

**The Sanctions Standoff in Ship Release:
Defining Reasonable Security and the Power of the Agreed
Forum**



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Sanction clauses in LOUs have become a modern deal-breaker in securing a ship's release from arrest, creating a critical standoff over what constitutes reasonable security. This article examines two landmark English decisions that provide definitive answers to high-stakes questions: whether qualified security is reasonable and must be accepted, and whether the power to decide lies with the arresting court or the parties' contractually agreed forum.

The purpose of a ship arrest is to obtain security for the claim. It follows that once reasonable security is offered and furnished, there is no justification for keeping the ship under arrest (*M/V Pacific Pearl Co Limited v Osios David Shipping Inc* [2022] EWCA Civ 798 at [25], [26], [28] and [41]). This distinguishes a ship arrest from other forms of detention, such as those imposed by authorities.

Hence, when a ship is arrested, it is often crucial for the shipowner to agree on security with the arresting party. Three types of issues may delay or prevent agreement on security. **First**, the *mode of security*. This includes questions such as whether security should be furnished by way of a cash deposit, a bank guarantee, or a letter of undertaking (LOU) from a P&I Club. The identity of the security provider also falls under this category. In the UK, as in many other jurisdictions, an LOU from an International Group (IG) P&I Club is generally regarded as an acceptable mode of security. **Second**, the *amount of security*. It is settled law that the claimant is entitled to an amount representing his "reasonably arguable best case" (*The*

Moschanthy [1971] 1 Lloyd's Rep 37), subject to the limit of the ship's value. **Third**, the *terms of the security*. At this stage, a key issue that may arise is the inclusion of a sanctions clause. Given the crippling effect of sanctions on the shipping industry, this can often be a deal-breaker. A security recipient—that is, the arresting party—may take the position that an LOU or bank guarantee containing a sanctions clause is no security at all, given the risk that it may be unenforceable or ineffective in practice due to potential future sanctions.

When the parties cannot agree on the security, it falls to the arresting court to determine it. But what happens when the arrest is made in jurisdiction X under the law of X, while the parties have agreed to submit their disputes to the courts of jurisdiction Y, or to arbitration seated in country Y under the law of Y? Here, the agreed jurisdiction is Y. The basic rule remains: it is the arresting court that determines the security. However, the court of the agreed jurisdiction may injunct the arresting party from abusing the arrest for an ulterior purpose, i.e. beyond securing reasonable security. Such an abuse may occur where a party arrests a ship in order to pressure the shipowner into settling the claim without allowing the dispute to be resolved through the agreed forum, or to compel the shipowner to submit to the jurisdiction of the arresting court in disregard of the agreed mode of dispute resolution.

Two classical cases illustrate this principle – one in non-contractual context, and another in contractual context.

The first is *Kallang Shipping v Axa Assurances Senegal and Comptoir Commercial Mandiaye Ndiaye* (“CCMN”) [2006] EWHC 2825 (Comm). In that case, the court acknowledged that it was for the arresting court to determine the security. However, the court of the agreed jurisdiction may injunct a party to restrain it from taking

steps before the arresting court in the course of security determination that would undermine the agreed mode of dispute resolution. Kallang Shipping were the owners of the vessel Kallang. Axa Assurances and CCMN were respectively the cargo insurers and cargo owners – together, the cargo interests. The bills of lading issued by The Kallang to the cargo owners incorporated a London arbitration and English governing law clause in the charterparty. Cargo owners alleged that the cargo was short delivered or found damaged upon arrival in Senegal, and they arrested the vessel there. The ship's P&I club – The American Club, an IG member – offered an LOU. However, the cargo interests rejected the LOU and instead insisted on a Senegalese bank guarantee, which would, in effect, require the substantive dispute to be resolved by Senegal litigation rather than London arbitration. In response, Kallang Shipping commenced proceedings in the English court to restrain the cargo interests from insisting, before the Senegalese court, on a form of security that would frustrate the London arbitration clause. At [36], Gloster J accepted that it was for the Senegalese court to determine the security. Nevertheless, the judge held that this did not prevent the English court from restraining the cargo interests, by an injunction, from advocating for a form of security before the Senegalese court that would require the substantive dispute to be resolved in Senegal, in breach of the London arbitration clause. The judge made the order accordingly.

The second is the recent case of *M/V Pacific Pearl Co Limited v Osios David Shipping Inc* [2022] EWCA Civ 798. This case involved a three-vessel collision between The Panamax Alexander (PA), The Sakizaya Kalon (SK) and The Osios David (OD). Parties entered into an agreement in the form of ASG 2 in August 2018. By this, they agreed that the claim of each party should be determined exclusively by the English courts (Clause A); to “provide security in respect of each other’s claim in a form **reasonably satisfactory** to the other”

(Clause C); and that the agreement should be governed by English law and any dispute arising thereunder should be submitted to the exclusive jurisdiction of the English courts.

While negotiations over security were ongoing, OD arrested The Panamax Christina (PC) in South Africa on 5 September 2018. PC was owned by a company **associated** with PA and such arrest was permissible under South African law. 7 September 2018, PA's P&I club – Britannia P&I, a member of IG – offered OD an LOU containing a sanctions clause. The effect of the clause was to **suspend** the payment in the event of a relevant sanction, or if any **bank** in the payment chain was unwilling to process the payment for sanctions-related reasons. OD rejected the LOU on the ground that it included a sanctions clause. Subsequently, on 10 September 2018, PC's P&I club – UK P&I Club, a member of IG – provided an LOU without a sanctions clause. OD accepted this LOU and released the vessel.

PA contended that the LOU offered by Britannia, despite including a sanctions clause, was reasonably satisfactory and that Clause C of the ASG 2 agreement obliged OD to accept it. On that basis, PA claimed that OD breached the agreement by refusing the LOU, and commenced proceedings in the English Court seeking damages for breach of contract.

At first instance, Sir Nigel Teare held that the question of whether a security offered was “reasonably satisfactory” must be assessed **objectively**. He found that “sanctions clauses” were “an **inevitable commercial** reality and was not unreasonable” for such a clause to be included in an LOU. Accordingly, he held that the LOU offered by Britannia, containing a sanctions clause, was reasonably satisfactory. However, he held that Clause C did not impose an obligation on OD

to accept a security that was reasonably satisfactory. Hence, he concluded that there had been no breach of contract.

PA appealed, contending Clause C obliged OD to accept a reasonably satisfactory security. OD issued a Respondent's Notice, arguing the terms of the LOU containing the sanctions clause as it was drafted was not reasonably satisfactory.

Males LJ, delivering the unanimous judgment of the Court of Appeal, allowed PA's appeal. He held that, both as a matter of construction and by necessary implication, Clause C imposed an obligation on each party to accept a security that was reasonably satisfactory. Construing Clauses C and F together, he held that it was for the English court – not the foreign arresting court – to determine whether a proposed security provided was “reasonably satisfactory” under English law.

As to the Respondent's notice, Males held that Sir Nigel Teare was entitled to reach the conclusion he did on the reasonableness of the sanctions clause, and that the appeal court would not be prepared to interfere with it. Accordingly, the court awarded damages to PA for OD's breach of the ASG 2 agreement.

Males LJ observed (at [25], [26], [28] and [41]) that even in the absence of a contractual obligation to accept a reasonably satisfactory security, the general rule remains that an arrested ship must be released upon the provision of reasonable or sufficient security. It is for the arresting court to decide if the security offered is reasonable/sufficient.



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