Liability limitations under Nordic law – the example of knock-for-knock agreements

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Presentation outline

- Offshore construction in the Nordic countries – liability often regulated in so-called knock-for-knock (hereafter K4K) clauses

- Presentation today: explain what K4K is, where it comes from, advantages and disadvantages, issues of validity

- Background for presentation: article "The validity of knock-for-knock clauses in comparative perspective", ERPL Vol. 26, Nr. 1-2018, pp. 3-30, available on SSRN at https://ssrn.com/abstract=3063280

K4K: what it is, where it comes from and main components

- Knock-for-knock = agreement on allocation of liability according to which **each party bears its own losses** – regardless of who caused such loss

Originates from agreements between members of allied forces during WW2 in case of collision between ships – also applied in vehicle insurance in common law countries

- The agreement allocates liability on an objective basis (**strict liability**) and disregards considerations of fault

Widely applied in large oil and gas contracts in the North Sea because of specific risk profile (dangerous operations, high values at stake, many actors on each project = need for a clear and objective allocation of liability)

Concept migrated to offshore windmill construction – and possibly also to land construction (Oslo Airport)

K4K: what it is, where it comes from and main components

- 3 main elements:

1) Each party (for example Employer and Contractor) agrees to **bear its own losses**, regardless of who caused such losses

2) **Mutual indemnity clause**: each party (for instance Employer A) **agrees to hold the other party** (Contractor B) **harmless**, in case B had to pay compensation to a third party to cover losses which A had to cover according to the K4K agreement

3) Each party takes on **insurance** covering the assets this party is responsible for pursuant to the K4K agreement – and the insurer agrees to **waive any recourse** against the party which caused the loss

Example of K4K clause – art. 30 in NTK 2015 (Norwegian contract for oil platform construction)

Art. 30 ANSVARSFRIHET. SKADESLØSHOLDELSE

30.1 Leverandøren skal holde Selskapsgruppen skadesløs for ethvert krav som knytter seg til:

a) personskade eller tap av menneskeliv blant ansatte hos Leverandørgruppen, og
b) tap av eller skade på eiendom som tilhører Leverandørgruppen,

og som måtte oppstå i forbindelse med Arbeidet eller som er voldt av Leveransen i dens levetid. Dette skal gjelde uten hensyn til ansvarsbetingende forhold i noen form fra Selskapsgruppens side.

Leverandøren skal så langt praktisk mulig sørge for at andre selskaper i Leverandørgruppen fraskriver seg retten til å gjøre gjeldende krav som omfattes av Leverandørens plikt etter bestemmelsene i denne art. 30.1.

Art. 30 EXCLUSION OF LIABILITY. INDEMNIFICATION

30.1 Contractor shall indemnify Company Group from and against any claim concerning:

a) personal injury to or loss of life of any employee of Contractor Group, and
b) loss of or damage to any property of Contractor Group,

and which might arise in connection with the Work or be caused by the Deliverables in their lifetime. This applies regardless of any form of liability, whether strict or by negligence, in whatever form, on the part of Company Group.

Contractor shall, as far as practicable, ensure that other companies in Contractor Group waive their right to make any claim against Company Group when such claims are covered by Contractor's obligation to indemnify under the provisions of this Art. 30.1

K4K – pros and cons

- Advantages:

- Clear and simple allocation of liability = avoid long and costly disputes concerning liability and allow swift insurance payouts
- Specially important in multiparty and multicontracts structures where identification of the responsible party is difficult
- Insurance savings – avoid double coverage?
- Access to market/projects for smaller actors (ex. Specialist contractors)

- Disadvantages:

- Prevention effect of liability is lost – no incentive to act carefully?
- Doubts as to the validity of K4K clauses, in particular in jurisdictions where liability for qualified forms of behaviour (gross negligence or wilful misconduct) cannot be excluded

K4K in English law: the view of the courts

- Several examples in case law where knock-for-knock clauses deemed valid:

- Smit International (Deutschland) GmbH v. Josef Mobius Baugesellschaft & Co [2001] EWHC 531 (Comm)

" *a crude but workable allocation of risk and responsibility*"

- Supreme Court: Farstad Supply v. Enviroco Limited & Anor [2010] UKSC 18

- [Knock-for-knock clauses] "[…] *as a whole represent a carefully considered balance between the interests of the owner on the one hand and the charterer on the other*"

- Further endorsement in Caledonia North Sea Ltd v. British Telecommunication PLC [2002] UKHL 4

➢ English law = wide freedom of contract – K4K as a rule valid

K4K under Nordic law

- Norwegian law: case law on K4K
- Danish law: no case law on K4K specifically – review of court practice on validity of liability exclusions clauses generally
- Review of Nordic case law – assessment of the criteria used by Nordic judges to enforce or invalidate liability exclusions

Knock-for-knock in Nordic law – issues of contract validity – legal basis

- Nordic Contracts Act § 36, s. 1:

"*A contract can be modified or set aside, in whole or in part, if it would be unreasonable or incompatible with the principle of good faith to enforce it*"

General clause – to be applied with cautiousness in contract between professionals where parties consciously and willfully accepted risk

- Same clause, but different scope of application / issues on focus in Nordic countries

Denmark = as regards liability exclusion, focus on the severity of the breach/degree of gravity of the fault leading to the damage

Norway = hierarchical position of the tortfeasor (management v subordinate employee)

Exclusion of liability in Nordic law: validity assessment criteria

Courts in Denmark and Norway use the same criteria to justify why a liability clause shall be deemed valid or not:

- **Contract between professional and equal parties**

RT 1994.626 Pier inspector case

- Exclusion of liability is **usual in the field** and/or **contained in standard contract terms**, in particular **agreed documents**

- UfR 1999.1161 Fire on ship transporting cars from Japan to Denmark, carriage completely destroyed

Supreme Court notes that clause granting the freight forwarder an absolute right to payment as soon as the goods were loaded on the ship and regardless of subsequent circumstances was *not uncommon in international line traffic* – and therefore no need to interpret the clause restrictively

- U 2005.2438 H og U 2006.632 H Exclusion of liability covering both negligence and wilful misconduct enforced because they were contained in standard terms of transport NSAB 2000 – Court states that the conditions of contracts were drafted and agreed on by professional organisations from both sides of the transport industry (freight forwarders and transport purchasers)

Exclusion of liability in Nordic law: validity assessment criteria (cont´d)

- Norway: focus on **who** acted negligently – negligence even qualified accepted for employees but not necessarily for high ranked actors (members of management or directors)

RT 1994.626 Pier inspector case

- **Insurance** considerations:

- ND 1991.180 Eidsivating Lagmannsrett in the case Chainco v Bube:

Court states that the reasonableness assessment cannot ignore insurance ("ved rimelighedsvurdering må man ikke se bort fra forsikring")

Pier inspector case named above: The insurances were aligned with the liability regime of the contract

U 2005 2438 H and U 2006.632 H: Court states that the standard terms of contract are assumed to be based on a global assessment, among other things with regard to the insurance possibilities

Legal literature: point made that if a loss is covered by insurance, no issue of fairness for the party suffering the loss

- **Predictability**

Pier inspector case: courts should not interfere with the allocation of liability agreed on by the parties

- **Conclusion**: Exclusion of liability enforced in a large majority of cases

Exception – Knock-for-knock clause set aside by Norwegian court

- Outlier: Gulating Lagmannsrett, decision dated May 25, 2013, LG-2012-77280

Collision between shuttle tanker and container ship - liability limitation in a knock-for-knock clause set aside on grounds of gross negligence by the party invoking the clause

Court stated that ship responsible for the collision did not respect safety requirements set in the parties contract, by authorities and in legislation, which were set with a view of safety in an area where potential damages are considerable = ground to sharpen the requirements of prudence and diligence for parties operating in the area

- Value as precedent?

- Decision does not discuss specificities of knock-for-knock, notably the aligned insurance regime
- Decision does not discuss reasonableness inter partes, but for society as a whole

Conclusion: should K4K clauses be deemed valid? Reflection points

- K4K is a **well-known model** and **usual practice** between professional actors in offshore construction – arguments of **predictability** speak in favour of validity and outweigh the apparent lack of reasonableness / hurt sense of justice (but most likely not without limits – exclusion of liability for wilful misconduct may still be invalid)
- **Deterrence effect** of liability can be and is possibly achieved by other means:
  - *Professional reputation* – uncareful actors are effectively excluded from market
  - *Public law safety regulations* – but how are they monitored/enforced?
- **Insurance considerations** are decisive: what makes the regime reasonable is the fact that the losses are indeed covered - K4K is not only a limitation of liability, but but an allocation of liability which shifts the source of compensation
- Uncertainties with respect to validity lead to carve outs in the clauses (exclusion of qualified form for faulty behaviour such as gross negligence and wilful misconduct) – undermine the efficiency of the clauses (disputes over question of whether a specific case is covered by the exclusion) and should be avoided

Thank you for your attention

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