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*Copied to
Defence: Contracts 15
with Iran*

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

21st January 1980

THE PRIME MINISTER

IRAN

As mentioned in the paper (OD(80)4) for tomorrow's meeting of OD, I have carried out an urgent study of the legal position as respects preventing the export of the ship KHARG to the Iranian navy.

2. The note has been prepared after discussion with Ministry of Defence, Trade and Foreign and Commonwealth department lawyers. No contact has been made with Swan Hunter or their parent British Shipbuilders who may have more information relating to the material facts affecting the contractual position. The latest information as to the giving of the thirty days notice of availability by Swan Hunter is that it will be given by the end of this week or at the latest by the beginning of next when the ship will commence its sea trials.

3. I am copying this to members of OD and the Secretaries of State for Industry and Energy, and to Sir Robert Armstrong.

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NOTE BY THE ATTORNEY GENERAL ON PREVENTING THE EXPORT OF THE SHIP KHARG

Facts

1. Under a contract dated 31 October 1974 Swan Hunter Shipbuilders Ltd contracted to build a fleet replenishment ship KHARG for the Ministry of War of the Imperial Government of Iran. The delivery was due to take place on 28 February 1978. By an amendment to the contract this date was extended by one year and under force majeure provisions Swan Hunter have one further year to deliver so that the ultimate date is 28 February 1980. The contract was initiated and negotiated by the Head of Defence Sales of the Ministry of Defence in conjunction with Millbank Technical Service Ltd and a separate contract was drawn up with the Iranian Navy in April 1976 for the Ministry to provide overseeing services and facilities for Iran's benefit, for which agreed charges were to be paid. The basic price of the vessel was £32 million of which approximately £29 million has already been paid. The estimated final price however is £39 million so that approximately £10 million remains to be paid but this figure has not yet been finally agreed by the Iranians. However it is understood that the Iranian delegate has recommended to Tehran that this figure be accepted. The ship^{is} about to undergo its final sea trials with a view to delivery in mid-February. Under the contract Swan Hunter undertook to deliver the vessel duly built and completed at the builders' yard. There is no mention in the contract of any requirement for an export licence as this was not necessary when the contract was made.

The Export Licence

2. By an amendment to the Export of Goods (Control) Order 1970, made on the 23rd December 1974 and coming into operation

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on 13th January 1975 the export of "ships of war" was prohibited without the licence of the Secretary of State. (The 1970 Order and its amendments have been consolidated and replaced by the Export of Goods (Control) Order 1978 SI 1978/796). The KHARG is clearly a ship of war for this purpose since it is armed and can carry helicopters and is intended to be in commission in the Iranian navy. Moreover the Ministry of Defence is satisfied that it should be categorised as a ship of war. Accordingly without a licence from the Secretary of State, which has not yet been given, the export of the ship is prohibited.

3. An application for a licence, which can be made either by Swan Hunter or the Iranians or Millbank Technical Services on their behalf, can be refused provided such a refusal is made in the general context of a policy to prohibit the export of arms to Iran.

Refusal of an Export Licence : Contractual and Financial Consequences under Domestic Law

A. Between Iran and Swan Hunter

4. There are two possibilities. First if the express object of the contract is simply to build and deliver a fleet replenishment ship then the contract can still be performed even though an export licence will be refused, Swan Hunter have built the ship and delivery under the contract is presumed to take place in the Tyne. If the Iranians do not pay the remaining £10 million due under the contract, they cannot maintain a claim for delivery in the UK courts and Swan Hunter will appear the innocent party. The financial implications are that Swan Hunter are £10 million out of pocket but the ship remains undelivered. If the Iranians do pay the £10 million, delivery can take place but the

/vessel

vessel will remain within the jurisdiction (subject to questions of inviolability see paras 8-10).

5. Secondly, and this view is to be preferred, if the express object of the contract is to build a fleet replenishment ship which is capable of being used as such outside the jurisdiction and an export licence is refused, performance of the contract will be delayed. This delay can be viewed in 2 ways:-

(i) It may be regarded as not rendering performance impossible in the sense that the anticipated period of delay is not out of proportion to the overall period of performance of the building contract. If that is right the contract specifically provides for the extension of the date of delivery for each day that delivery is rendered impossible through no fault of the builder. Once again the result will be that Swan Hunter will be out of pocket for £10 million for an indeterminate period.

(ii) The alternative view would be that the delay is so substantial as to render performance as a matter of commercial common sense impossible. The law then regards the contract as frustrated. It is considered that the proper law of the contract is English. The Law Reform (Frustrated Contracts) Act 1943 would apply. The effect of this Act would be that losses and advantages stay where they fall but (a) the Iranians could only keep their ship in return for a financial allowance for the benefit received and, (b) Swan Hunter could keep all or part of the instalments received to reflect the expenses incurred. Pending the resolution of the dispute Swan Hunter would hold on to the instalments and possession of the ship.

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6. The possibility of an argument being advanced by Iran on the basis that it was an implied term of the contract that Swan Hunter should obtain an export licence has been considered but ruled out because the highest that this could be put would be that Swan Hunter use their best endeavours to apply for and to obtain a licence.

B. Between Iran and HMG

7. In the UK courts there would be no cause of action because the refusal of an export licence would be the exercise of a statutory power for reasons of legitimate policy. Although the Ministry of Defence and Millbank Technical Services appear to have acted as agents for Iran it is not considered that they could be said to be under a duty to use their best endeavours to apply for an export licence still less to obtain such because this in effect would be the Crown applying to itself for a licence and any such obligations to Iran would be a fetter upon the exercise of a statutory discretion. If this argument were wrong an action could be brought seeking to recover damages for the loss of use of the vessel for the period of delay e.g. interest on the capital invested. The quantum of this claim would depend on the considerations in the previous paragraph.

/Inviolability

Inviolability

8. If the ship were inviolable it would be unlawful under international law for us to impede its departure. Unless and until the ship is commissioned it is not inviolable as a public ship of war and is therefore subject to UK law. A warship is defined in Article 8(2) of the Convention on the High Seas 1958 as being, "a ship belonging to the naval forces of a state and bearing the external marks distinguishing warships of its nationality, under the command of an officer duly commissioned by the government and whose name appears in the Navy List, and manned by a crew who are under regular naval discipline".
9. The act of refusing consent to commissioning rests upon the basis that commissioning is an act of sovereignty which cannot be performed on the territory of another state (see:- Lord McNair, Vol I International Law Opinions at page 103).
10. However it is considered that subject to practical considerations the refusal of consent to commissioning should be notified to the Iranian Government within a reasonable time. Furthermore it would not of course be effective if the ship left harbour and was commissioned outside territorial waters and then returned to the UK because then it would have ~~acquired~~ ^{acquired} inviolability. There is a provision in the contract enabling the ship to leave territorial waters for the purposes of sea trials.

Self Help

11. The Iranians might if they decided ~~the~~ their first priority was to obtain possession of the ship, attempt to sail the vessel out of United Kingdom waters. Once they become aware of the risk that they will not be permitted to sail the vessel away after

.../delivery

delivery they might simply take over the vessel at a point when it was outside United Kingdom territorial waters on its trials and sail it away. It appears that they have the physical resources and capacity to do this. There would be Swan Hunter employees on board, nominally in charge of the ship. These could perhaps be deposited at some convenient port of call, or even taken to Tehran, whence they might or might not be returned forthwith. Although in theory proceedings for the breach of our law might then be contemplated, they would probably be met by a claim of State immunity under the State Immunity Act 1978, and in any event they would serve little purpose. If we knew of the attempt to export without the necessary export licence while the ship was still in port or within territorial waters, Customs and Excise have the legal powers to prevent such action.

Customs Powers

12. In the absence of a valid export licence for the ship any attempt to export the ship will render the ship prima facie liable to forfeiture under s68 (1) Customs and Excise Management Act 1979 and anyone knowingly concerned in the attempt liable to a penalty of 3 times the value of the ship on summary conviction or an unlimited penalty on conviction on indictment. If any attempt is made to sail the ship out of UK waters without an export licence the ship would probably be liable to forfeiture.
13. Under s 139 of the Act anything (including a ship) liable to forfeiture can be seized or detained by inter alia customs officers or any member of Her Majesty's armed forces and under s 11 of the Act it is the duty of members of Her Majesty's armed forces to assist in the enforcement of customs law,

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including seizing a ship which is liable to forfeiture. Once the ship is seized then a seizure notice may have to be served and the owner may make a claim before our courts against forfeiture within 1 month.

State Immunity

14. On the assumption that we had made it clear that the Kharg could not be commissioned and that it was therefore not entitled to inviolability as a foreign public warship there nevertheless remains a question of whether these provisions in regard to forfeiture of the vessel could be enforced in view of the sovereign immunity of the State of Iran. The position in regard to immunity is now regulated by the State Immunity Act 1978. Although this Act created numerous exceptions from the previous rule of absolute immunity it seems that none of them could plausibly be held to cover proceedings for forfeiture brought by the United Kingdom Government against the Iranian Government as owners of the vessel. It could be argued that a claim against forfeiture made by the Government of Iran would amount to a submission to the jurisdiction - but section 2(3) and (4) provide that a State is not deemed to have waived its immunity if it intervenes or takes any step in the proceedings only for the purposes of claiming immunity. It could be argued that the Iranian Government is not entitled to have its ship until it allows a United Kingdom court to determine the substantive question of whether the ship is liable to forfeiture, the onus of proof being on the Iranians as plaintiffs. But this analysis is to some extent not in accordance with the true facts of the situation since the real question is whether the United Kingdom can enforce its prohibition on the export of a foreign warship - saying on the one hand that the ship is a warship and therefore contrary to Iranian expectations needs an export licence but on the other hand is notⁱⁿ international law a warship and can

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therefore be detained and forfeited under United Kingdom law. In a situation where we have real reason to fear retaliation by Iran the legal subtleties may be of less importance than the public justification of our position in ordinary terms.

International Law Claims by Iran

15. The Foreign and Commonwealth Office believe that once the Iranians became aware that we intended to prevent the ship leaving for Iran, they would in fact be unlikely to pursue their domestic remedies through the United Kingdom Courts. Unless they decided that their first priority was to obtain use of the vessel and attempted to sail it out of United Kingdom waters, they would be more likely immediately to present an international claim against the United Kingdom Government through diplomatic channels.
16. A government-to-government claim could be based on allegations of estoppel - that we had caused Iran direct damage by failing to carry out undertakings, whether express or implied, to facilitate the construction and delivery of a vessel for which they had paid or were ready to pay the full purchase price. The exact scope of the doctrine is far from settled but in general it may be said that where the clear statements or conduct of one Government lead another Government bona fide and reasonably to act to its own detriment or to the benefit of the first Government then the first Government is estopped from going back on its statements or conduct.
17. There appears to be a substantial case on the ground of estoppel. The contract was promoted and consistently furthered by the Ministry of Defence. In his letter of 10 September to His Excellency General H Toufanian, Iranian Vice Minister for War and Armaments, the Head of Defence Sales said:-

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"The Ministry of Defence will, of course, carry out appropriate functions of inspection and overseeing. Swan Hunter are licence holders for the export of this ship design, and we are very lucky that amidst the boom in shipbuilding a firm of such quality is available to carry out this work within a satisfactory time scale. Millbank Technical Services will, of course, provide assistance to you with the contractual and financial questions and I, myself, will take personal interest in the progress of the transaction".

In consequence of these assurances the Iranians acted to their detriment in not placing the order for the ship in another country and to the economic benefit of the United Kingdom. It could reasonably be implied from such a statement that the United Kingdom Government would not for political reasons withhold or revoke an export licence for the vessel after it had been constructed and the purchase price - or most of it - paid.

18. An alternative to estoppel might be that our conduct amounted in substance to an expropriation even although title to the vessel had not been affected. Given that this vessel has been constructed over a period of years to precise Iranian specifications it would not be a commodity which could readily be marketed in the United Kingdom. By refusing an export licence with the deliberate aim of causing injury to Iranian interests we should effectively have deprived them of the use and enjoyment of their possession. There is some support from international arbitrations for the proposition that there may be a "taking" such as constitutes expropriation in international law where, even though the title remains intact, the owner is effectively denied the use of his property. Whether Iran could ultimately show that this amounted to expropriation would depend on whether the detention was prolonged and whether the ship was readily marketable. If we offered to pay the difference

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between the losses they suffered by our detention of the ship and the purchase price they could obtain by selling it elsewhere, there would be no liability under international law. In the alternative we could offer to buy the vessel from them and mitigate our own losses by selling it (which we could presumably more easily do than the Iranians). Again there would be no liability in international law, since no expropriation would have taken place if the Iranians agreed to sell the vessel to Her Majesty's Government. It should be noted that the duty under international law to expropriate only under certain conditions (which would not be satisfied here because expropriation would be discriminatory and unrelated to internal needs of the taking State) and to provide compensation is reinforced by the terms of Article 1 of the First Additional Protocol to the European Convention on Human Rights. This provision does not impose greater obligations than does customary international law, but it gives treaty force to them.

19. Although we could certainly argue in response to a government-to-government claim that we did not fail in the specific undertakings made by the Ministry of Defence, and that the refusal of an export licence could not in any circumstances amount to expropriation under international law, our position would be an exposed one from the point of view of international law. The Iranians would almost certainly not under present circumstances take us to the International Court of Justice, or even invoke arbitration under the International Chamber of Commerce Rules as they would be entitled to by virtue of the contract with the Ministry of Defence. Much more likely is that they would submit a direct government claim through diplomatic channels for full compensation, supported by argument which is more than plausible. In the event of a refusal of compensation they could well consider themselves entitled to proceed to direct retaliation against our interests in Iran.

/Conclusions

Conclusions

20. In the light of the foregoing hurried analysis of the legal position, the following tentative conclusions may be made.

- (1) In the context of a general embargo on the export of arms to Iran, and provided the ship has not become inviolable, an export licence may legitimately be refused.
- (2) If Ministers do decide not to allow the ship to be exported notice must be given that HMG refuses permission for the ship to be commissioned and at the same time notice ought to be given that an export licence is required and that one will be refused.
- (3) If action under (2) above results in the Iranians failing to pay the balance due, the ship will not be delivered. The financial consequences will be that Swan Hunter will be £10 million short on the contract price until delivery takes place. It is conceivable that the Iranians will assert frustration of the contract which will have somewhat more substantial financial implications, i.e. a return of part of the instalment (£29 million) already paid. The Iranians, however, up to now have seemed very keen to obtain the ship.
- (4) If the Iranians do offer to pay the £10 million balance Swan Hunter must deliver the ship and the issue will then become one between HMG and Iran.
- (5) If the issue is one between HMG and Iran then the Iranians may either try to remove the ship in defiance

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of UK law or submit a direct claim to HMG under international law. In either case our legal position would be weak and there would be serious risk of Iran retaliating against our interests if we failed either to furnish the ship or to pay compensation. Such compensation would amount to at least the value of the loss of the ship for such period as they were denied it.

LAW OFFICERS' DEPARTMENT

21 January 1980

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