that was made before the Order came into force provided the Treasury is notified of the details (paragraph 6).

(c) "**General Licence 3 – Contracts of Insurance**" stated a relevant person:-

(i) "may continue to provide insurance cover under an existing contract with [IRISL] for a period of 7 days from the date on which the Order came into force" (paragraph 5), and

(ii) is required to provide information to the Treasury in respect of insurance cover which continued to be provided as permitted by paragraph 5 of the licence (paragraph 6).

In accordance with paragraph 6 of General Licence 3 the Club notified the Treasury that it was continuing to provide insurance cover to IRISL and (see [38]) there were discussions between them as to whether the Club was subject to the Order and the direction.

31. Paragraph 5 of the Temporary Licence issued on 19 October 2009 and with effect until 30 October 2009 stated that "[the Club] may continue to provide insurance cover under an existing contract with IRISL".

32. The further licence issued on 30 October 2009 that came into effect on that day (the "30 October Licence") *inter alia* provides:

"**Definitions**

4. In this licence:
…

The Insurance Cover means any insurance cover provided by [the Club] to IRISL prior to 24.00hrs on 30 October 2009…"

Blue Card means the document evidencing that insurance is in place meeting the liability requirements of International Convention on Civil Liability for Bunker Oil Pollution Damage 2001 ("the Bunker Convention"), or the Conventions on Civil Liability for Oil Pollution Damage 1969 and 1992 ("the CLC Conventions")
…

Third-party Insurance Claims

5. Under this licence, [the Club] may continue a business relationship with IRISL to the extent necessary in order to handle, negotiate and pay claims … arising under the Insurance Cover
.

Blue Cards

6. Under this licence:

6.1. [the Club] may continue to provide insurance cover in accordance with the Blue Cards issued to IRISL, for a period of 3 months, starting on 30 October 2009, or until [the Club] is discharged from liability by the State Authorities to whom the Blue Cards have been issued, whichever is the sooner;

> 6.2. [the Club] may continue a business relationship with IRISL to the extent necessary in order to handle, negotiate and pay any claims arising under the insurance cover described in paragraph 6.1.
>
> …
>
> **Payments from IRISL**
>
> 8. Under this licence:
>
> 8.1 [The Club] may receive any payments from IRISL … which are due under …(i) the Insurance Cover …
>
> **Payments to IRISL**
>
> 9. No payments may be made by [the Club] to IRISL except in accordance with General Licence 2. …"

33. The reference in paragraph 6.1 to Blue Cards issued "to" IRISL does not reflect what in fact happens. The cards are issued by the Club to the CLC Bunkers Maritime and Coastguard Agency. It is the State Party, here the United Kingdom, which issues the certificate required by Article 7(2) of the Bunkers Convention. There is, however, no suggestion that paragraph 6.1 of the 30 October Licence is either ambiguous or unworkable. In context "to IRISL" is either to be read as "in respect of IRISL" or "with respect to IRISL's ships".

VI. The Facts

34. These are principally taken from the agreed statement of facts but there are some additions from the documents, particularly concerning the correspondence between the Club and the Treasury before the Licence was issued on 30 October. On 19 February 2009, the Club issued a "Certificate of Entry and Acceptance" with number 27799/1, which certified that the "ZOORIK" was entered for Class 1 Protection and Indemnity insurance with it with effect from Noon GMT on 20 February 2009 to Noon GMT on 20 February 2010. The terms of the insurance were set out in the Certificate of Entry and in the Club's Rules for 2009/2010, as to which, see [16] - [25].

35. On 16 March 2009, the Club issued a Blue Card evidencing that insurance meeting the requirements of the Bunkers Convention was in place in respect of the "ZOORIK". The Blue Card was addressed and issued to the CLC Bunkers Maritime and Coastguard Agency.

36. On 19 March 2009, under the authority of the Government of United Kingdom of Great Britain and Northern Ireland, the Maritime and Coastguard Agency issued in accordance with article 7 of the Bunkers Convention, a "CERTIFICATE OF INSURANCE OR OTHER FINANCIAL SECURITY IN RESPECT OF CIVIL LIABILITY FOR BUNKER OIL POLLUTION DAMAGE", with certificate number HQ 3215/012240, to IRISL in respect of the "ZOORIK". This stated:

> "This is to certify that there is in force in respect of the above-named ship [the ZOORIK] [while in IRISL's ownership] a policy of insurance or other financial security satisfying the requirements of article 7 of the International Convention on Civil Liability for Bunker Oil Pollution Damage, 2001.
>
> …
>
> Period of Insurance: from **16 March 2009 to Noon GMT 20 February 2010**.
>
> Provided always that the insurer may cancel this Certificate by giving three months written notice to the above Authority whereupon the liability of the insurer hereunder shall cease as from the date of the expiry of the said period of notice but only as regards incidents arising thereafter."

37. On 12 October 2009, when the Order made on 9 October came into force, HM Treasury issued the interpretative note and the licences, the material terms of which are set out at [30]. On that day it also wrote to the Club informing it that: (a) the Order had been made; (b) the three General Licences had been made; and (c) the Interpretative Note had been published. The letter enclosed copies of each of these documents. It stated that General Licence 3 "is intended to provide an opportunity for … IRISL to obtain alternative insurance cover outside the UK". The letter was not sent or copied to IRISL. However, HM Treasury wrote to IRISL on the same day notifying it of the Order, the three general licences and the interpretive note.

38. There was a meeting on 16 October between the Club and the Treasury. The Treasury indicated that, while it considered that the Club was subject to the Order, it would give the matter further consideration, and would, on 19 October, issue a short licence extending the time for compliance with the order until it had done so. In the light of that indication, the Managers of the Club stated that it might become necessary for it to give IRISL 30 days notice pursuant to Rule 14(ii)(c) terminating the entry of all IRISL's ships in the Club. The Treasury duly issued that licence on 19 October. Paragraph 5 stated that the Club "may continue to provide insurance cover under an existing contract with IRISL".

39. Between 22 October 2009 and 30 October 2009 there was correspondence between the Treasury and the Club concerning the scope and effect of the Order and the licences granted by the Treasury and the terms of a further licence to be issued by the Treasury (which was in fact issued on 30 October). None of this correspondence was sent or copied to IRISL.

40. In a letter to the Club dated 22 October the Treasury stated that:

> "… as a relevant person, the [Club] is required to cease business relationships and transactions with IRISL … and not to enter into new ones. The Club is exempt from the requirements of the direction under the terms of the temporary licence until 30 October 2009."

41. On that day, the Club wrote to the Treasury requesting a further licence from 30 October 2009 in the following terms:

> "(1) To continue insuring IRISL under existing contracts of insurance:

> (a) until these expire at noon on 20th February 2010 (being the end of the current policy year); or
>
> (b) In the event that you are unwilling to provide a licence on the above terms, alternatively for such period as will be sufficient to enable the Bermuda Club to give 30 days notice of cancellation to IRISL pursuant to Rule 14 ii c of its Rules; and
>
> (2) Additionally, to continue the provision of the services identified below to IRISL for the periods specified:
>
> (a) Cover for oil pollution liabilities pursuant to the Bermuda Club's Rule 25 vi and subject to the provisions of those Rules generally, solely insofar as those liabilities are secured by:
>
> (i) Certificates of financial responsibility, counter-secured by the Bermuda Club; and/or
>
> (ii) Blue Cards issued by the Bermuda Club;
>
> for 90 days from the granting of such licence so as to enable the Bermuda Club to give notice of cancellation in accordance with the respective terms of the counter-securities for the Certificates of Financial Responsibility and/or the blue cards…."

42. In that letter the Club also sought permission, "notwithstanding any termination of the policies of insurance" "to be entitled to provide insurance cover … to IRISL in respect of all claims arising during the insured periods prior to the policies' dates of termination/cancellation" including "handling insured claims by, or against, IRISL …".

43. The Treasury responded to these requests on 27 October. It stated:

> "In relation to the specific requests set out in your letter our approach would be as follows:
>
> 1) To continue insuring IRISL under existing contracts of insurance
>
> We consider that the provision of ongoing insurance cover to IRISL, either until February 2010 or for a 30 day period, would be contrary to the objective of the Order. A licence will therefore not be issued for either of these requests. The temporary licence issued to you on 19 October allows you to continue to provide insurance cover to IRISL under your existing contract until 30 October 2009. After this point, the restrictions contained in the Order will apply.
>
> 2) To continue the provision of services:
>
> (a)We are content in principle to license the continuation of existing provision of Blue Cards for 90 days to enable Bermuda Club to give notice of cancellation. However, we ask that you provide us with cancellation dates."

The Treasury also asked the Club to provide further details in respect of Certificates of Financial Responsibility.

44. The letter also stated

> "We are content in principle to license you to deal with claims by or against IRISL that arose on or before 30 October 2009. This would include being able to communicate with and obtain documents and evidence from IRISL in order to achieve this."

and

> "We would look to license secured claims where [the Club] has an obligation to pay direct to a third party, but can you please provide more information on unsecured claims s we can assess what the impact is likely to be on [the Club] and third parties if we do not license such claims. Will third parties be able to receive funds in relation to these claims direct from IRISL or another entity if [the Club] is unable to make the payment?"

45. On 28 October 2009, the Club wrote to H.M. Treasury as follows:

> "1. Insurance of IRISL under existing contracts of insurance
>
> We understand that the temporary licence issued to [the Club] will expire at midnight on 30 October 2009. Please confirm.
>
> 2a. Continued provision of services
>
> Blue Cards
>
> Blue Cards are provided by [the Club] pursuant to the Bunkers and CLC Conventions. We understand that you are content in principle to licence [sic] the continuation of existing provision of Blue Cards for 90 days to enable [the Club] to give notice of cancellation as permitted thereunder….it is proposed to give notice of termination pursuant to all Blue Cards that have been issued as evidence of insurance of vessels whose registered owners are Islamic Republic of Iran Shipping Lines (IRISL) or related SPVs. Such notices of termination will be given prior to the deadline on 30 October 2009, and we will provide you with confirmation.
>
> (a) … Under the Bunkers Convention each vessel over 1,000 GT must have a certificate on board issued by a contracting Convention State…evidencing proof of insurance and rights of direct action against the insurer up to the relevant limit.
>
> Accordingly, if called upon in accordance with the relevant Conventions, [the Club] must respond to liability for an oil spill pursuant to its "Blue Card" which has been issued as evidence of insurance to the relevant State issuing the certificate of proof of insurance relied on by third parties.
>
> (b) Payments made by [the Club] pursuant to the Blue Cards will be made to those asserting a direct claim against the insurer. This may be third party claimants, or those State authorities to whom the Blue Cards have been issued. In the case of many of the vessels in the IRISL fleet in respect of which Blue Cards have been issued, the relevant State Authority is the CLC Bunkers Maritime and Coast Guard Agency of the United Kingdom.
>
> (c) If a licence is not issued to permit [the Club] to make payments pursuant to the Blue Cards already issued during the 90 day termination period, then clearly the Club will be in breach of it obligations under its Blue Cards and will be liable to suit, but more importantly, the claimants and/or authorities seeking to enforce the insurance provided by the Club will be unpaid…. "

46. The letter of 28 October also stated that a failure by the Club as an insurer to respond to an existing liability pursuant to a Blue Card which is still in force "will have an incalculably damaging effect on the acceptability of Blue Cards issued by P & I Clubs to State authorities". This was said to be because State authorities "need to rely on the existence of the insurance before they issue in turn the necessary Convention certificates to vessels which in effect permit those vessels to trade". It appears from the subsequent email exchanges that the Treasury did not respond to this letter and did not indicate any disagreement with the understanding of the Club that the permission

only applied to direct claims against it. It attached a draft licence to an email sent with a time mark of 1555 hours on 30 October, inviting comments but stating it "would like to grant the licence today". A further email, timed at 1726 hours, thanked the Club for its comments and attached the finalised licence.

47. Very shortly after this, in an attachment to an email timed at 1734 on 30 October, the Club notified IRISL that:

> "In accordance with the terms of the Order, the Club applied for and was granted a license [sic] to continue to provide insurance cover under existing contractual arrangements with IRISL up until midnight UK time today 30th October 2009. HM Treasury has now informed the Club that this licence will not be continued and that, accordingly, the restrictions in the Order noted above will apply from that time. As any transaction or business relationship including the provision of insurance shall then be prohibited by law, the cover of and any contract of insurance with IRISL in respect of all vessels entered in the Club will be terminated and discharged by reason of frustration or supervening illegality with effect from midnight UK time on 30th October 2009."

48. On 31 October 2009 at 2040 GMT, (0440 PRC time on 1 November 2009), the day after the Club's notification, the Vessel was stranded off Xiluhua Island near Luhuashan, Zhoushan, in the territorial waters of the People's Republic of China. In consequence of this casualty, the Vessel sustained damage to its hull, including its bunker tanks, thereby resulting in the escape of fuel oil. Subsequently, it was established that the damage to the Vessel was such as to render it a constructive total loss and the services of salvors were engaged to remove oil remaining on board and the wreck. In addition, the escape of bunkers caused pollution which necessitated a clean-up operation.

49. On 4 November 2009, the Club informed IRISL by email that while the Club would "honour its obligations as a guarantor of IRISL's liabilities under the Bunker Convention *to the extent provided in the Blue Card*, it was primarily IRISL's obligation to bear all costs and liabilities relating to actual and threatened bunker pollution" *(emphasis added)*. The Club also stated that "the vessel was not entered with the Club at the time of the incident" and that IRISL would not be indemnified in relation to any pollution damage claims, including those from the "ZOORIK" casualty.

50. A letter from the Club to HM Treasury dated 1 December 2009 (and copied to IRISL's solicitors) summarised the Club's understanding of the effect of the licence and the difference between it and IRISL and asked the Treasury to "indicate its position with regard to the scope and correct construction of the terms of paragraph 6 of the licence … since the Club wishes to ensure that it continues to act in accordance with its obligations under the Order".

51. In a letter dated 9 December, IRISL's solicitors wrote to HM Treasury (and sent a copy to the Club's solicitors) summarising IRISL's understanding of the effect of the licence and seeking the Treasury's "urgent confirmation that the Order and Licence permit the continuance of the whole of the underlying contracts of insurance entered into before 30 October 2009 between the Club and IRISL so far as cover is provided for liabilities falling within the Bunker Convention… in respect of vessels for which Blue Cards have been issued …".

52. HM Treasury replied to IRISL's solicitors in a letter dated 21 December which re-stated the terms of the licence but declined to address the "more general comments regarding the Order and the licence" in the letter dated 9 December. IRISL's letter before action is dated 23 December. In it IRISL again sought guidance as to the construction of the licence, asked the Treasury to vary its terms, and asked for the information relied on in support of the designation of IRISL in the Order. The Treasury responded in a letter dated 6 January 2010 which *inter alia* stated:

> "The authorisation given by paragraph 6 of the licence is for [the Club], if it wishes to, to continue to provide the insurance cover that it was providing in respect of Blue cards prior to the coming into force of [the Order] on 12 October 2009 in the same terms as it provided that insurance cover prior to 12 October 2009. Nothing in the licence alters or otherwise affects the terms of this insurance cover."

The letter refused to comment on the dispute between IRISL and the Club and declined to vary the licence because the Treasury considered its terms to be clear.

53. Following further correspondence between the parties and the Treasury, proceedings under section 63 of the 2008 Act were issued on 12 January, came before Gross J on 9 February, were stayed, and these proceedings were launched on 15 February: see [10].

54. As to liabilities, costs and expenses resulting from the casualty, paragraph 21 of the agreed statement of facts in these proceedings states:

> "21. As a result of the Casualty, claims have been made against IRISL in the People's Republic of China, the current status of which, and of payments made by IRISL in consequence, can be summarised as follows:
>
> A. The fishery companies
>
> No formal claims have been lodge by any fishery company, but the following two companies sent a letter to ZM Law Office, PRC lawyers instructed on behalf of IRISL, stating their claims as follows:-
>
> 1. Shengsi Lvdao Deep Sea Aquaculture Cooperative Association (Representative of the individual fish farm owners) - an estimate loss of RMB7,890,000 (USD1,151,800)
>
> 2. Shengsi Blue Sea Ecological Industry Development Co., Ltd - an estimate loss of RMB37,610,000 (USD5,490,500).
>
> B. Local Fishery Bureau
>
> The local Fishery Bureau are claiming for environmental damage and loss of fishing resources. According to their draft expert's report, they estimate their claims to be about RMB78,880,000 (around USD11.3 million).
>
> C. The Maritime Safety Administration
>
> So far the MSA have not presented IRISL or their representatives in PRC with any formal claim, but they have asserted that oil clean-up costs amount to about RMB2 million (USD295,000) per day and have asked for security in the sum of USD5 million which IRISL have declined to provide on the basis that they will set up a limitation fund.
>
> IRISL have, however, made an advance cash payment of RMB5 million (USD 730,000) to the MSA.

D. The Donghai Rescue Bureau arranged helicopters to lift the crew to safety immediately after the grounding. They also arranged a boat to monitor the extent of pollution for a few days following the grounding but were not proactive in the clean up. We understand they presented IRISL with an invoice in the sum of USD195,220. Following negotiations, IRISL paid the sum of RMB 900,000 in respect of this invoice.

E By a Wreck Removal and Marine Services Agreement dated 26 November 2009 IRISL contracted with (1) Zhejiang Jiaolong Group and (2) Ningbo Zhenhai Manyang Shipping Co Ltd as contractors, for "The removal and disposal of bunkers, lube oil and other pollutants from the Vessel and in the vicinity of the Vessel at the casualty's location; the removal and disposal of the wreck; and the pollution clean-up operations at the casualty site from the date of the Agreement." The lump sum price payable by IRISL under this contract was RMB 12 million. Further, under clause 12 of the contract property title and risk in the Vessel was transferred to the Contractors on the date of completion of the Services."

VII. Discussion

Issue 1: What, if any, insurance cover was the Club permitted to continue to provide to IRISL?

55. Ultimately the submissions on this issue depend on the wording of the 30 October Licence construed in the light of the purpose and nature of the liability system of the Bunkers Convention. Reliance was also placed by Mr Hirst on the factual background and the correspondence between the Club and the Treasury after 19 October (as to which, see [87] – [95]). Mr Butcher QC reserved IRISL's position as to the admissibility of the correspondence but, if it is admissible, agreed with Mr Swift QC, on behalf of HM Treasury, that reference to it should be cautious. They submitted that the Treasury's statements were of more relevance and significance than the Club's.

56. Mr Swift adopted almost all of Mr Butcher's principal submissions as to the language, meaning, and effect of the 30 October Licence.[2] Mr Butcher also relied on the principle that subordinate legislation be construed so; (a) it is compatible with public international law and the European Convention on Human Rights, and (b) doubtful penalisation is avoided. Mr Swift did not adopt Mr Butcher's submissions concerning the admissibility of the correspondence, the construction of the Licence by reference to public international law, the European Convention on Human Rights, and the principle against doubtful penalisation.

57. The essence of Mr Hirst's case can be summarised as follows:-

(1) The wording of the 30 October Licence materially changed the nature of what was permitted thereafter. In particular, it did not permit the Club to provide insurance cover and thereby to indemnify IRISL in respect of claims made by third parties against it concerning its liabilities under the Convention. This was because it only permits "insurance cover in accordance with the Blue Cards". That cover cannot refer to cover given "to IRISL" because Blue Cards are issued to the Maritime and Coastguard Agency not the shipowner, and are not insurance "in accordance with" the relevant part of Rule 25(vi).

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2 They differed on the meaning and effect of paragraph 5 of the Licence: cf. paragraph 34(1) of Mr Swift's Skeleton Argument and paragraph 58 of Mr Butcher's.

(2) The 30 October Licence enabled the Club to handle and settle claims brought against it by third parties pursuant to the direct right conferred by Article 7(10) of the Bunkers Convention. It thus enabled the Club to continue a business relationship with IRISL but only to the extent necessary to do so, because IRISL and not the Club would know the circumstances giving rise to such a claim: see Skeleton Argument, paragraph 44.

(3) This construction is not incompatible with the Bunkers Convention because its purpose is to protect third parties. Since the direct action against insurers given to third parties by Article 7(10) of the Convention does not (with limited exceptions) permit insurers to raise defences which they would have had in a claim by the assured, the aim of protecting third parties is achieved whether or not the policy of insurance remains in force or the assured is able to claim. Mr Hirst submitted (see Skeleton Argument, paragraph 63(4)) that "the Bunker[s] Convention is not concerned with the assured's rights (or lack thereof) under the policy of insurance nor does it seek to confer rights on the parties to the contract of insurance, because the right of direct action explicitly remains unaffected by the assured's claim, effective or otherwise, under the policy".

(4) The factual background, that is the Treasury's interpretive note and the exchanges between the Treasury and the Club before it issued the Licence, supports the submission that the 30 October Licence was not intended to permit the Club to provide insurance cover to IRISL but only to permit payments to third parties asserting a direct right of action against the Club.

58. It is the construction of the 30 October Licence read in context which determines the answer to this issue. But the requirements of the Bunkers Convention are relevant to the construction of paragraph 6. This is because of the reference in paragraph 6.1 to "insurance cover in accordance with the Blue Cards issued …" and the fact that the Blue Cards were issued to the State Party, here the United Kingdom, to show that the insurance required by the Convention was in place, and to enable it to issue the certificate required by Article 7(2). It is thus to be presumed that the Licence issued by HM Treasury will, absent clear language, be consistent with the United Kingdom's international law obligations under the Convention. Mr Butcher's primary submission does not rely on this presumption. It is that the meaning of the Licence is clear from its wording. But he also submitted that any ambiguity should be removed by the application of the presumption because the Club's submissions, if correct, would not be consistent with those obligations.

59. Mr Hirst's written submissions deal first with the wording of the 30 October Licence. But his starting point in this section of his submissions is (see Skeleton Argument, paragraph 51) a position as to the nature of the liability scheme of the Bunkers Convention. In their oral submissions both he and Mr Butcher first dealt with the Convention. I too start with the purpose and nature of the Convention. I will then turn to the terms of the Licence.

60. The regime of the Bunkers Convention is one of strict liability on the part of the shipowner (Article 3), compulsory insurance or other financial security (Article 7) and

direct rights of action by third parties (Article 7(10)). Mr Hirst submitted (Skeleton Argument, paragraph 59(2)) that "the purpose of the Convention is to benefit third parties who suffer pollution damage". He relied on paragraph 6 of the preamble to the Convention and Dr Zhu's *Compulsory Insurance and Compensation for Bunker Oil Pollution Damage* (2007), p 50. Dr Zhu in fact states that the protection of third parties is "the main purpose" of the compulsory insurance or financial security requirement. He also refers (*ibid* pp 2-3) to the purpose of having measures that will be applied uniformly in contracting states. I accept that an important and possibly the "main" or most important purpose of the Convention is the protection of third parties and, in the words of paragraph 6 of its preamble, that there be measures to ensure "the payment of adequate, prompt and effective compensation" for bunker oil pollution. But, contrary to Mr Hirst's submission, I do not accept that the protection of third parties is its only purpose.

61. Article 1(9) defines bunker oil pollution damage as including the costs of "reasonable measures of reinstatement" and those of "preventive measures" and "further loss or damage caused by preventive measures". The promotion of preventive measures and reinstatement are thus also purposes of the Convention. But they, particularly the promotion of preventive measures, are purposes which are not only for the protection and benefit of third parties. If their costs are incurred by a third party, the shipowner will be liable to that third party and, if it does not meet its liability, the effect of the insurance will, as a result of the direct action, benefit the third party. But Article 1(7) makes it clear that preventive measures may be taken by "any person", which includes the shipowner (see also Zhu, *op cit*. p. 183). De la Rue and Anderson's, *Shipping and the Environment* (2nd ed) 371, states, of preventive measures, that "frequently they are taken by the owner himself, and the conventions expressly provide for his expenses to be taken into account". Indeed in the present case (see paragraph 21E of the agreed facts, set out at [54]) IRISL contracted with two firms for the removal and disposal of bunkers from the "ZOORIK" at a price of RMD 12 million, which cost it will bear.

62. Mr Hirst's submissions did not grapple with the role of preventive measures and reinstatement, and the significance of including cover against their cost in the compulsory insurance required. Both categories of costs fall within the compulsory insurance required by Article 7(1). However, neither Article 1(9) nor Article 7(1) makes any distinction as to whether the costs of preventive measures and reinstatement are initially borne by the shipowner or a third party. Whoever does so, the insurance must cover those costs.

63. Putting this more broadly, with the exception of Article 7(10), to make a sharp distinction between the position of the insured shipowner and that of third parties does not reflect the language of the Convention. There is no reference to third parties in Article 7(1). Mr Hirst pointed to the fact that it requires compulsory insurance or security "to cover the liability of the registered owner" but does not require this to be by indemnity cover. He also relied on the absence in the Convention of a requirement that shipowners be insured against their own liabilities and of any reference to a right by an insured shipowner against the insurer. The latter is, he observed, a matter left to individual contracts of insurance and thus in the case of P & I Clubs to their rules rather than the subject of compulsion: see Skeleton Argument, paragraph 62(4).

64. If, however, the Convention's regime is indifferent to the rights of the shipowner, why adopt the discourse of insurance as a mechanism of protection? In describing the birth of compulsory insurance for oil pollution liability, Dr Zhu observes (*op cit.*, p 77) that P & I Clubs "paid great attention to the differences between being a guarantor and being an insurer" and "insisted on maintaining the identity of an insurer rather than of a guarantor". Zhu's view is they can be regarded as both and Hazelwood, *P & I Clubs Law and Practice*, 3rd ed. (2000), 293 describes the Blue cards issued under the CLC as a "guarantee of an anticipatory nature". But, in the case of preventive measures and reinstatement which are or will be undertaken by the shipowner, the only way of securing the shipowner's position by "insurance or other financial security" is by an arrangement which would indemnify that shipowner.

65. The direct action against the insurer that Article 7(10) enables a third party to bring was at the core of this part of Mr Hirst's submissions. In particular, he relied on the fact that in response to such a direct action, apart from a defence that the pollution resulted from the wilful misconduct of the shipowner, the insurer is not entitled to invoke any defence which it might have been entitled to invoke against the shipowner. Thus, unlike the Third Parties (Rights Against Insurers) Act 1930[3] and, I add, the Contracts (Third Party Rights) Act 1999, the liability of the insurer to a third party under the Convention is not commensurate with its liability to the insured. Mr Hirst argued this was the explanation for the absence of explicit provision requiring indemnity for the shipowner and that Article 7(10) thus provides for a direct action by a third party whether or not the policy of insurance remains in force. Paragraph 66(2) of his Skeleton Argument states that Article 7(10) "precisely" provides for this. As the provision does not explicitly provide for or refer to direct actions by third parties where there is no longer a contract of insurance in existence, Mr Hirst can only be referring to implicit provision.

66. Mr Butcher submitted that Mr Hirst's position on the effect of Article 7(10) is inconsistent with the plain words of Article 7(6). Article 7(6) provides that insurance cover does not satisfy Article 7 if it can cease "for reasons other than the expiry of the period" of the cover "before three months have elapsed from the date on which notice of its termination" is given to "the authorities issuing or certifying the certificate". He argued that there was no reason to believe that "defences" in Article 7(10) included the termination of the contract. Its penultimate sentence precluding an insurer from invoking "any other defence" which it might have been entitled to invoke in proceedings brought by the shipowner was not deprived of meaning if "any defences" did not include terminating cover. Accordingly, if, contrary to his primary submission, there is any ambiguity in the terms of the 30 October Licence it should be construed so as to avoid inconsistency with Article 7(6).

67. Mr Butcher's submissions on this are also of relevance to the question whether the parties made provision for the allocation of the risk of this, thus precluding the frustration of the contract. I deal with this at [110] – [113].

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[3] The Third Parties (Rights against Insurers) Act 2010 (not yet in force) removes the requirement in the 1930 Act that the third party establish its claim in proceedings against the assured before obtaining any rights against the insurer.

68. There is undoubtedly some tension between the unqualified wording of Article 7(6) and Mr Hirst's argument, and no distinction is made in Article 7(6) between the position of the assured and that of a third party. Mr Butcher submitted that, by issuing the Blue Cards, the Club was providing insurance cover for bunker oil pollution that was not cancellable for three months. There is, however, also force in Mr Hirst's submission that Article 7(6) does not mean that the rights of the shipowner-assured have to remain in place for the three month period after notice is given to the authorities if the policy is to satisfy the requirements of the Bunkers Convention. If Article 7(6) required this, the insurance provided by P & I Clubs, including the Club in this case, would not satisfy Article 7(6). That would put into question the certificates issued by the Maritime and Coastguard Agency on behalf of the United Kingdom government because of the common provisions in the rules of P & I Clubs, including the Club in this case, to terminate cover "forthwith" (see [25]) and in some cases automatically (see Rule 35) which would give rise to a "defence" to any claim by the assured thereafter. The position taken by Mr Butcher involves regarding the issuing of a Blue Card by the Club as a waiver by it of all rights to terminate cover for any reason. But there is no foundation for this in the agreed facts.

69. Moreover, in the light of the last sentence of Article 7(10) of the Bunkers Convention it is difficult to see a basis for inferring such a waiver. Mr Hirst's submission is that the third parties' direct action and the limitations the last sentence of Article 7(10) places on the defences upon which the insured can rely in such an action mean that that such insurance does satisfy Article 7(6). This is because only after the three month period has expired can the Club rely on the termination of cover in a direct action brought by a third party, and it would do so pursuant to Article 7(6) rather than by way of a defence under the contract of insurance. If he is correct, termination by the Club of IRISL's cover for liability in respect of bunker oil pollution would not be a breach of Article 7(6) and would not put the United Kingdom in breach of the Bunkers Convention. Accordingly, there is no Bunkers Convention need to construe the terms of the 30 October Licence as permitting the cover to continue.

70. Mr Hirst's position is also supported by the provisions of Article 7(3) of the Bunkers Convention. On this, there is broad similarity between the Club's position and that of HM Treasury. Mr Hirst argued (see Skeleton Argument, paragraph 66) that that termination of IRISL's cover for liability in respect of bunker oil pollution would not put the United Kingdom in breach of Article 7(3)(a) of the Convention. This, he submitted, is because the Maritime and Coastguard Agency's certificate required by that provision relies on and guarantees the completeness and accuracy of the Blue Card when it is "so issued" but does not guarantee the continuing existence of the policy of insurance during the currency of the Blue Card (i.e. until the end of the period of the insurance).

71. The main thrust of this part of Mr Hirst's argument is also based on the wording of Article 7(10) which he stated (see Skeleton Argument, paragraph 66(2)(i)) "precisely provides for situations where the policy of insurance does not continue during the currency of the Blue Card". If it did not, the consequence, said to be absurd, would be the ineffectiveness of the provisions in the rules of most P & I clubs for the policy to be terminated before the end of the period of the insurance.

72. On behalf of the Treasury, Mr Swift observed that Article 7(3)(c) expressly empowers the issuer of a certificate to withdraw it. He submitted that there is no indication in the Bunkers Convention that a State Party is under a positive duty to guarantee the continuing applicability of the information in the certificate until the end of the policy period. Although I incline to the view that the submissions of Mr Hirst and Mr Swift are to be preferred, in view of my conclusions as to the meaning of the 30 October Licence, there is no need for me to reach a decision on this point.

73. I therefore turn to the language of that Licence. It is significant that paragraph 6.1 states that the Club "may continue to provide insurance cover". The use of the words "to continue" and "insurance cover" is important. Before 30 October the permitted cover included cover which would indemnify IRISL in respect of all the Rule 25 risks, including those under 25(vi).This was without limit apart from the restrictions concerning payments to be made to or received from IRISL. It is clear that the Treasury's intention was to narrow what performance was permitted after 30 October. But there is no indication in the terms of the Licence that what was intended was a fundamental change in *the nature* of the cover and to whom it was given as opposed to its scope; that is removing any element of indemnity cover. Such an indication might have been given by explicit reference to third parties in paragraph 6.1, whether by stating that the Club was only permitted to respond to claims by them or otherwise. This was not done. I deal with the implications to be drawn from the pre-Licence correspondence at [87] – [94].

74. As to the scope of the cover, it is clear that after 30 October only part of the cover in Rule 25(vi) was permitted. The difference in the meaning of the term "insurance cover" as used in paragraph 6.1 and the term "The Insurance Cover" used in paragraphs 5 and 8 (with a capital "I" and capital "C") and defined in paragraph 4 (see [32]) appears to be one of scope. The latter appears to include "any insurance cover" whereas the former (in lower case) includes only "insurance cover in accordance with the Blue Cards".

75. Mr Hirst also relied on the nature and purpose of Blue Cards. He argued (see Skeleton Argument, paragraph 52) that, for four reasons, insurance "in accordance with the Blue Cards" "cannot refer to the insurance cover given to IRISL" but can refer to insurance cover provided to third parties in respect of their rights of direct action under the Bunkers Convention. First, the Blue Card is issued to the Maritime and Coastguard Agency and not to the shipowner. Secondly, the purpose of the Blue Card is to identify the insurer to the Agency. It is the Agency which issues the certificate which enables a third party to identify the insurer and to claim directly: Skeleton Argument, paragraphs 52(3) and 65(2). The direct action by third parties under Article 7(10) is thus also central to this part of his submissions. Thirdly, the insurance cover given "in accordance with the Blue Cards" does not exist to protect the shipowner and is not insurance in accordance with Rule 25(vi) of the Club's rules. Rule 25(vi) does not refer to "Blue Cards" and provides wider cover, including in respect of pollution from the escape of substances other than bunker oil. Put in another way, insurance given to IRISL is not given "in accordance with the Blue Cards" but "in accordance with the Club's rules". Fourthly, any claim by a shipowner against the Club would be pursuant to the contract of insurance in the Club's rules and not the Convention or the Blue Card.

76. There are a number of difficulties with these points. The first is that the phrase "insurance cover in accordance with the Blue Cards" in paragraph 6.1 shows that the cover permitted by it is the cover required by Article 7. The Blue Card certifies (to a State Party to the Convention) that there is in force "a policy of insurance satisfying the requirements of Article 7". Those requirements include cover in respect of the costs of preventive measures and reinstatement regardless of whether they are initially borne by the shipowner or a third party. I have referred to the fact that, in the case of measures undertaken by the shipowner, the only way of meeting the obligation to provide insurance or other financial security is by an arrangement which would indemnify the shipowner. But on the Club's position, the 30 October Licence, unlike the Convention's provisions concerning preventive measures and reinstatement and its other provisions, makes a sharp distinction between the position and rights of the shipowner (here IRISL) and those of third parties, albeit it does not do so expressly.

77. Secondly, this part of Mr Hirst's submissions appears to rest on the proposition that third parties are entitled to rely on the Blue Card. In fact it is the certificate issued by or on behalf of the relevant State Party which is the document on which third parties and other States which are Party to the Convention rely. Thirdly, it is difficult to see liability to a third party in respect of events post-dating the termination and discharge of the contract of insurance as liability "under" that contract of insurance as opposed to a potential direct liability resulting from the law of a State Party to the Bunkers Convention and the certificate issued by that State Party. If this is so, the corollary would be that the exposure to third party claims under Article 7(10) of the Bunkers Convention which the Club submits is all that is permitted by Article 6.1 is not "insurance cover" within the ordinary meaning of that term. It would follow that, since what the Club is permitted to provide is "insurance cover", the exposure to third party claims would not fall within the permission.

78. What of the fact that paragraph 6.1 does not explicitly refer to "insurance cover *to IRISL*" (emphasis added), whereas the definition of the term "The Insurance Cover" in paragraph 4 does do so? Mr Hirst submitted the difference of language shows that whereas there was cover "to IRISL" before 30 October, there was not after that time. He also relied on the absence of any reference in paragraph 6 of the Licence to "IRISL's losses".

79. I do not consider that the omission of the words "to IRISL" after the words "insurance cover" and of any reference to the cover being in respect of "IRISL's losses" has the significance that Mr Hirst placed on it. I also do not consider that reading paragraph 6.1 as IRISL and the Treasury invite me to do, involves illegitimately writing those words in to the Licence. Apart from the absence of the words, there is no indication that the term "insurance cover" in paragraph 6.1 is used other than in the ordinary sense of that term. I recognise the elusiveness of a satisfactory definition of "contract of insurance" (see, for example, *McGillivray on Insurance Law* (11th ed.) 1-001 and Clarke, *Insurance Contracts* (6th ed.) 1-1). However, while recognising this, adapting the words of Channel J in *Prudential Insurance Co v Inland Revenue Commissioners* [1904] 2 KB 658, one can state the ordinary sense of the term. It is (see *Chitty on Contracts* (30th ed.) 41-001) the provision of cover by an insurer to an assured, in this case IRISL, in respect of an adverse event which is uncertain and the object of which is to provide against loss to the assured, whether as a result of liability to third parties or otherwise or to compensate for prejudice.

80. Moreover, for the reason given at [77], the term "insurance cover" does not fit the situation where the contract of insurance has been discharged and the third party brings a claim based on events post-dating that discharge. Mr Butcher also relied on the fact that the direct right of action in Section 165(1A) of the Merchant Shipping Act 1995, which implemented the provisions of the Bunkers Convention into English law, is provided in respect of discharge of bunker oil occurring "while there was in force a contract of insurance" satisfying the requirements of Article 7 of the Convention. Mr Hirst submitted that the direct action in the United Kingdom is thus available in a narrower range of circumstances than is required under the Convention. Whether or not he is right in this, the language of the 1995 Act is a guide to the intention of the United Kingdom authorities when they issued the Licence on 30 October 2009.

81. The artificiality of the position taken by the Club is also shown by its submission that, where it does respond to claims brought directly against it by third parties, IRISL would be liable to indemnify it for any amounts which it is liable to pay the third party. To fall within the permission in paragraph 6 of the 30 October Licence, on the Club's case, that potential liability with a right of reimbursement from IRISL would have to be "insurance cover in accordance with the Blue Cards". I accept Mr Butcher's submission (Skeleton Argument paragraph 52) that "it is impossible to think that this is what the draftsman of the 30 October Licence was referring to when using the phrase 'insurance cover'".

82. Another difficulty with Mr Hirst's argument on the meaning of paragraph 6.1 is that it involves substituting the definition of "The Insurance Cover" (upper case) in paragraph 4 for the words "insurance cover" (lower case and no definite article) in paragraph 6.1. I consider this to be an illegitimate substitution. First, paragraphs 5 and 8 refer to "The Insurance Cover" but paragraph 6.1 does not. That is a clear indication that the definition in paragraph 4 is not relevant to the words "insurance cover" in paragraph 6.1. Secondly, paragraphs 5 and 8 are dealing with claims arising out of incidents before 30 October whereas paragraph 6 is dealing with insurance cover "starting on 30 October".

83. I conclude by observing that paragraph 6.1 does contain the words "to IRISL", but with reference to whom the Blue Cards were issued and not following the words "insurance cover". It states that Blue Cards were issued "to IRISL". I have referred (see [33]) to the fact that this is clearly not the case and to Mr Hirst and Mr Swift's agreement that the words should be read as "in respect of IRISL" or "with respect to IRISL's ships". There was no suggestion that the words "to IRISL" have been misplaced in the paragraph or transposed and should have followed the words "insurance cover". There may possibly have been some confusion with practice under the 1969 International Convention on Civil Liability for Oil Pollution, in respect of which Hazelwood (*op cit.,* at 293) states the relevant Blue Cards are "supplied to owners" who then provide them to the appropriate authority to enable it to issue the certificate.

84. I turn to paragraphs 6.2 and 5 of the 30 October Licence. Mr Hirst submitted that they support and reflect the difference between the position of direct claims by third parties and claims by IRISL. The reference in paragraph 6.2 to "insurance cover" is to the

cover "described in paragraph 6.1". As to, paragraph 5, he submitted it only applies to claims arising under "the Insurance Cover", and that is defined to mean insurance cover provided by the Club "to IRISL" prior to 2400 hours on 30 October. He also argued that the Licence had to be construed as subject to the Order and, since "the purpose of the Order was not to benefit IRISL, … the narrow reading of the Licence is the correct one".

85. I do not consider that paragraphs 6.2 and 5 provide any free-standing support for the distinction made by Mr Hirst. The terms of paragraph 6.2, which authorise the club to pay "any claims arising under the insurance cover described in paragraph 6.1", reflect and track paragraph 6.1. They are also a further indication that what is authorised is the payment of claims made by the insured under its insurance in respect of the cover (under the Bunkers Convention) which is authorised by the Licence. As Mr Butcher submitted (Skeleton Argument paragraph 55), "paragraph 6.2 does not draw a distinction between claims which may be brought directly against the Club by third parties and claims which might be brought by IRISL against the Club". There is force in his submission based on the phrase "pay any claims". If not inconsistent with the Club's submission, that phrase, and the word "any" in it, sits very uncomfortably with it. As for paragraph 5, for the reasons given in [82], I do not consider it assists Mr Hirst.

86. Accordingly, while acknowledging Mr Hirst's submission that it is not permissible to add words to paragraph 6.1, there is force in Mr Swift's submission (Skeleton Argument paragraph 38) that the paragraph "cannot sensibly have any other meaning as [the Club] was not providing insurance cover in respect of bunker pollution damage to any party other than IRISL pursuant to any contract conceivably affected by the 2009 Order".

87. What of the correspondence between the Club and the Treasury in the period before the 30 October Licence was issued? There are no doubt some differences between the role of pre-legislative and pre-contractual material in the construction of legislation and contracts. The correspondence in this case also differs from the position of the Explanatory Memorandum and the Inspector's decision letter considered in *R (Confederation of Passenger Transport UK) v Humber Bridge Board* [2003] EWCA Civ 842; [2004] QB 310 because the former is a formal and public document issued with the legislation and the latter is part of the statutory decision-making process. But I consider that the correspondence is in principle an admissible aid to the construction of the Licence. Since it is the intention of the Treasury in issuing the Licence that is crucial, what is of primary relevance is what is stated in the Treasury's letters to the Club. Moreover, while that is relevant, it is not determinative. The primary tool for the construction of the Licence is the words used in it.

88. It is clear from the interpretive note issued by the Treasury when the Order came into force that it would not be possible for the Club to continue to perform any existing transaction with IRISL unless licensed to do so. It is also clear that such permission was given to the Club to "continue to provide insurance cover" under existing contracts with IRISL by the first two licenses (General Licence 3; [30], and the Temporary Licence issued on 19 October [31]). The Treasury's letter dated 22

October stated that under the terms of the latter the Club was "exempt from the requirements of the direction" in the Order until 30 October.

89. Mr Hirst relied on the terms of the request by the Club for a further licence in its letter dated 22 October, the response of the Treasury in its letter dated 27 October, and the Club's letter dated 28 October setting out its understanding of what the Treasury stated would be permitted by it. The material parts of these exchanges are set out at [40] and [43] – [46]. He submitted (Skeleton Argument, paragraph 76) that the Treasury's reply in its letter dated 27 October that the provision of "ongoing insurance cover to IRISL" either until the cover expired or for a 30 day period would be "contrary to the object of the order" made it clear that permission for cover to IRISL would expire on 30 October. He also submitted that the agreement in that letter "to license the continuation of …Blue Cards for 90 days…" only referred to "payments to those asserting a direct right of action against the insurer".

90. The Treasury did not respond to the Club's letter dated 28 October and did not disagree with or contradict the Club's understanding as set out in that letter. What it did (see [46]) was to send out a draft licence shortly before 4:00pm on 30 October inviting comments but stating it wished to issue the licence that day. The Treasury received further comments from the Club, and sent it a copy of the finalised licence shortly before 5:30pm.

91. Mr Hirst submitted (Skeleton Argument, paragraph 76(6)) that the correspondence made it clear that "liabilities pursuant to the Blue Card could not include the Club's liability to IRISL for pollution damage". This, he stated was because "insurance cover to IRISL under the existing contract of insurance…was to be prohibited" and insurance "pursuant to the Blue Cards" meant "payments to those asserting a direct right of action against the insurer".

92. I have concluded that it was not made clear *by the Treasury* in that correspondence that insurance "pursuant to the Blue Cards" meant payments to those asserting a direct right of action against the Club in respect of pollution damage liabilities secured by the Blue Card. The Club relied on the distinction between its request in its letter dated 22 October "to continue insuring IRISL under existing contracts of insurance" and the continuation of "the provision of…services identified…to IRISL". But the first service identified in that section of the letter was "*cover* for oil pollution liabilities *pursuant to the…Club's Rule 25 (vi)* solely insofar as those liabilities are secured by…Blue Cards issued by [the Club]" *(emphasis added)*. The Club's requests thus drew a distinction between insurance cover of the full scope provided under the existing contracts of insurance and cover for one part of the oil pollution liabilities given by Rule 25 (vi).

93. The first and second requests were not alternatives: the latter request was (see [41]) an additional request. The use of the word "cover" in the second request (2(a)) is significant. It is noteworthy that this request does not at any stage draw an explicit distinction between direct claims by third parties and claims by the assured. The Treasury agreed to the second of these requests. That agreement is, as Mr Swift submitted, consistent with an intent to issue a licence permitting the continuation of insurance cover to the extent required by the Bunkers Convention. The refusal of

the first request was a refusal to continue the full extent of cover for which IRISL's ships had been entered.

94. It is unfortunate that the Treasury did not respond to the Club's letter dated 28 October setting out its understanding of what the Treasury's response to the Club's earlier request meant. However, the Treasury had already stated what licence it was prepared to grant, the temporary licence was to expire on 30 October, and time for putting a replacement in place was very short. There is no indication by the Treasury that the Club's understanding was what the Treasury intended to implement, or that the Club's understanding played a role in its determination of the wording of the licence.

95. Taking account of the fact that the Club's second request, to which the Treasury agreed, was for "cover", it is significant that paragraph 6.1 of the licence used the term "*insurance* cover" and stated that the Club "may *continue* to provide" the "insurance cover" specified (emphasis added).

96. For the reasons I have given, on its proper construction, the overall effect of the 30 October Licence, and in particular paragraph 6 permitted the Club: (a) to continue to provide IRISL with insurance cover in respect of the risks required to be insured by reason of the provisions of the Bunkers Convention; and (b) to meet all claims made in respect of those risks and not only claims made by third parties pursuant to Article 7(10)'s direct right of action.

97. It is therefore not necessary for me to reach a decision on the other principles of construction relied on by Mr Butcher. These are; that subordinate legislation be construed to be compatible with public international law and the European Convention on Human Rights, and that doubtful penalisation be avoided. I have indicated (see [72]) that I incline to the view the submissions of the Club and the Treasury that, on the facts of the present case, the withdrawal by the Club of bunker pollution damage cover would not have placed the United Kingdom in breach of its obligations under the Bunkers Convention are to be preferred. If so, there would be no arguable inconsistency between the 30 October Licence and the requirements under the convention and thus no scope for the operation of the construction based on compatibility with public international law.

98. As far as construing the 30 October Licence by reference to the interpretative obligation in Section 3 of the Human Rights Act is concerned, I make two observations. First, these proceedings do not concern the challenge to the legality of the Order or the Licence. That is the subject of the proceedings under Section 63 of the 2008 Act which (see [10]) have been stayed. Accordingly, at this stage, and in these proceedings, to apply the interpretative obligation in Section 3 would pre-empt an issue at the heart of the Section 63 proceedings. Secondly, assuming (as seems probable) that the Order and the Licence amount to an interference with a right falling within Article 1 of Protocol 1 of the European Convention on Human Rights, there have been a wide range of circumstances in which it has been held that an interference is lawful and proportionate: see for example the discussion in

Clayton and Tomlinson *The Law of Human Rights* (2nd ed.) 18.37-18.38, and 18.116-18.118. Whether that will turn out to be so in this case is a matter for the Section 63 proceedings. In any event, the point was not developed by Mr Butcher.

Issue 2: Was the effect of the Order and the 30 October Licence to discharge the insurance by reason of frustration?

99. Under the contract of insurance the Club insured IRISL against the full range of P & I risks within Class 1 of its Rules. It is common ground that at midnight on 30 October (i.e. before the Casualty) it became unlawful for the Club to insure IRISL in respect of all risks apart from those required to be insured by reason of the provisions of the Bunkers Convention. I have concluded that paragraph 6 of the 30 October Licence permitted it to continue to provide IRISL with insurance cover and to meet all claims in respect of those risks. The next question is whether, notwithstanding this, the contract of insurance was frustrated at midnight on 30 October 2009.

100. In 1948 Lord McNair deplored the tendency to include impossibility arising from supervening illegality within the conception and terminology of frustration: see *Legal Effects of War* (3rd ed. 1948) 134. Today it is (see *Chitty on Contracts* 30th ed, 23-024) "customary to treat supervening illegality as an instance of frustration". But it is also well recognised that when considering supervening illegality, the court is concerned not only with allocating or distributing the loss caused by the supervening event and "reaching a solution which may do justice between the contracting parties". The court "is also concerned with the public interest that the law is observed": see Sir Guenter Treitel, *Frustration and Force Majeure* 2nd ed. 8-002 and 8-003.

101. Bearing that in mind, I turn to the three notable statements of the test for frustration in the second half of the twentieth century. They are those by Lord Radcliffe in *Davis Contractors Ltd v Fareham UDC* [1956] AC 696, 729, Lord Simon of Glaisdale in *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675, 700, and Bingham LJ in *The"Super Servant Two"* [1990] 1 Lloyd's Rep. 1.

102. Lord Radcliffe gave what is now accepted to be the classic test. He stated:

> "frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would make it a thing radically different from that which was undertaken by the contract".

103. Lord Simon stated:

> "frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or

> obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances…".

104. Bingham LJ stated (as had Lord Simon) that the doctrine "was evolved to mitigate the rigour of the common law's insistence on literal performance of absolute promises" and that its object was "to give effect to the demands of justice" and "to achieve a just and reasonable result…as an expedient to escape from injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances…". He also stated, as has been stated in many cases, that because the effect of frustration is to bring the contract to an end and discharge parties from further liability under it, "the doctrine is not to be lightly invoked, must be kept within very narrow limits and ought not to be extended…".

105. More recently, in *The "Sea Angel"* [2007] 2 Lloyd's Rep 517 Rix LJ stated (at [111]) that, while the doctrine of frustration needed an overall test such as that provided by Lord Radcliffe, its application "requires a multi-factorial approach". He identified a number of factors which have to be considered. Some of these factors exist at the time of the contract and can be called *ex ante* factors. They are the terms of the contract, its matrix or context, and the parties' knowledge, expectations, assumptions and contemplations, in particular as to risk, as at that time so far as these can be ascribed mutually objectively. The other factors are post-contractual. These are the nature of the supervening event and the parties' reasonable and objectively ascertainable calculations as to the possibility of future performance in the new circumstances.

106. As to risk, Rix LJ stated "since the allocation and assumption of risk is not simply a matter of express or implied provision but may also depend on less easily defined matters such as "the contemplation of the parties", the application of the doctrine can often be a difficult one". He also stated that, while the test of "radically different" tells us that the doctrine is not to be lightly invoked and that mere incidence of expense, delay or onerousness is not sufficient, it "does not in itself tell us that the doctrine is one of justice, as has been repeatedly affirmed on the highest authority". He accepted that the demands of justice should not be overstated or taken to mean that the court has a broad absolving power. He regarded the demands of justice as "a relevant factor which underlies all and provides the ultimate rationale of the doctrine": see [2007] 2 Lloyd's Rep 517 at [112] – [113] and [132].

107. Before turning to the parties' submissions, I make two observations. First, none of these cases, and indeed none of the cases relied on by the parties, concerned a contract of insurance. *Davis Contractors* concerned the impact of labour shortages on a building contract; the *Panalpina* case concerned the impact on a lease of a warehouse of the closure of a street which was the only vehicular access to the warehouse; *The "Super Servant Two"* concerned the effect of the loss of a contract to transport a drilling rig; and *The "Sea Angel"* concerned the effect of delay on a charterparty. Secondly, none of them use the language of the "main purpose" or "foundation" of the contract which was used in earlier cases, including *Denny-Mott and Dixon Ltd v James Fraser and Co Ltd* [1944] AC 265, upon which Mr Hirst relied.

108. The Club's case is that, whatever the proper construction of the 30 October Licence, because it became unlawful for the Club to insure all the other risks, the contract of insurance between IRISL and the Club was discharged by frustration. Mr Hirst submitted:-

> (1) In cases of frustration in general and in particular in cases of supervening illegality, the Court looks at the contract *as a whole*. What the court considers is whether (a) the purpose (or main object) as gathered from its terms has been defeated (*Denny Mott & Dickson Ltd v. James Fraser & Co. Ltd* [1944] A.C. 265 at 273; Treitel, *Frustration and Force Majeure* 2nd ed 8-028) or (b) the contractual obligation was rendered "radically different" from that which was undertaken: Lord Radcliffe in *Davis Contractors Ltd v Fareham UDC* [1956] AC 696, 729. In this case both tests are satisfied:
>
> > (a) the purpose of the contract of insurance was the provision of the multitude of risks in standard Class 1 P & I cover, and that could not be provided, so the purpose of the contract was defeated, and
> >
> > (b) the entirety of the contract except for one small part was made illegal. After 30 October it was no longer a general indemnity insurance policy providing Class 1 P & I cover by way of mutual insurance. The difference cannot be characterised as only a change to the scope of the risks because only part of the cover under one of the 21 categories of cover, the pollution cover provided by Rule 25(vi) survived, namely the cover required by reason of the Bunkers Convention remains legal. The Order and Licence prohibited performance of the entirety of the contract, save for that one part. Moreover, what was left could not be said to be mutual insurance.
>
> (2) The fact that performance of a subsidiary stipulation, namely in this case insurance cover to IRISL in accordance with part of Rule 25(vi), was still lawful in accordance with the Licence does not displace the point that frustration of the main object kills the contract as a whole.
>
> (3) Absent a clear indication that the parties intended a clause to be applicable in the event of frustration, the Court will be slow to draw the inference that it was so intended. Here the clauses in the Rules relating to dispute resolution were clearly intended by both the Club and IRISL to survive frustration, but the same cannot be said of Rule 25 (vi).
>
> (4) "Severance" is not appropriate or possible in this case because what would be involved is "severing" all but one of the obligations. In any event:
>
> > (a) there is no indication by the parties that severing cover for all risks bar one part of Rule 25(vi) was their intention in the event of frustration, and

(b) the obligation to provide pollution cover cannot be severed with ease (or at all) from the contract as a whole with its 21 categories of risks. For instance, it is unclear how the Club could calculate calls and premiums in relation to part of one of those categories of cover.

(5) The event of frustration would not provide any "*windfall*" to the Club because on termination the premium was pro-rated, and the Club remains liable to third parties in respect of pollution liabilities pursuant to the third parties' rights of direct action.

(6) The frustrating impact of the Order and Licence of 30 October is also demonstrated because, under the terms of the Order and General Licence 2, any payment by the Club could not be made to IRISL and would have to be into a Restricted Account. By General Licence 1, paragraph 7.2, no payment out of that account would be permitted unless the Treasury granted a licence to do so.

109. Mr Butcher submitted:

(1) The parties provided for the event which occurred because the Bunkers Convention required the insurance for bunker oil pollution not to be capable of being brought to an end for three months after notice was given, and by issuing the Blue Card, the Club waived the right to do so. In respect of bunker oil pollution, the Club thus took the risk that something might occur which would otherwise permit it to be released from the insurance.

(2) The Order and the 30 October 2009 Licence did not frustrate the contract because they did not affect the nature of the insurance as an indemnity insurance policy. What changed was that the scope of the risks covered was significantly reduced. That made the Club's obligations less, not more, onerous.

(3) An obligation to provide cover in respect of Rule 25(vi) is no different and no more onerous after 30 October than it was before then. Nor did the actions of HM Treasury change the allocation of risk under the insurance.

(4) Although the insurance did not identify any particular risk as being the "main" risk covered, the "pollution cover" required under the Bunkers Convention was a significant element of that cover, an essential part of the insurance, and an important part of its purpose because a ship could not trade without it. Since it remained legal for the Club to provide such cover, it cannot be said that the purpose of the insurance was destroyed.

(5) It is not unjust to hold the Club to do what it promised to do. First, the intention of HM Treasury was to permit the Club to continue to provide cover in respect of liabilities arising under the Bunkers Convention. Secondly, a finding of frustration would provide the Club with a windfall because it has had the benefit of the premium and calls paid by IRISL, but would be excused from performing the very obligation that it undertook and

the United Kingdom guaranteed under Article 3(a) of the Bunkers Convention.

(6) The Club cannot invoke the law's non-recognition of "partial frustration" to seek to lower the standard of what amounts to an event which frustrates and thus discharges the entire contract.

(7) Alternatively, the parts of the insurance which it became illegal for the Club to perform were severable so that cover in respect of the liabilities under the Bunker Convention remained binding.

110. I have approached this issue bearing in mind the need for what Rix LJ described as a "multi-factorial" approach. The first question to consider is whether the contract of insurance, at least in respect of bunker oil pollution, provided for what happened so that the Club took the risk. I reject Mr Butcher's submission that this was so and that the Club took the risk that something might happen which would otherwise permit it to be released from the contract of insurance.

111. First, the parties did not provide for the events which occurred; i.e. the making of the Order on 9 October 2009 and the Licence on 30 October. I do not consider that any mutually and objectively determined assumption or contemplation to this effect can be found. There was no material before me from which it could be said that in February 2009, when the "ZOORIK" and IRISL's other vessels were entered with the Club, that measures pursuant to powers under the Counter-Terrorism Act 2008 were contemplated in respect of Iranian companies.

112. Secondly, I do not consider that, by issuing the Blue Cards, the Club (at least *quoad* the assured) waived the right to terminate the contract within three months. The Blue Card was issued to enable the UK government, as a State Party to the Bunkers Convention, to issue the certificate required by that convention.The Blue Card does not certify that the insurer accepts liability to third parties under the Convention. It does not say anything about third parties and is not made available to third parties. It is the certificate issued by the State Party and not the Blue Card which is carried on board vessels.

113. Thirdly, the terms of Article 7(10) of the Bunkers Convention expressly contemplate a situation in which the insurer has a defence against an insured shipowner and specify that the defence is not to be available against a third party bringing a direct action. There is no indication in the Blue Card issued for the purposes of the Convention that issuing it is a waiver of a right which the Convention contemplates the insurer will have against the insured shipowner. Moreover, (see [26] and [72]) Article 7(3)(c) empowers a State Party which has issued a certificate to withdraw it.

114. I turn to the other elements of the "multi-factorial" approach. It was not suggested that the contract was frustrated by the Order itself or before 30 October 2009. Such a suggestion would have been untenable because on 9 October, the date the Order was made, the Club was permitted to provide insurance cover "under an existing contract" with IRISL, first by General Licence 3, for 7 days, and then by the temporary licence issued on 19 October which operated until 30 October.

115. The 30 October Licence permitted the Club to "continue to provide insurance cover in accordance with the Blue Cards issued to IRISL for a period of 3 months" or until the Club was "discharged from liability by the state authorities to whom the Blue Cards have been issued, whichever is the sooner". I have concluded that the effect of this did not render the Club's obligations radically different so as to frustrate the contract of insurance. First, the obligation the performance of which remains legal, "to provide insurance cover in accordance with the Blue Cards", i.e. in respect of liability under the Bunkers Convention, has not altered at all. It is clear on the authorities that in considering the applicability of frustration what has to be considered is the contract as a whole. In this case the contract as a whole is a contract of insurance. Its purpose is to provide indemnity insurance on a mutual basis to those who enter their ships with the Club. I accept Mr Butcher's submission that while the scope of the cover now permitted is significantly narrower than it was before 30 October, its nature is not different. It remains indemnity insurance.

116. I have referred to *Denny-Mott and Dixon Ltd v James Fraser and Co Ltd* [1944] AC 265, upon which Mr Hirst relied. That case concerned a trading agreement between two timber merchants providing that one of them should purchase all its supplies of specified wood from the other and should let a timber yard to the other with an option to purchase or lease the yard. The trading part of the agreement became impossible as a result of emergency legislation introduced on the outbreak of World War Two. The House of Lords rejected the argument that the emergency legislation did not frustrate the contract because it remained possible for the sale of the timber yard to proceed. But the House unanimously regarded the main purpose of the contract as trading and the property transaction as subsidiary: see [1944] AC 265 at 271, 272-3, 280 and 284. If one analyses the purpose of the contract between the Club and IRISL, it was to provide indemnity insurance. Part of that purpose remained lawful. For this reason the *Denny-Mott* case is distinguishable. Mr Hirst pointed to the contrast between the Club's unlimited liability for other risks and the $1 billion limit for pollution cover. But it cannot be said that the extent of the cover for bunker oil pollution was not significant. Moreover, a ship could not trade within the territorial waters of State Parties to the Convention without such cover.

117. Mr Hirst also referred to *Leiston Gas Co v Leiston-cum-Sizewell UDC* [1916] 2 KB 428, a case not relied on by Mr Butcher. He observed it provided the strongest support for Mr Butcher's submissions, but had been doubted in *Denny-Mott*'s case by Viscount Simon LC and Lord Wright: see [1944] AC at 271 and 280. The *Leiston Gas* case concerned the impact of wartime blackout regulations on a five-year contract to provide gas street lamps, to maintain them, and to light and extinguish them at set times. Four years later the lighting of street lamps was prohibited by the regulations. It was held that the contract was not frustrated because the contract also provided for supply and maintenance of the plant and those parts of the contract remained lawful. I do not consider the doubt expressed in *Denny-Mott*'s case by Viscount Simon and Lord Wright about the result assists Mr Hirst. It may possibly be because they considered that lighting the district was in fact the main purpose of a street-lighting contract. In any event, the House of Lords did not overrule the decision and it is not questioned by Sir Guenter Treitel in *Frustration and Force Majeure* (2nd ed), see 7-017ff and 8-029. Sir Guenter notes that in none of the English cases in which the effect of blackout regulations on

street-lighting contracts was considered was the contract held to be frustrated. In *Egham and Staines Electricity Co v Egham UDC* [1944] 1 All ER 107 the House of Lords (including 3 members of the Appellate Committee in the *Denny-Mott* case) held that, as a result of the blackout regulations, the local authority was excused from making further payments under a street-lighting contract. This, however, was because of an express term of the contract and not because the contract was frustrated.

118. What of Mr Hirst's submission that, as a result of the restrictions in the Order and the Licence, the contract was no longer mutual insurance, and that its nature therefore did change? He emphasised the fact that under General Licences 1 and 2 payments to and by IRISL had to be paid into restricted accounts. The Order undoubtedly prohibited a business relationship between IRISL and the Club save to the extent permitted by a Licence. Before 30 October the Club was permitted to provide insurance cover under an existing contract with IRISL. The existing contracts with IRISL were contracts of insurance for indemnity and of a mutual nature. The entire range of cover remained and it was not suggested by Mr Hirst that at that stage the contract was frustrated because of the restrictions on payments to and by IRISL.

119. So what was the position after 30 October? IRISL's position is that it remains liable for calls and additional premium. Frustration, however, operates automatically and does not depend on choice: see *Joseph Constantine Steamship Line Ltd v Imperial Smelting Corporation Ltd* [1942] AC 154, 170, 171 (Viscount Maugham), 187-188 (Lord Wright) and *Denny-Mott and Dixon Ltd v James Fraser Company Ltd* [1944] AC 265, 274 (Lord Wright).

120. It remained lawful for the Club to "continue a business relationship with IRISL to the extent necessary in order to handle, negotiate and pay any claims arising under the insurance cover" described in paragraph 6.1 of the Licence. That was cover in accordance with the Blue Cards, which it is common ground was the cover required by the Bunkers Convention. The Club's business relationship with its assured, including IRISL, is within the context of mutual insurance and its rules. Those rules include provision for calls and additional premiums. General Licence 1 and General Licence 2 respectively permitted the Club to receive and hold funds from or on behalf of a designated person. Where payment is due by or to a designated person under an agreement made before the Order came into force, they authorised payment, albeit into a restricted account. The business relationship in respect of the permitted insurance cover thus contemplated payments to and, significantly in this context, by IRISL. Even after 30 October, it was not illegal for IRISL to pay the Club sums due under "the Insurance Cover": see Clause 8.1 of the 30 October Licence. I do not consider that the restrictions on payment which, before 30 October were not regarded as frustrating the contract, had that effect thereafter because of the narrower range of cover permitted.

121. The intention of the Treasury was to permit the Club to provide cover in respect of liabilities arising under the Bunkers Convention, if only because the United Kingdom is under an obligation in respect of those liabilities. A finding of frustration as a result of the Order and Licence would therefore interfere with the contract between the parties in a way which went beyond that necessary to give

effect to the Order and the Licence. It would, in fact, defeat the intention of that Licence. I consider that particular care should be taken before concluding that the 30 October Licence has that effect.

122. Mr Swift, supported by Mr Butcher, submitted that the general approach as to the effect of the exercise of statutory powers on contractual rights in *K Ltd v National Westminster Bank PLC* [2006] 2 Lloyd's Rep 569 at [10] – [11] and *Shah v HSBC Private Bank (UK) Ltd* [2009] 1 Lloyd's Rep 328 at [39] is of assistance. However, the context and circumstances of those cases are very different. They were concerned with the effect of a disclosure by a bank made pursuant to its duty under the Proceeds of Crime Act 2002 on the bank's obligations to its customer. They were not concerned with partial illegality.

123. I have, however, been assisted by the factual scenario in the many soyabean cases which came before English Courts in the late 1970s when United States authorities prohibited the export of soyabean save in very restricted circumstances. Sir Guenter Treitel relies on these cases in the section on "partial illegality" in *Frustration and Force Majeure*. He recognises (see 8-029) that the cases turned on the operation of express provisions in the contract dealing with prohibitions of export or *force majeure*. But he uses them as illustrations of the principle that the liability to perform the part of a contract which is still lawful may remain even though other parts of the contract have been prohibited. He states this will be so where "the part of the performance which has become illegal is severable, in the sense that the performance of the part which remains lawful would make as much commercial sense as performance of the whole, and in which performance of the part which remains lawful is in no way dependent on the other part, the performance of which has been prohibited". So, in the soyabean cases, where the United States' export restrictions applied to, say 60% of the soyabean sold under a given contract, the prohibition did not affect the seller's liability to deliver the 40% which could lawfully be delivered.

124. Sir Guenter's use of the word "severable" in this context differs from its more familiar use in the context of the effect of illegality on contracts. The classic requirements of severability include the "blue pencil" rule, that the illegal promise must not form the main consideration, and that the effect of severance should not alter the scope and intention of the agreement. Since those do not apply in this context, the word "severable" may not be appropriate. But the soyabean cases are a useful illustration of a factual scenario in which, despite partial illegality, the legal part of a contract remains performable. While the fact that they are decisions on the terms of the contracts in question rather than the doctrine of frustration means that caution is required in deploying them, they are, as Mr Butcher submitted, illustrations of the operation of principle in the context of partial illegality.

125. There is also some similarity between those cases and the position in respect of partial physical impossibility, for instance by partial failure of a crop that has been sold. In such a case the contract may not be discharged but the seller will have an excuse for non-performance of the part of the crop that has failed: see *Howell v Coupland* [1876] 1QBD 258, 262 and *HR and S Sainsbury Ltd v Street* [1972] 1WLR 834, discussed by Sir Guenter Treitel, *op. cit.* at 5-013 and 8-029.

126. The performance by the Club of the part of the cover under Rule 25(vi) which remains lawful is not dependent on the other parts of the cover, the performance of which has been prohibited by the Order, not permitted by Licence since 30 October 2009 and therefore no longer lawful. The Order and Licence do not make it illegal for IRISL to pay the Club: see General Licence 1 and Clause 8.1 of the Licence dated 30 October 2009. To this extent the requirements of mutuality remain. Moreover, since IRISL has paid premium and any calls to the Club and those payments are not recoverable, it is difficult to see why it should not be able to recover in respect of that part of the cover which remains lawful. For this reason, performing the part of the contract of insurance which remains lawful also makes commercial sense. Accordingly, there is no reason for the legal part of the contract which is performable not to remain in force.

127. I have referred to the intention of the Treasury and whether a finding of frustration would interfere with the contract between the parties in a way which went beyond that necessary to give effect to the Order and the 30 October Licence. Those factors, and whether discharge of the entire contract would defeat the clear intention of the 30 October Licence are also of relevance to the issue of the demands of justice, referred to in the cases I have discussed. In *The Sea Angel* Rix LJ stated that the dictates of justice are a relevant factor which underlies all, provides the ultimate rationale of the doctrine of frustration, and should be used as a "reality check", although they must not be overstated. As to this, I accept Mr Butcher's submission that a finding of frustration would provide the Club with a windfall because it has had the benefit of the premium and calls paid by IRISL but would be excused from performing the very obligation that it undertook under Rule 25(vi).

128. Moreover, the effect of finding that the contract is frustrated would be that the Club is able to excuse itself from the performance of an obligation which has remained entirely unaltered simply because it can no longer be called upon to perform different obligations, which had they arisen would have been onerous to it. The contract as a whole has become less onerous because the Club would have a defence by reason of the illegality in respect of other parts of the insurance cover. Why should the fact that it would have such a defence justify it excusing itself from the performance of an obligation which has not been rendered illegal and has remained unaltered? For the reasons given, I have concluded that the Order and the 30 October Licence did not frustrate the contract of insurance between IRISL and the Club.

129. It is thus not necessary to consider Mr Butcher's further submission that the parts of the insurance which became illegal for the club to perform were severable in the classic sense of that term. He submitted that severance does not involve rewriting the insurance or lead to a fundamental change to its character as insurance of specified risks. Those risks are divisible because it is an ordinary feature of insurance policies that certain risks may be included or excluded. Nor, he submitted, do the illegal covenants constitute substantially the whole of or the main consideration for the promise that IRISL seeks to enforce, and severance would not offend public policy. Had the cover permitted extended to the entirety of the cover within Rule 25(vi), this form of severance could (as Mr Hirst conceded, see Skeleton Argument paragraph 100(2)) in principle have been possible. However, not all the cover within Rule 25(vi) was permitted by the 30 October Licence. For

this reason, had it been necessary to decide this point, it would have been difficult to conclude that the contract could be severed in this way.

Issues 3 and 4:

130. In the light of my conclusions on Issues 1 and 2, it is possible to deal with Issues 3 and 4 very briefly. With regard to Issue 3, since the contract of insurance was not discharged by reason of frustration, IRISL is entitled to be indemnified in respect of its costs and liabilities arising out of the casualty. With regard to Issue 4, since the Club is liable in respect of the costs and liabilities arising out of the casualty, it is not entitled to an indemnity or reimbursement from IRISL in respect of any liabilities that it incurs to third parties under Article 7(10) of the Bunkers Convention.