HAYNES BOONE

KNOCKING AT AN OPEN DOOR

The English law approach to mutual indemnities in the offshore oil and gas sector

Glenn Kangisser
Partner
Teena Grewal
Counsel
Mette Duffy
Counsel

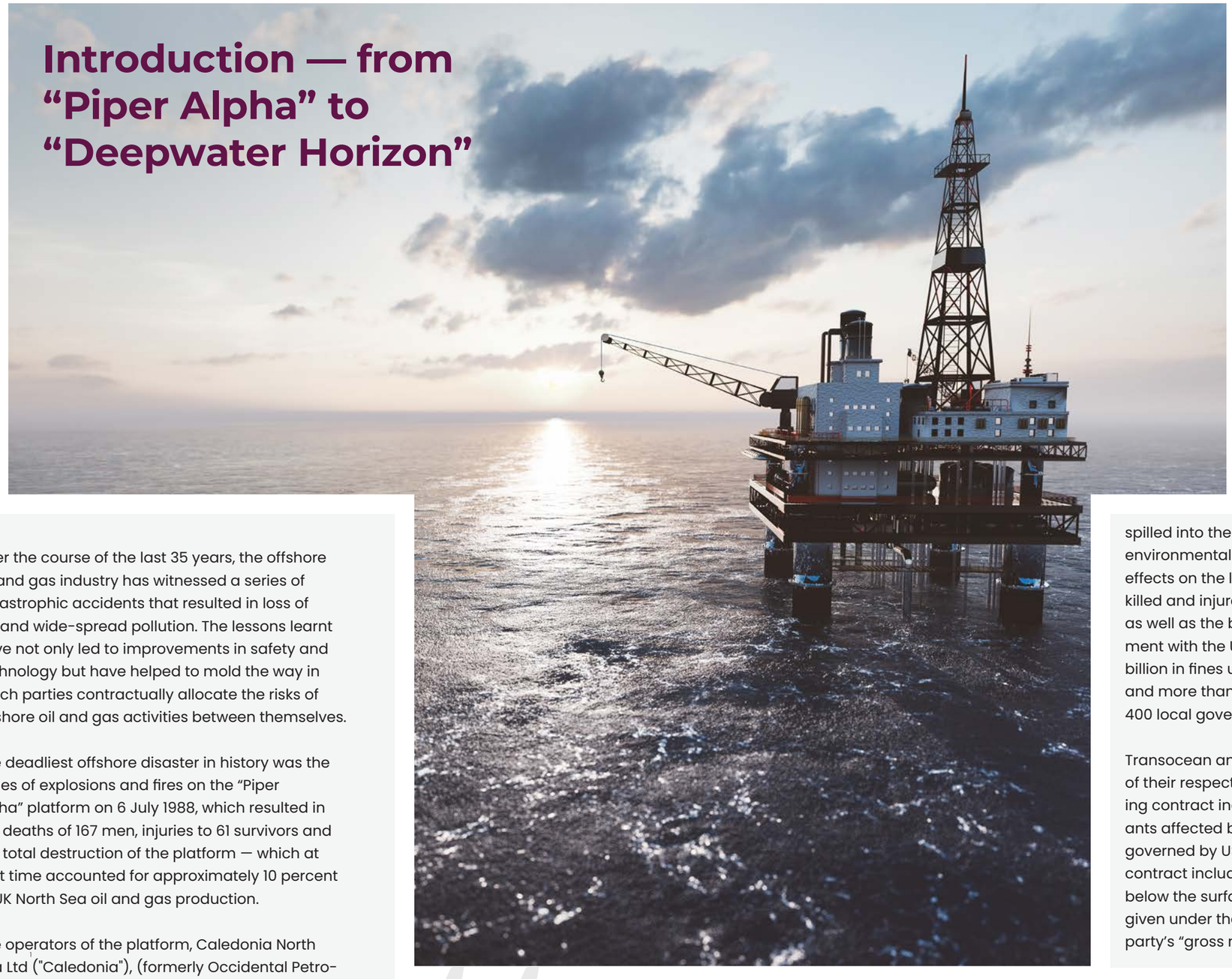
Contents

Executive Summary

The ability of an offshore contractor to survive a major offshore disaster often hinges on whether the risks of loss and damage have been appropriately allocated under its offshore contract. It is for this reason that so-called “knock for knock” indemnity clauses attract the most attention both at the drafting stages of an offshore contract and following a major incident during offshore operations.

This guide provides a summary of key issues relating to the drafting of knock for knock indemnity clauses and considers the evolution of the interpretation of these provisions by the English courts.

Introduction — from “Piper Alpha” to “Deepwater Horizon”



Over the course of the last 35 years, the offshore oil and gas industry has witnessed a series of catastrophic accidents that resulted in loss of life and wide-spread pollution. The lessons learnt have not only led to improvements in safety and technology but have helped to mold the way in which parties contractually allocate the risks of offshore oil and gas activities between themselves.

The deadliest offshore disaster in history was the series of explosions and fires on the “Piper Alpha” platform on 6 July 1988, which resulted in the deaths of 167 men, injuries to 61 survivors and the total destruction of the platform — which at that time accounted for approximately 10 percent of UK North Sea oil and gas production.

The operators of the platform, Caledonia North Sea Ltd ("Caledonia"), (formerly Occidental Petroleum Ltd), its co-venturers and insurers settled the fatal accident and personal injury claims between themselves within months of the disaster.

They then brought proceedings to enforce contractual indemnities given by the 24 contractors concerned, which had employed 189 of the men killed or injured.

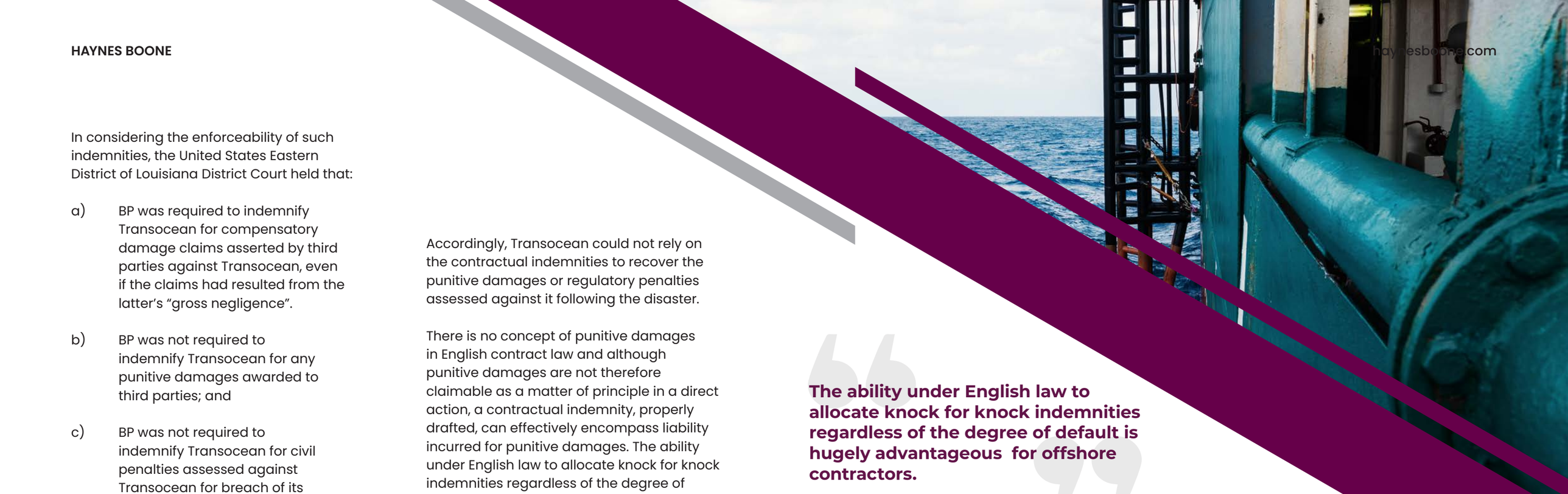
The trial of this action became the longest civil trial in British legal history, lasting almost three and a half years. The House of Lords held that Caledonia and its insurers were able to recover under the so-called “knock for knock” indemnities provided to Caledonia by its contractors under their respective contracts. In the judgment, the House of Lords also gave express recognition to the industry practice of knock for knock indemnities in the offshore sector.

More recently, the Macondo disaster of 20 April 2010 dominated news around the world for weeks; an uncontainable expulsion of oil followed a blow-out from a well being drilled for BP by Transocean’s “Deepwater Horizon” drilling rig. 11 workers died, 17 others were seriously injured, and a reported 3.2 million barrels of oil spilled into the Gulf of Mexico over 87 days, making it one of the largest environmental disasters in US history. The accident had far- reaching effects on the lives of tens of thousands of people, from the families of those killed and injured to those whose livelihoods depend on the Gulf of Mexico, as well as the broader oil and gas industry. In July 2015, BP reached a settlement with the US federal and state entities. BP agreed to be liable for US$5.5 billion in fines under the US Clean Water Act, US$8 billion in clean-up costs and more than US$6 billion in damages to nearly 65,000 claimants and to 400 local government entities affected by the spill.

Transocean and BP engaged in significant litigation to determine the extent of their respective liabilities to each other and the enforceability of the drilling contract indemnities in protecting Transocean from third party claimants affected by pollution damage. The drilling contract between them was governed by US federal maritime law. In keeping with usual practice, the contract included an indemnity from BP to Transocean for pollution risks below the surface of the water and stated that each of the indemnities given under the contract would equally apply in the case of the indemnified party’s “gross negligence.”

The trial of this action became the longest civil trial in British legal history, almost three and a half years.

1 Caledonia North Sea Limited v British Telecommunications Plc (Scotland) and Others [2002] UKHL4



In considering the enforceability of such indemnities, the United States Eastern District of Louisiana District Court held that:

a) BP was required to indemnify Transocean for compensatory damage claims asserted by third parties against Transocean, even if the claims had resulted from the latter's "gross negligence".

b) BP was not required to indemnify Transocean for any punitive damages awarded to third parties; and

c) BP was not required to indemnify Transocean for civil penalties assessed against Transocean for breach of its statutory and regulatory liabilities under the US Clean Water Act 1972; notably the court also expressly indicated that it would hold similarly concerning penalties assessed for breach of statutory and regulatory obligations under the Outer Continental Shelf Lands Act 1953.

Specifically, the federal court considered that the "public policy" purpose behind punitive damages and civil penalties levied as deterrents under the US Clean Water Act 1972 (which is to discourage defendants from conducting themselves unreasonably and to reduce the risk of future pollution incidents) and the Outer Continental Shelf Lands Act 1953 (which governs leasing and lease activities on federal oil and gas lands in the offshore areas of the US and thus regulates ongoing compliance with all aspects of operations, not just pollution events, and provides for criminal penalties in addition to civil) would be defeated if liability could be passed to another party by means of a contractual indemnity.

Accordingly, Transocean could not rely on the contractual indemnities to recover the punitive damages or regulatory penalties assessed against it following the disaster.

There is no concept of punitive damages in English contract law and although punitive damages are not therefore claimable as a matter of principle in a direct action, a contractual indemnity, properly drafted, can effectively encompass liability incurred for punitive damages. The ability under English law to allocate knock for knock indemnities regardless of the degree of default is hugely advantageous for offshore contractors.

While knock for knock indemnities and pollution indemnities are well established in the offshore oil and gas industry, their scope and interpretation are often far from straightforward. We therefore explore some of the key issues that arise in drafting effective knock for knock indemnities in offshore contracts.

ISSUE 1 — THE EXTENT OF GROUPS

One of the main purposes of knock for knock indemnities is to limit the substantial risks involved in any significant offshore project to a level acceptable to the Contractor and to avoid the need for multiple and overlapping layers of insurance. This is achieved by permitting the field operator (the "Company") and the various contractors to carry insurance covering their own equipment and personnel rather than the damage this equipment and personnel can cause to others.

The ability under English law to allocate knock for knock indemnities regardless of the degree of default is hugely advantageous for offshore contractors.

Any significant offshore development will, however, involve, among others, numerous contractors and subcontractors and the knock for knock indemnities will usually be extended to all members of each party's group. Consequently, the Contractor and the Company indemnify each other against any claims arising in connection with damage to property or injury to personnel of any member of their respective groups, including, if they fall within the Company group, the Company's other contractors and their subcontractors.

Thus, if the Contractor is held liable for damage caused to property belonging to a member of the Company's Group, the Company will be obliged to indemnify the Contractor against this liability. The Company Group member may be entitled to bring its claim against the Contractor, but will, where it is operating under a parallel indemnity scheme with the Company, be obliged to indemnify the Company against its liability to the Contractor, thereby rendering the process circular.

The ambit of the Company and Contractor Groups can, however, be the subject of considerable disagreement, with some of the larger oil companies in particular being reluctant to extend their indemnities to cover damage and injury caused to all of their other contractors and subcontractors and their property and personnel.

This reluctance reflects the administration required, the extent of the risk involved in obtaining and enforcing "back-to-back" indemnities from these other contractors and the complexity of field ownership structures.

DRAFTING NOTE

If a Contractor is not able to extend the definition of Company Group to include all of the Company's other contractors , then, if the contract does not provide an acceptable mutual hold harmless regime between the Contractor and Company's other contractors, the Contractor should consider entering into mutual hold harmless agreements with each of these contractors on an individual basis and should aim to ensure consistency of terms as much as possible.

> Post Macondo, we have seen examples of suppliers and vendors attempting to pass the risk of catastrophic incidents to the Contractor in the relevant supply contract. However, in the contract between the Contractor and the Company, the catastrophic risk indemnities which the Company gives to the Contractor Group would typically in our experience only be given to such vendors or suppliers if they are included within the definition of Contractor Group. It may be challenging to persuade the Company to include such vendors or suppliers in the definition of Contractor Group alongside subcontractors in its contract with the Contractor, especially where their equipment was not directly supplied for the performance of work under that contract. The Contractor should therefore consider very carefully how to address such risk before it provides such indemnities to its vendors and suppliers.

ISSUE 2 — DEALING WITH NEGLIGENCE

(a) "Simple" negligence

In *Canada Steamship Lines Ltd v The King*,[2] a fire caused as a result of negligence of the Crown's employees gave rise to a claim by Canada Steamship against the Crown for damages. The Privy Council held that since the fire had been caused by the negligence of the Crown's employees, it was not exempted from liability or entitled to an indemnity under the terms of the contract. Lord Morton, sitting on the Privy Council, formulated the following three-stage approach to guide the interpretation of clauses purporting to exclude liability for negligence altogether:

1. If the clause contains language which expressly exempts [the defendant] from the consequence of the negligence of his own servants, effect must be given to that provision;
2. If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the [defendant];
3. If the words used are wide enough for the above purpose, the court must then consider whether the exclusion clause is capable of applying to negligent and non-negligent breaches, which are not fanciful. If it is, then one should approach the exclusion clause on the basis that it was not intended to exclude liability for negligence unless the clause makes such an intention clear.

Although the Canada Steamship case was cited with approval by both the Court of Appeal and the House of Lords in subsequent years, in the case of *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*,[3] Lord Bingham commented on Lord Morton of Henryton's statement in Canada Steamship, as follows:

"Lord Morton was giving helpful guidance on the proper approach to interpretation and not laying down a code. The passage does not provide a litmus test which, applied to the terms of the contract, yields a certain and predictable result. The Court's task of ascertaining what the parties intended, in their particular commercial context, remains."

In recent years the English courts have softened their approach to exemption clauses[4] and indemnity clauses and have increasingly moved away from any strict application of the Canada Steamship guidelines.

In a case involving an indemnity clause contained in a share purchase agreement, the Court of Appeal in *Capita (Banstead 2011) Ltd v RFIB Group Ltd*[5] quoted with approval the following passage from *Capita (Banstead 2011) Ltd v RFIB Group Ltd*[6] (where Popplewell J summarised the principles to be gleaned from the authorities in this area at the time):

1. *The Canada Steamship principles are not to be applied mechanistically and ought to be considered as no more than guidelines; the task is always to ascertain what the parties intended in their particular commercial context in accordance with the established principles of construction: They nevertheless form a useful guide to the approach where the commercial context makes it improbable that in the absence of clear words one party would have agreed to assume responsibility for the relevant negligence of the other.*
2. *"A clear intention must appear from the words used before the Court will reach the conclusion that one party has agreed to exempt the other from the consequences of his own negligence or indemnify him against losses so caused. The underlying rationale is that clear words are needed because it is inherently improbable that one party should agree to assume responsibility for the consequences of the other's negligence": Smith at p. 168D-E; Ailsa Craig at p.970; HIH at [11], [63]; Lictor at [36].*
3. *These principles apply with even greater force to dishonest-wrongdoing, because of the inherent improbability of one party assuming responsibility for the consequences of dishonest-wrongdoing by the other. The law, on public policy grounds, does not permit a party to exclude liability for the consequences of his own fraud; and if the consequences of fraudulent or dishonest misrepresentation or deceit by his agent are to be excluded, such intention must be expressed in clear and unmistakable terms on the face of the contract. General words will not serve. The language must be such as will alert a commercial party to the extraordinary bargain he is invited to make because in the absence of words which expressly refer to dishonesty the common assumption is that the parties will act honestly: HIH at [16], [68]-[75], [97]".*

This three-stage approach was discussed in *Persimmon Homes Ltd v Ove Arup & Partners Ltd*,[7] where Jackson LJ commented:

"Over the last 66 years there has been a long running debate about the effect of that passage [in the Canada Steamship case] and the extent to which it is still good law. In hindsight we can see that it is not satisfactory to deal with exemption clauses and indemnity clauses in one single compendious passage. It is one thing to agree that A is not liable to B for the consequences of A's negligence. It is quite another thing to agree that B must compensate A for the consequences of A's own negligence…my impression is that, at any rate in commercial contracts, the Canada Steamship principles (insofar as they survive) are now more relevant to indemnity clauses than to exemption clauses".

2. [1952] A.C. 192
3. [2003] UKHL 6
4. Please also note the paper on "Limiting Your Liability – Drafting Effective Limitation Clauses in Offshore Drilling Contracts" by Glenn Kangisser, Partner.
5. [2015] EWCA Civ 1310
6. [2014] EWHC 2197 (Comm)
7. [2017] EWCA Civ 373

In *PA(GI) Limited v Cigna Insurance Services (Europe) Limited*[8], the Commercial Court found in favour of the claimant, PA(GI) Limited ("PAGI") in a trial of preliminary issues relating to claims for indemnification for payment protection insurance ("PPI") mis-selling liabilities and related costs under a business transfer agreement ("the Agreement")[9]. In her judgement, the Judge, Dame Clare Moulder DBE, after considering recent cases, found that the indemnities given by Cigna Insurance Services (Europe) Limited ("Cigna") in the Agreement did apply in the case of negligence and/or breach of regulatory/statutory duty even though there was no express mention of negligence and/or breach of regulatory/statutory duty in the indemnities.

Cigna provided an indemnity in the Agreement to the Seller, Royal & Sun Alliance Insurance plc ("R&SA") and members of the Seller's Group, which at that time included PAGI, that the Buyer, Cigna, shall: *"(a) assume liability for and indemnify and keep indemnified the Seller or any other member of the Seller's Group against the payment or performance of the Liabilities with effect from…….and any and all actions, costs, claims, losses, liabilities, proceedings or expenses (including reasonable legal expenses) which the Seller (or other member of the Seller's Group) may suffer or incur in respect thereof".* "Liabilities" was defined in the Agreement as all liabilities of the Business (except for certain Excluded Liabilities).

DRAFTING NOTE

The simplest way of avoiding the scope for argument as to whether or not the indemnities apply notwithstanding negligence is to state so expressly in the indemnity provisions. But see our comments below on "gross" negligence and wilful misconduct.

8. [2023], EWHC 1360 (Comm)
9. *Please see Haynes and Boone article "Update on contractual indemnities under English law" by Glenn Kangisser (Partner) and Teena Grewal (Counsel).*

In reaching her decision, the Judge also considered the Supreme Court's decision in *Triple Point Technology Inc v PTT Public Co Ltd*[10], where Lord Leggatt acknowledged in his judgement that commercial parties are free to make their own bargains and allocate risks as they think fit and the task of the Court is to interpret the words used fairly applying the ordinary methods of contract interpretation. He stated that *"Although its strength will vary according to the circumstances of the case, the court in construing the contract starts from the assumption that in the absence of clear words the parties did not intend the contract to derogate from these normal rights and obligations."*

Citing previous authority, Lord Leggatt re-stated the principles that: (i) a party is unlikely to have agreed to give up a valuable right that it would otherwise have had without clear words ; and (ii) the more valuable the right, the clearer the language will need to be.

In reaching its decision in that case, the court also considered the factual context, including that it was inherently unlikely in its view to have been the parties' intention to leave the claimant, which was a subsidiary of the defendant, with any liabilities which it could not pass on to the defendant, as the defendant had agreed in a sale agreement with the claimant to take over all of the claimant's property rights and assets.

The Judge found in this case that liabilities for PPI mis-selling (save as regards the life element of the liabilities) were within the scope of the relevant indemnities in the Agreement other than where such liabilities arose as a result of fraud or dishonesty (including deceit) on the part of PAGI's agent such that the indemnity was held to apply in the case of negligence and/or breach even though there was no express reference to that in the indemnities. In reaching her decision, the Judge considered the indemnity language, business common sense and the factual context, including the overall structure of the sale of the business as a going concern by PAGI's parent company to Cigna as part of a management buy-out, the risk of PPI mis-selling being in the reasonable contemplation of the parties and that in another related document where the parties did not want a clause to apply in the case of negligence, that was expressly stated.

10. [2021] UKSC 29

(b) "Gross" negligence [11]

Judge Carl Barbier issued a hugely significant ruling in September 2014 in the litigation following the Macondo blow-out. The finding that this "*was the result of gross negligence and wilful misconduct*" on the part of BP made it possible for courts to impose penalties of up to US $18 billion under the US Clean Water Act 1972. The finding of gross negligence and wilful misconduct is clearly very significant in terms of the level of damages payable by BP, but what is the approach of the English courts to "simple" and "gross" negligence?

While gross negligence has an established meaning under English criminal law, under English civil law, courts have historically held that gross negligence is not distinct from simple negligence.

In 1997, Lord Justice Millett in the Court of Appeal in *Armitage v Nurse* [12] said that *"It would be very surprising if our law drew the line between liability for ordinary negligence and liability for gross negligence. In this respect, English law differs from civil law systems, for it has always drawn a sharp distinction between negligence, however gross, on the one hand and fraud, bad faith and wilful misconduct on the other". He did refer to it being a difference "merely one of degree."*

However, if commercial parties use the term "gross negligence" in indemnity and limitation of liability provisions in a contract governed by English law, the English courts now appear willing to give meaning to "gross negligence" as being something beyond simple negligence. In *Camerata Property Inc. v Credit Suisse Securities (Europe) Ltd*, [13] Mr Justice Andrew Smith said that, when interpreting references to "gross negligence" in a modern contract, the correct question "*is not whether generally gross negligence is a familiar concept in English civil law, but the meaning of the expression*" in the contract.

Since the expressions "negligence" and "gross negligence" were both used in the contract, he could not accept that the parties intended the term "gross negligence" to mean mere negligence. The Judge stated that the distinction between gross negligence and negligence is one of degree and not of kind and as such "*it is not easy to define or even to describe with any precision*". The Judge endorsed Mr Justice Mance's non-binding statement in *Red Sea Tankers Ltd v Papachristidis* [14] ("the "Ardent"), a case which related to a contract governed by New York law , that *"If the matter is viewed according to purely English principles of construction,…"Gross" negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence",* and there is no reason to depart from conventional English law principles of construction when giving effect to a limitation clause. Mance J also stated that *"as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious [dis]regard of or indifference to an obvious risk."* In the case *(1) Toucan Energy Holdings Limited; (2) Toucan Gen Co Limited;* [15] *and (1) Wirsol Energy Limited and (2) Wircon UK Solar Assets GmbH; and (3) Wircon GmbH* , the Judge held in relation to one point that there was *"indifference to an obvious risk so as to constitute gross negligence for the purposes o*f" a carve-out from a limitation clause in the EPC Contract. Therefore, while there is still no accepted definition of gross negligence under English law, if the term is to be used in an English law contract without being specifically defined, the courts will seek to interpret the phrase in the context of the contract as a whole.

11. This topic is addressed in more detail in Haynes and Boone CDG, LLP's Briefing Note "The US $18 billion question– is there a distinction between "gross" negligence and "simple" negligence under English law? By Glenn Kangisser and Teena Grewal
12. [1997] EWCA Civ 1279
13. [2011] EWHC 479
14. [1997] 2 Lloyd's Rep. 547
15. [2021] EWHC 895 (Comm)

DRAFTING NOTE

In order to avoid such uncertainty as to how the term "gross negligence" may be interpreted in a contract, if the parties to a contract wish to make no distinction between gross and simple negligence, the parties should refer in their contracts only to "negligence" or, alternatively, "negligence (in any form)." If, however, the parties wish to provide that the indemnities and limitations in the contract will apply in the case of simple negligence, but not in the case of gross negligence, then they should include a specific definition of "gross negligence" in the contract and also clarify whose gross negligence is to be carved out from the indemnities and limitations in the contract, so the lines of demarcation are clearly drawn.

ISSUE 3 — APPLICATION IN THE CASE OF BREACH

While the practice that mutual knock for knock indemnities are expressed to apply irrespective of negligence is well established, less consideration is often given at the drafting stage to the extent to which the indemnities should also apply where the damage is caused by breach of contract or breach of statutory duty:

(a) Breach of contract

In the *Super Scorpio II* (1998), [16] the Contractor (Smedvig) and the Company (Elf Exploration) exchanged knock for knock indemnities, with the Company agreeing to indemnify the Contractor against all claims in respect of or in connection with damage to Company's Items. Smedvig undertook to "*take all necessary care of Company's Items as required by good oil and gas industry practice and to return them to the Company in their original condition" and "to ensure the storage, safekeeping, protection and the general maintenance by its personnel of Company's Items.*"

During offshore operations, a Company Item, the "Super Scorpio II," a remotely operated vehicle (ROV), was damaged by the negligence of one of Smedvig's employees. The owners of the "Super Scorpio II" obtained damages from Smedvig for the cost of repairing the ROV, and Smedvig in turn sought an indemnity from the Company against this liability.

Elf Exploration accepted that the ROV was a Company Item but contended that the Company's obligation to Indemnify the Contractor in respect of any damage done to a Company Item did not apply where the act which gave rise to the claim was itself a breach by the Contractor of its obligation under the contract to take all necessary care of the Company's Item.

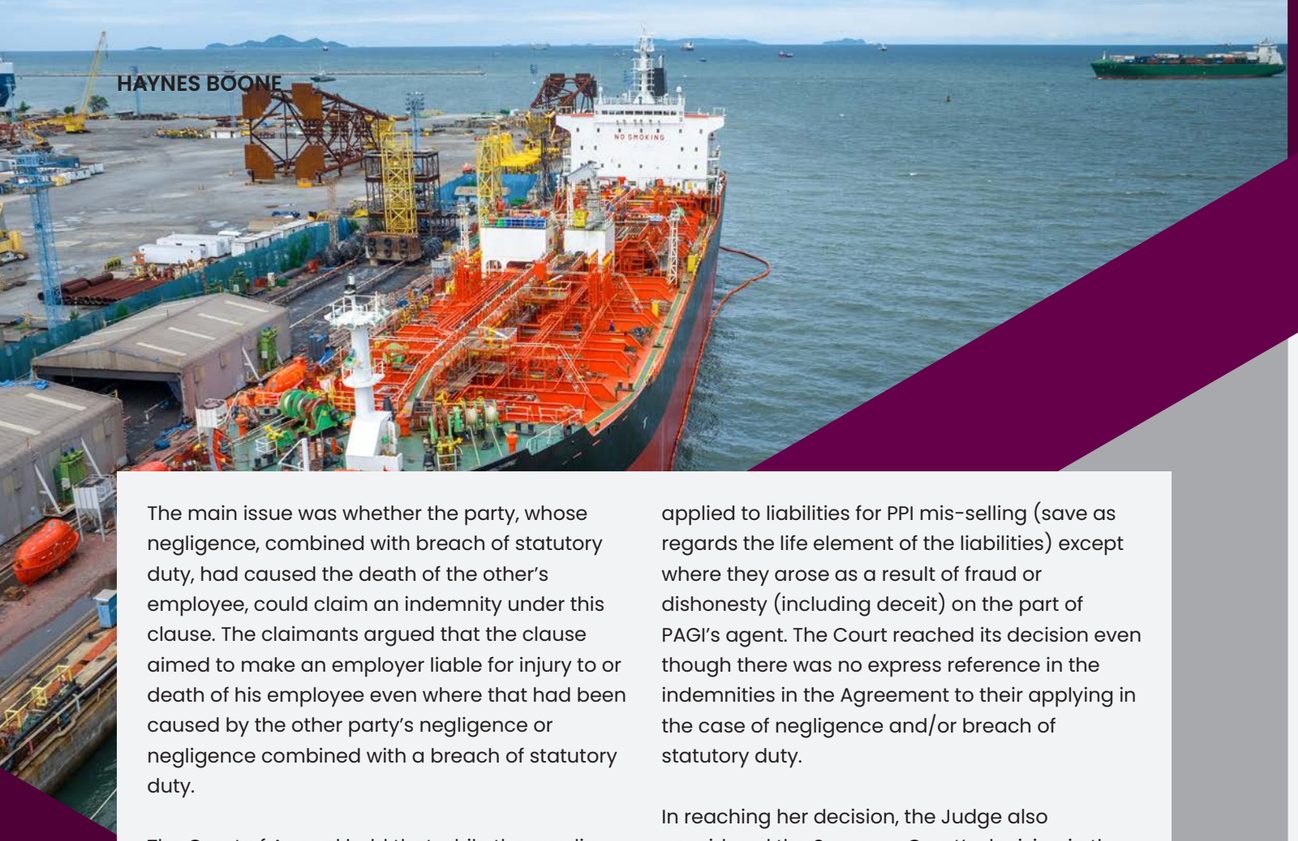
The Court held that the allocation of risk in the contractual indemnities was clear. The Contractor remained obliged to take care of any Company Item entrusted to it, but the financial consequences of any damage to property caused by lack of care were nonetheless dealt with under the knock for knock indemnity regime.

(b) Breach of statutory duty

In *EE Caledonia Ltd v Orbit Valve*, [17] the defendant engineers agreed to supply one of their service engineers to work on the "Piper Alpha" which was jointly owned and operated by the claimants. Under the contract, each agreed to indemnify "*the other … from and against any claim … or liability (including the cost of litigation) arising by reason of any injury to or death of an employee … of the indemnifying party, resulting from or in any way connected with the performance of this Order.*"

The service engineer was killed in the explosion and fire on the rig whilst off duty and his dependants successfully sued the claimants for negligence and breach of statutory duty. They, in turn, started proceedings under the indemnity clause in their contract with the engineer's employers, the defendants.

16. [1998] 2 Lloyd's Rep. 659
17. [1994] 1. W.L.R 1515



The main issue was whether the party, whose negligence, combined with breach of statutory duty, had caused the death of the other's employee, could claim an indemnity under this clause. The claimants argued that the clause aimed to make an employer liable for injury to or death of his employee even where that had been caused by the other party's negligence or negligence combined with a breach of statutory duty.

The Court of Appeal held that while the wording of the indemnity was potentially wide enough to include death and personal injury caused by negligence, an alternative cause of action, namely for losses caused by breach of statutory duty, potentially also fell within its framework. Since the alternative cause of action was not fanciful or remote, applying the Canada Steamship principles, the court held that the possibility of that other cause of action meant that the claimants could not rely upon the indemnity given to it since their own negligence and breach of statutory duty had together caused the death of the defendant's employee.

By comparison, in its more recent decision in *PA (GI) Limited v Cigna Insurance Services (Europe) Limited* discussed above, the Commercial Court found that the indemnities given by Cigna in the business transfer agreement ("the Agreement") applied to liabilities for PPI mis-selling (save as regards the life element of the liabilities) except where they arose as a result of fraud or dishonesty (including deceit) on the part of PAGI's agent. The Court reached its decision even though there was no express reference in the indemnities in the Agreement to their applying in the case of negligence and/or breach of statutory duty.

In reaching her decision, the Judge also considered the Supreme Court's decision in the *Triple Point* case discussed above in which Lord Leggatt acknowledged that the task of the court is to interpret the words used fairly applying the ordinary methods of contract interpretation.

In reaching her decision, the Judge considered the broad language of the indemnities and the factual context. The Judge noted that the Agreement was professionally drafted and complex and in these circumstances the Court is entitled to give significant weight to the language used particularly where it is clear and unambiguous. The Judge did not consider that the factual context of this case altered the broad language of the indemnities.

DRAFTING NOTE

An express statement in the contract to reflect expressly the intention of the parties as to whether or not an indemnity applies notwithstanding negligence or breach of duty (statutory or otherwise) would avoid the scope for argument on this point.

ISSUE 4 — WILFUL MISCONDUCT

Although it is common to provide that indemnities apply regardless of the indemnified party's negligence, the issue of whether such indemnities apply in the event of the indemnified party's wilful misconduct is much more controversial. The approach of the English courts to wilful misconduct is summarised in the following cases:

In *National Semiconductors (UK) Ltd v UPS Ltd*[18], a valuable cargo of semiconductors belonging to the claimant was to be delivered by the defendant to Milan.

The driver of the vehicle carrying the semiconductors parked in a street while waiting for the time when the vehicle could be unloaded. He avoided an area where he knew it was unsafe to park and chose a well lit street, then went to eat at a restaurant from which he could not see the vehicle, against company instructions. Upon his return, the vehicle had vanished. The claimant sought to recover the full value of the cargo on the grounds of the wilful misconduct of the driver.

Mr Justice Longmore reviewed previous authorities, and summarised that in order for wilful misconduct to be proved, there must be either:

(i) an intention to do something which the person knows to be wrong; or

(ii) a reckless act in the sense that the person is aware that loss may result from his act and yet does not care whether loss will result or not. Recklessness involved somebody taking a risk which he knew he ought not to take.

On the facts, the Judge held that the claimant had not established wilful misconduct since there was no conscious taking of risk by the driver.

Mitsubishi Corp v Eastwind Transport Ltd[19] and others related to the applicability of an exclusion clause in a contract of carriage to damage to goods caused during the voyage. The exclusion clause provided that the shipowner "shall not be responsible for loss or damage to or in connection with the Goods of any kind whatsoever (including deterioration, delay or loss of market) however caused (whether by unseaworthiness or unfitness of the vessel…or by faults, errors or negligence, or otherwise howsoever)."

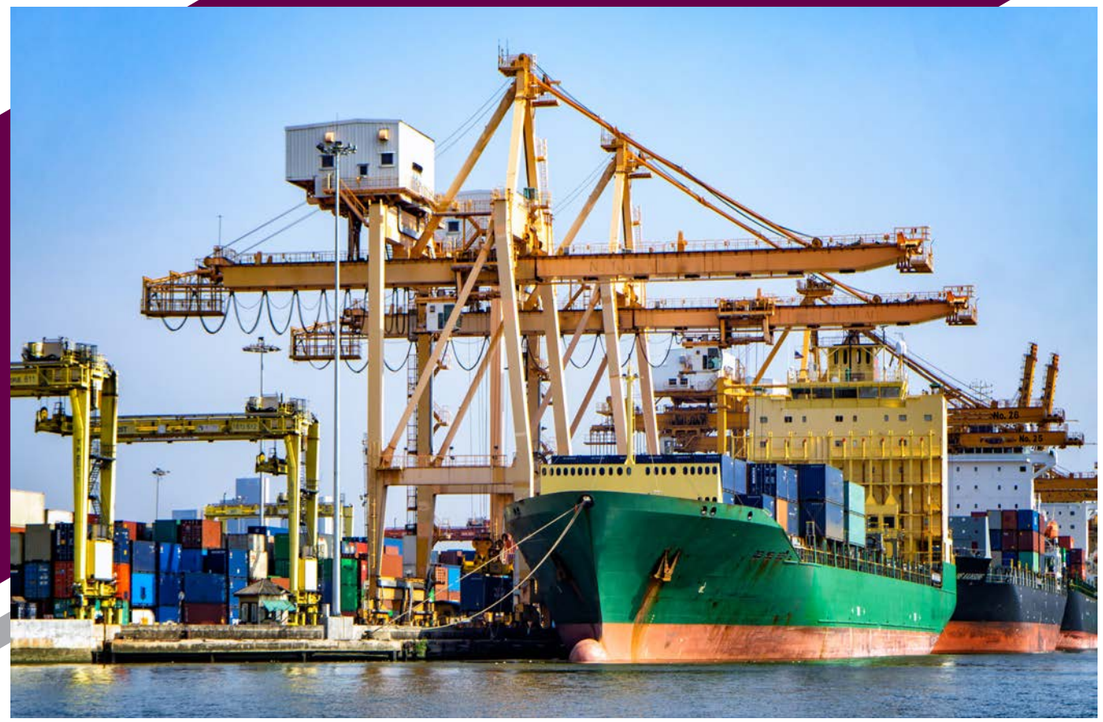
In deciding that the clause was enforceable and covered the damage in question, the Court said that, notwithstanding the apparently wide wording used in the clause when considered in light of the purpose of the contract as a whole, it would not cover loss and damage caused by dishonesty; it would not be strong enough to relieve the carrier from liability for loss or for damage to the goods caused by it arbitrarily refusing to ship them to the port of discharge at all.

In deciding that the clause was enforceable and covered the damage in question, the Court said that, notwithstanding the apparently wide wording used in the clause when considered in light of the purpose of the contract as a whole, it would not cover loss and damage caused by dishonesty or arbitrary refusal to ship the goods.

DRAFTING NOTE

In order to avoid uncertainty as to whether or not an indemnity or an exclusion or limitation of liability clause applies in the event of a party's wilful misconduct, the parties should specify in the contract whether the indemnities, exclusion and limitation of liability clauses are to apply in the event of wilful misconduct and define what conduct constitutes wilful misconduct.

18. [1996] 2 Lloyd's Rep. 212
19. [2004] EWHC 2924



ISSUE 5 — ADDRESSING CONSEQUENTIAL LOSSES

Most offshore oil and gas contracts will also exclude the liability of either party for its, and its group's, own "*consequential loss*". The term "*consequential loss*" will normally be broadly defined in a contract so as to include, among other things, any loss or deferral of production, loss of product, loss of revenue and loss of profit, and the parties will usually also agree to indemnify each other and the members of their respective groups against such loss.

Under English law, there are various losses typicall included for breach of contract are recoverable if the two-limbed test of remoteness in *Hadley v Baxendale*[20] is satisfied.

The first limb allows the recovery of losses which arise directly and naturally from the breach of contract and which are reasonably foreseeable in the ordinary course of events. These are known as direct losses. The second limb allows the recovery of losses which arise from a special circumstance of the case and which may reasonably be supposed to have been in the contemplation of the parties at the time that they made the contract, as a probable result of the breach of contract. Losses under the second limb are known as indirect or consequential losses.

Under English law, various losses typically included in the definition of consequential loss in contracts, e.g, loss of profit, loss of revenues and loss of savings can be either a direct or an indirect loss, depending upon whether the specific loss satisfies the first or second limb of *Hadley v Baxendale*.

A number of decisions of the English courts have established that contractual exclusions for "consequential and indirect losses" will be limited to losses which fall within "limb two".[21] For instance, in *British Sugar plc v NEI Power Projects Ltd* the Court of Appeal referred to the decisions in several cases, including *Croudace Construction Limited v Cawoods Concrete Products Limited*[22] which established that the word "consequential" did not cover losses which occur naturally or directly (i.e "limb one" of *Hadley v Baxendale*).

In *Markerstudy Insurance Company Limited v Endsleigh Insurance Services Limited*,[23] a clause excluded liability for *"any indirect loss or consequential loss (including but not limited to loss of goodwill, loss of business, loss of anticipated profits or savings and all other pure economic loss)".*

Mr Justice Steel construed this clause as only excluding liability for indirect or consequential losses. He stated that the use of the phrase "*including but not limited to*" is a strong pointer that the specified heads of loss are but examples of excluded indirect loss. Therefore, to the extent that any loss of goodwill, loss of business, loss of anticipated profits or savings claimed represented direct losses (i.e., they arose naturally from the breach in question), liability for those losses was not excluded under this clause.

Another clause in the contract excluded liability for *"any indirect or consequential loss or loss of profit or loss of business".* Mr Justice Steel acknowledged that the specified forms of loss are free-standing and inclusive of both direct and indirect loss. However, he held that the introductory phrase "*any indirect or consequential loss*" governed and defined the

20. [1854] EWHC Exch J70

21. [1997] EWCA Civ 2438

22 [1978] 2 Lloyds Rep 55

23. [2010] EWHC 281 (Comm)

scope of the specified forms of loss. Therefore, to the extent that the loss of profits or loss of business claimed was a direct loss under English law, it was not excluded by this clause.

By comparison, in *Star Polaris LLC v HHIC-PHIL Inc*,[24] the High Court was asked to consider the effect of an exclusion clause and in particular the meaning of the term "consequential losses". The court rejected the contention that the term must be given the meaning attributed to it in a number of previous court decisions (namely, that it merely covered losses falling within the second limb of *Hadley v Baxendale*), as the parties would have contracted against the background of these previous decisions. The court gave the term (and therefore, the exclusion of liability clause) a broader meaning so that it excluded all losses that were factually caused by a breach of contract, save as otherwise expressly permitted by the terms of the contract.

The underlying dispute concerned the purchase of a ship by Star Polaris ("the Buyer") from HHIC-PHIL (the "Seller"). Following delivery, the ship suffered a serious engine failure and was towed to Korea for repairs. The Buyer sought damages. The contract provided that:

"*Except as expressly provided in this Paragraph, in no circumstances and on no ground whatsoever shall the BUILDER [Seller] have any responsibility or liability whatsoever or howsoever arising in respect of or in connection with the VESSEL or this CONTRACT after the delivery of the VESSEL. Further, but without in any way limiting the generality of the foregoing, the BUILDER [Seller] shall have no liability or responsibility whatsoever or howsoever arising for or in connection with any consequential or special losses, damages or expenses unless otherwise stated herein.*"

24. [2016] EWHC 2941 (Comm)

The Buyer contended that its claims (including for diminution in value of the vessel) were recoverable. The arbitral tribunal allowed the Buyer to claim the cost of repairing the vessel but held that the Seller's liability to the Buyer for all other losses (such as the claim for diminution in value) was excluded as they constituted "consequential and special losses." The Buyer appealed that finding to the Court.

The Court considered whether the term "consequential losses" worked to exclude all losses that were caused by a breach of contract (as the Seller contended) or whether the term merely sought to exclude liability for losses that fell within the second limb of *Hadley v Baxendale*.

The Court pointed out that the meaning given to the term "consequential losses" had to be interpreted in the context of the contract in question. As the contract:

- imposed a liability on the Seller for defects and all repair and replacement costs;
- expressly provided for the Buyer to be responsible for the removal costs to the Seller's shipyard or other port; and
- stated that the buyer would have no responsibility or liability for breach of contract after delivery of the vessel, save as [expressly] provided by the terms of the contract

, the contract therefore provided as a complete code for contractual liability. As the particular losses for which the Seller would be responsible were listed in the contract, and as there was no express provision allowing the Buyer to make a claim for financial loss or diminution in value, the claim for diminution in value was not recoverable.

In those circumstances, the Court agreed with the Tribunal's decision that the term "consequential losses" was used in a cause-and-effect sense. It excluded liability for all financial losses that were caused by a breach of contract, save for the cost of replacement and repair, and not merely those losses that fell within the second limb of *Hadley v Baxendale*. The claim for diminution in value of the vessel was therefore excluded.

The Court pointed out that the wording in the contract must be given its ordinary meaning. In reaching its decision, the Court also considered that it was of fundamental importance in considering this clause that the contract provided a complete code for determining liability. The Court noted that *"It is not therefore a question of simply determining what liability is excluded, but ascertaining what liability is undertaken".*

The Buyer had relied on a series of authorities which lay down the principle of interpretation that a clause which excludes liability for consequential loss excludes liability only for damages falling within the second limb of the rule. Chitty on Contracts (31st Ed). Summarizes the position: *"The exclusion of liability for "consequential loss or damage" will not cover loss which directly and naturally results in the ordinary course of events from the breach, but only loss which is less direct or more remote".*

The Court agreed with the Tribunal that while the meaning of "consequential loss" in an exemption clause usually meant the exclusion of losses falling within the second limb of *Hadley v Baxendale*, unless the particular exclusion clause which they were considering in this contract had been the subject of specific judicial consideration, they were not bound to follow any such decisions. The Court emphasized that any particular clause fell to be construed on its own wording in the context of the particular agreement as a whole and its particular factual background. The Court agreed with the Tribunal that in the context in which the words "consequential loss" were used in the contract, the word "consequential" was used in a cause and effect sense.

By comparison, in April 2020, the Technology and Construction Court upheld the traditionally narrow interpretation of indirect and consequential loss exclusion clauses in *2 Entertain Video Ltd & Ors v Sony DADC Europe Ltd*.[25] The judgment also highlights the well-established legal principles of contract construction whereby a court's task is to ascertain the objective meaning of the language that parties have chosen to express their agreement, having regard to the meaning of the

25. [2020] EWHC 972 (TCC)

language that parties have chosen to express their agreement, and having regard to the meaning of the relevant words in their documentary, factual and commercial context.

The claim arose out of an arson attack on Sony's warehouse in North London during the riots that occurred across London and other cities following the shooting of Mark Duggan. On the night of 8 August 2011, the defendant's warehouse was burned down by a gang of rioters carrying petrol bombs, destroying the warehouse and all of its contents.

The claimants were commercial divisions of the BBC who publish, market and sell pre-recorded Blu-ray discs, DVDs, CDs and other home entertainment media. The defendant, Sony, provides logistics services, including warehouse storage and distribution of home entertainment media. The claimants and the defendant entered into a logistics services agreement under which the defendant agreed to provide logistics services for the claimants, including storage and distribution facilities at the warehouse.

At the time of the fire, the claimants had stock with a sales value of approximately £40 million stored at Sony's warehouse. The court held that Sony should have taken more steps to prevent the fire. In particular, the Agreement required Sony to ensure that adequate security measures were in place and that the goods were kept in a secure location. However, the warehouse security was insufficient and the court held that the primary cause of damage was negligence on the part of Sony, rather than the fire.

The claimants were compensated for the value of the loss of their stock by the defendant's insurers but commenced proceedings to pursue further claims, such as loss of profits and business interruption losses. One legal issue that the case raised related to the meaning and effect of the following exclusion clause:

"*Neither party shall be liable under this Agreement in connection with the supply of or failure to supply the Logistics Services for any indirect or consequential loss or damage including (to the extent only that such are indirect or consequential loss or damage only) but not limited to loss of profits, loss of sales, loss of revenue, damage to reputation, loss or waste of management or staff time or interruption of business.*"

As discussed above, under English law, loss of profits, sales or revenue can either be a direct or an indirect loss, depending upon whether the specific loss satisfies "limb one" or "limb two" of *Hadley v Baxendale.*

The defendants argued that the claimants' claim fell within "limb two" of *Hadley v Baxendale* and therefore could not be pursued or recovered as they would be excluded by the above exclusion clause.

In addition to referring to the traditional line of authority, the court also made reference to the recent line of authority that challenges the traditional approach of categorizing losses. In *Transocean Drilling UK Limited v Providence Resources plc*,[26] the Court of Appeal noted that courts *"are more willing to recognize that words take their meaning from their particular context and that the same word or phrase may mean different things in different documents.*" Similarly, in the *Star Polaris* case discussed above, the court stated that "*although the meaning of "consequential loss" in an exemption clause usually meant the exclusion of losses falling within the second limb of Hadley v Baxendale, in the absence of judicial consideration of the clause in question, it should be construed on its own wording in the context of the particular agreement as a whole and its particular factual background*".

However, the court ultimately reached the same conclusion in this case as the traditional approach and decided that the direct and natural result of the fire was the destruction of the goods and the warehouse, causing lost profits and business interruption losses to the claimants.

26. [2016] EWCA Civ. 372

The court reached this decision in particular due to the (highlighted) words "*any indirect or consequential loss or damage* ***including (to the extent only that such are indirect or consequential loss or damage only***) but not limited to loss of profits…" in the exclusion clause covered by such exclusion.

The 2023 case, *EE Limited v Virgin Mobile Telecoms Limited*[27], considered questions of whether the losses sought to be recovered by one party, EE Limited ("EE") against the other party, Virgin Mobile Telecoms Limited ("Virgin Mobile") for a breach of an exclusivity obligation should be properly classified as a "loss of profit", which was excluded under the agreement between them.

The case concerned the provision by EE of 2G, 3G and 4G mobile network services to Virgin Mobile under a Telecommunications Supply Agreement ("TSA"). EE claimed that Virgin Mobile had breached its exclusivity obligation under the TSA to use EE's network in providing services to Virgin Mobile's customers. EE claimed substantial damages for losses representing amounts that it says Virgin Mobile would have been obliged to pay EE under the TSA if it had not breached the exclusivity clause.

Virgin Mobile denied that it was in breach and claimed, among other things, that EE's claim was excluded by clause 34.5 (a) of the TSA which excluded the parties' liability to each other for "*anticipated profits*" or "*anticipated savings*". The exclusion applied in all circumstances except in the case of wilful or reckless misconduct or gross negligence.

EE referred to several cases, including *The Ease Faith*[28], to argue that its claim was not a claim for loss of profit. This was a shipping case concerned with whether a claim was excluded by a clause excluding liability for *"loss of profit, loss of use, loss of production or any other indirect or consequential damage for any reason whatsoever."*

In *The Ease Faith*, the owner of a vessel claimed damages under a tug hire contract for the late delivery of the vessel to a buyer in China. Such damages were for the reduced sale price of the vessel due to late delivery. The court considered in that case that such loss *"is more akin to a diminution of price than a loss of profit".* It also noted that the exclusion clause in that contract only excluded liability for indirect loss of profit due to the words *"or any other indirect or consequential damage"* in the exclusion clause.

EE also claimed that on Virgin Mobile's interpretation of clause 34.5 (a), EE "*would have no remedy at all*" for Virgin Mobile's breach of the exclusivity clause, depriving it of all contractual force and turning it into a mere statement of intent. EE claimed that the TSA should be construed so as to avoid this result.

EE relied upon *Kudos Catering (UK) Ltd v Manchester Central Convention Complex Ltd*,[29] a case which concerned a claim for lost profits arising by reason of the repudiatory breach of a contract for the provision of catering services. In the Kudos case, the Court of Appeal construed a clause referring to lost profits in its particular context, so as to have a narrow meaning, namely lost profits arising by reason of the defective performance of the agreement and not lost profits arising by reason of the defendant's complete refusal to perform the contract. Lord Justice Tomlinson (as he then was) observed that it was inherently unlikely that the parties could have intended the clause to have a wider effect in circumstances where that would render the agreement as *"effectively devoid of contractual content since there is no sanction for non-performance."*

The Court found that EE's claim for damages against Virgin Mobile was a claim for loss of profits which was excluded by the terms of clause 34.5 (a) of the TSA and granted summary judgment in Virgin Mobile's favour.

The Court considered that the facts of this case were different to *The Ease Faith* and there was no "difference in price" analysis available to EE. The Court also considered that case law concerning a claim for wasted expenditure was also not relevant and found that EE's claim was in fact a claim for loss of profits.

27. ([2023] EWHC 1989 (TCC)),
28. ([2006] 1 Lloyd's Rep. 673)
29. ([2013] EWCA Civ 38)

The Judge considered that in giving the phrase "anticipated profits" its natural meaning in the context of clause 34.5 (a) of the TSA, the contract was seeking to exclude damages claims for loss of profits of any kind which it was foreseeable would be made by either party. The Judge did not consider that there was any distinction between "anticipated profits" and "lost profits" for these purposes. The Court noted that the TSA was a bespoke, lengthy and detailed contract negotiated by two sophisticated parties operating in the field of telecommunications. As a result, it is more likely that the TSA could be successfully interpreted "principally by textual analysis."

The Court considered whether the wider context of the TSA and the importance of the exclusivity clause was sufficient to cast doubt on the clear and natural meaning of the words used in clause 34.5 (a) and concluded that it was not. The authorities clearly provide that the court should not apply a strained meaning to an exclusion clause, or effectively rewrite its language, where the words of the clause are clear unless the effect of the clause is to relieve a party of all liability for breach of any of its obligations under the contract.

The Judge distinguished this case from the *Kudos* case for three reasons:

1. The wording of clause 34.5 of the TSA was clear;

2. Virgin Mobile's interpretation of clause 34.5 did not denude the TSA of all commercial effect. It only excluded liability for specific types of loss. It would not preclude a claim for wasted expenditure. Nor would it preclude a claim for injunctive relief against Virgin Mobile for breach of the exclusivity clause. The Judge considered that EE would likely have a strong claim for injunctive relief in appropriate circumstances.

3. EE remained contractually entitled to the payment of Minimum Revenue Commitments under the TSA and was entitled to bring a debt claim for payment of any sums that were due under the TSA and unpaid.

The Judge therefore considered that it was wrong to suggest that Virgin Mobile's interpretation of clause 34.5 left EE without the fundamental consideration that it required for entering into the contract, i.e, the charges that EE was seeking to recover in this case.

As the Judge noted, the true nature of a party's claim and whether it will fall within the terms of a potentially relevant exclusion clause is a case sensitive issue. It depends on understanding how the claim is advanced, its true nature and whether it is genuinely concerned with a loss of profit (rather than for example wasted expenditure or diminution in price).

In the case of *Transocean Drilling UK Limited v Providence Resources Plc*,[30] the Court of Appeal,[31] reversing the High Court's decision, held that the consequential loss clause in the drilling contract between Providence and Transocean prevented Providence from recovering spread costs incurred during downtime caused by Transocean.[32]

The dispute between Transocean and Providence arose in respect of delays which occurred during the drilling of a well by Transocean's semi-submersible rig, "Arctic III," offshore Ireland.

Providence claimed approximately US $10 million in respect of alleged wasted marine spread costs incurred during the period of delay, which was found to have been caused by Transocean's failure to maintain the rig.

Transocean challenged Providence's claim on the basis that the spread costs were excluded by the consequential loss clause in the contract. This clause excluded the parties' liability for (among other things):

"….loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including, without limitation, those provided by contractors or subcontractors of every tier or third parties)". At first instance, the High Court held in favour of Providence, finding that this clause did not preclude Providence's claim for wasted marine spread costs incurred during the period of delay.

30. [2016] EWCA Civ, 372;

31. [2014] EWHC 4260 (Comm)

32. "The High Court's decision is discussed in the Haynes and Boone CDG, LLP Briefing Note "The High Court lays down the law– "no special treatment"for offshore contractors" dated 6 January 2015 by Simon Curtis, Glenn Kangisser and William Cecil

The High Court's decision caused huge consternation for offshore contractors, who until that point, had generally understood that their liability for an operator's spread costs would be excluded by the consequential loss provisions typically employed in offshore oil and gas contracts.

Transocean appealed this aspect of the High Court's decision, arguing that the wasted spread costs fell within the meaning of "loss of use" in the consequential loss clause. The Court of Appeal agreed. The Court of Appeal found that the High Court Judge erred in the interpretation of the consequential loss clause. In reaching their decision, the Lord Justices of Appeal held that:

1. The "starting point" in construing the consquential loss clause must be the language of the clause itself. In this case, the parties had used clear language to explain what they meant by "loss of use." This language was "plainly apt" to include the wasted spread costs.

2. The Judge at first instance had misused the *ejusdem generis principle*.[33] The inclusive examples in brackets that followed the phrase "loss of use" were expressed to be "without limitation" and were used to explain and expand on this phrase, not to limit its scope.

3. The Judge at first instance had misapplied the *contra proferentem* principle. It had no part to play in this case because the clause was unambiguous and did not favour one party over the other.

4. The consequential loss clause was an integral part of the broader scheme set out in the contract for apportioning loss; it was not a simple clause of the kind that might otherwise be construed restrictively. It contained bespoke mutual undertakings where each party had deliberately and clearly intended to give up some of their rights in the event of the other's breach.

5. The consequential loss clause did not render the contract "devoid of legal content" simply because the parties had agreed not to be liable to the other for consequential loss.

The Court of Appeal's decision reaffirms a key principle of English law that, except in the case of fraud, parties in commercial contracts remain free to allocate responsibility for losses as they see fit, provided their contracts contain clear language to this effect.

It is relevant to note that the Court of Appeal's interpretation of "loss of use" was guided by the additional inclusive wording that followed in brackets. On this basis, it remains to be seen whether the expression "loss of use" on its own will, in future, be interpreted to cover wasted spread costs; this will depend on the particular wording used in the contract and the overall context of each dispute.

In the 2022 case of *Soteria Insurance Limited v IBM United Kingdom Limited*,[34] the Court of Appeal, reversing the High Court's decision on this point, held that the consequential loss clause in the contract between the parties did not exclude liability for wasted expenditure.

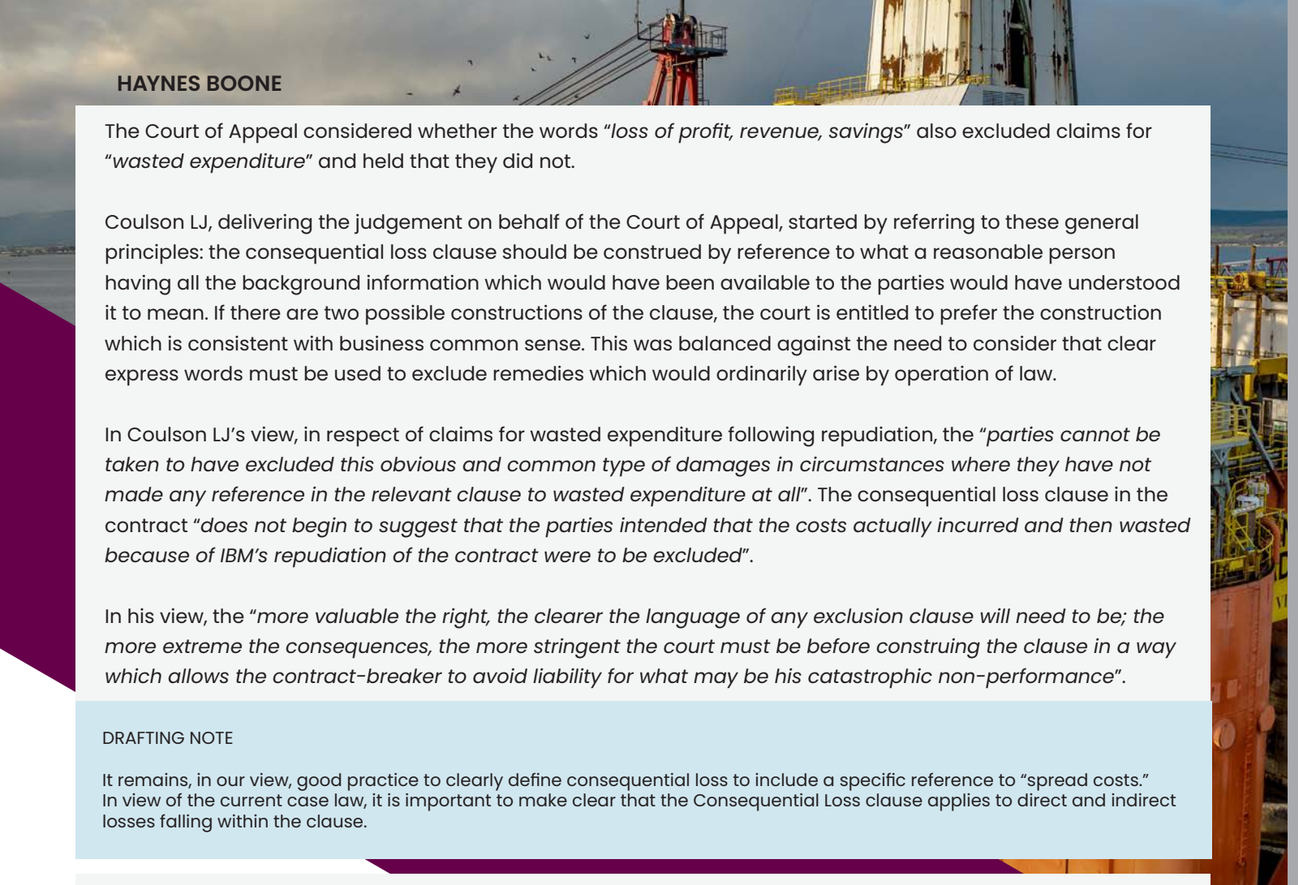
The underlying dispute in that case concerned the provision of an IT system by IBM to Soteria which was delayed and not finally delivered. IBM terminated the contract for non-payment of an invoice submitted by it. Soteria claimed that such payment was not due as it had not received the IT system and IBM had wrongfully repudiated the contract.

Soteria brought a claim against IBM for its wasted expenditure following IBM's repudiation of the contract. IBM argued that the consequential loss clause in the contract excluded liability for such claims.

The consequential loss clause in the contract excluded claims for "..indirect or consequential losses, or for loss of profit, revenue, savings (including anticipated savings), data (save as set out in clause 24.4 (d), goodwill, reputation (in all cases whether direct or indirect)".

33. This is a principle of construction by which general words may be given a limited meaning when they follow a list of specific matters which can be seen to be of a similar kind

34. [2022] EWCA Civ 440



The Court of Appeal considered whether the words "*loss of profit, revenue, savings*" also excluded claims for "*wasted expenditure*" and held that they did not.

Coulson LJ, delivering the judgement on behalf of the Court of Appeal, started by referring to these general principles: the consequential loss clause should be construed by reference to what a reasonable person having all the background information which would have been available to the parties would have understood it to mean. If there are two possible constructions of the clause, the court is entitled to prefer the construction which is consistent with business common sense. This was balanced against the need to consider that clear express words must be used to exclude remedies which would ordinarily arise by operation of law.

In Coulson LJ's view, in respect of claims for wasted expenditure following repudiation, the "*parties cannot be taken to have excluded this obvious and common type of damages in circumstances where they have not made any reference in the relevant clause to wasted expenditure at all*". The consequential loss clause in the contract "*does not begin to suggest that the parties intended that the costs actually incurred and then wasted because of IBM's repudiation of the contract were to be excluded*".

In his view, the "*more valuable the right, the clearer the language of any exclusion clause will need to be; the more extreme the consequences, the more stringent the court must be before construing the clause in a way which allows the contract-breaker to avoid liability for what may be his catastrophic non-performance*".

DRAFTING NOTE

It remains, in our view, good practice to clearly define consequential loss to include a specific reference to "spread costs." In view of the current case law, it is important to make clear that the Consequential Loss clause applies to direct and indirect losses falling within the clause.

ISSUE 6 — FRAUD

In *Innovate Pharmaceuticals Ltd v University of Portsmouth Higher Education Corporation*[35] (TCC), the Technology and Construction Court[36] considered limitation clauses in the context of fraudulent misrepresentation, specifically whether liability in relation to this can be effectively excluded. Innovate Pharmaceuticals ("Innovate") entered into a contract with the University of Portsmouth (the "University"), under which the University would conduct research into the properties of a patented drug designed to treat brain tumors (the "Contract"). This research to be conducted under the Contract was to be led by the University's Dr Richard Hill.

Sometime after the contract was entered into, a dispute regarding a paper published by Dr Hill occurred, and Innovate claimed that Dr Hill had fraudulently misrepresented raw data from the research conducted. Innovate sought to recover their estimated loss in value of the patent due to the inaccuracies associated with Dr Hill's research. Given these dishonesty allegations, Innovate argued that the University's liability was not limited by the limitation clause contained in Clause 11 of the contract, which provided that:

"11.4 … the University is not liable to the Funders because of any representation (unless fraudulent) or any warranty (express or implied), condition or other term, or any duty at common law, non-observance or non-performance of this Agreement for:

any loss of profits, business, contracts, opportunity, goodwill, revenues, anticipated savings, expenses, costs or other similar loss; and/or any indirect, special or consequential damages or losses (whether for loss of profits or otherwise).

35. [2024] EWHC 35
36. This case is discussed further in HB's article "The sky isn't the limit – recent judicial consideration of limitation clauses" by Jack Spence dated 27 September 2024

11.5 The liability of a Party to another howsoever arising (including negligence) in respect of or attributable to any breach, non-observance or non-performance of this Agreement or any error or omission (except in the case of death or personal injury or fraudulent misrepresentation) shall be limited to £1 million."

The sitting Judge determined that Mr Hill had not been dishonest and therefore he did not need to decide whether Clause 11 would have still applied if there had been fraud. However, he made some interesting obiter comments on this point. Both parties accepted that one cannot contract out of their fraud in inducing a contract.

However, drawing on *Frans Maas (UK) Ltd v Samsung Electronics (UK) Ltd*[37], the Judge concluded that whether a clause excludes liability for fraud in performance of a valid contract is a matter of construction of the commercial provisions and risk allocation. In other words, provided that a clause is clear that liability for fraud in the performance of a contract is covered by a limitation clause, there is no rule of principle invalidating such a provision.

In respect of Clause 11.4, the Judge considered that the words "unless fraudulent" applied only to "any representation" and did not apply also to a breach of warranty or term of the contract which was committed fraudulently. The exclusion for fraudulent misrepresentation from the limitation clause would therefore only apply to a claim based "*…in the tort of deceit*" and "*…loss of profits caused by a breach of contract not involving a representation is excluded even if that breach was committed fraudulently."*

The limitation clause in this case was considered by the Judge to be reasonable because the parties were considered to be of equal bargaining power, Innovate was assisted by legal representative during negotiations, and the monetary value of the fees payable to the University for the work being undertaken by it was relatively low – only £50,000. This last factor appeared to carry the most weight with the Judge who commented that "*The amount of the claim in this case (arguably in excess of £100 million) compared to the amount payable to the University under the Agreement underlines the commercial reality, perhaps necessity, of the two clauses.*"

The Judge's obiter comments indicate that the current judicial trend may be to favour upholding freely negotiated commercial bargains, particularly where they are serving a valid commercial purpose. However, the concept that a party might limit their liability for fraud in the performance of a contract gives some pause for thought. It is important to flag that the Judge's comments were obiter and were in the context of an agreement with relatively low value, where the breaching party would have assumed responsibility for losses far in excess of the value of the contract. It remains to be seen if the Judge's view in this case finds judicial acceptance in other cases.

By comparison, as discussed above in Issue 2, the Court of Appeal in *Capita (Banstead 2011) Ltd v RFIB Group Ltd*[38] quoted with approval a passage from Popplewell J's judgement in *Capita (Banstead 2011) Ltd v RFIB Group Ltd*,[39] including that "*…The Law on public policy grounds, does not permit a party to exclude liability for the consequences of his own fraud; and if the consequences of fraudulent or dishonest misrepresentation or deceit by his agent are to be excluded, such intention must be expressed in clear and unmistakable terms on the face of the contract. General words will not serve. The language must be such as will alert a commercial party to the extraordinary bargain he is invited to make because in the absence of words which expressly refer to dishonesty the common assumption is that the parties will act honestly*: HIH at [16], [68]-75, [97]."

DRAFTING NOTE

It is not possible under English law to limit liability for fraud in inducing a party to enter into a contract. If parties wish to limit liability for their agent's fraudulent misrepresentation in performing a contract, that should be stated very clearly in the contract. However, it remains to be seen whether a court would consider a clause seeking to limit liability for fraudulent misrepresentation as valid.

37. [2004] EWHC 1502
38. [2015] EWCA Civ 1310
39. [2014] EWHC 2197 (Comm)

FUTURE TRENDS

The Macondo incident clearly emphasised the importance of well-drafted knock for knock indemnities. The dramatic collapse in the oil price in recent years together with the impact of the COVID-19 pandemic led (among other things) to a very significant reduction in demand for offshore vessels and the resultant over- supply considerably reduced the bargaining power of offshore contractors.

The consequence of this was that offshore contractors were unlikely to achieve all of the key protections previously available by way of indemnity and limitation of liability provisions. However, largely as a result of the international energy crisis and the easing of the impact of COVID-19, this tide has turned. Offshore contractors now have a significantly greater prospect of achieving the key protections they need with the assistance of appropriate legal advice on the drafting of their indemnity and limitation provisions.

Where the relevant risks cannot adequately be addressed by the terms of the contract, the Contractor should seek as far as possible to mitigate such risks by appropriate insurance coverage.

As outlined, what may appear to be a standard knock for knock indemnity can, on closer analysis, prove inadequate to cover the potential liabilities that may arise on a complex offshore project.

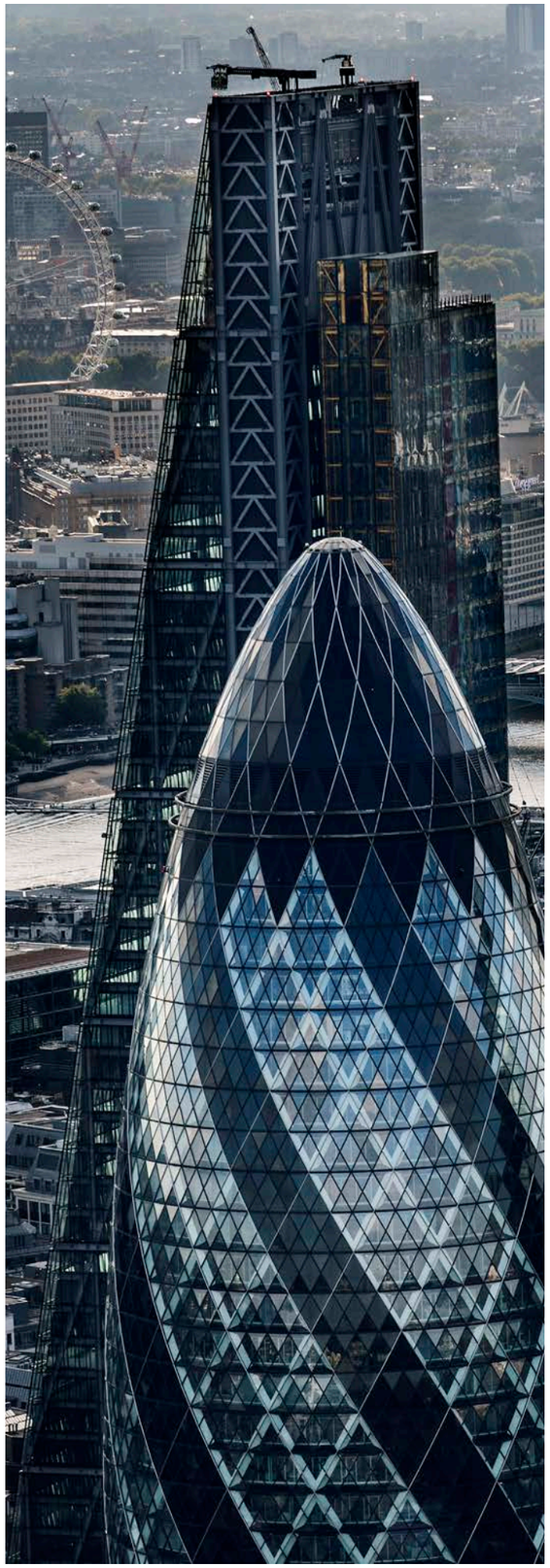
GLENN KANGISSER
Partner
T +44 (0)20 8734 2814
Glenn.Kangisser@haynesboone.com

Glenn Kangisser is a leading lawyer specializing in offshore, oil and gas, and shipping industries, with expertise in upstream exploration, production, and oil and gas transportation. He advises clients throughout the lifecycle of drilling units, from design and construction to operations, maintenance, and eventual disposition or recycling.

Known for his pragmatic approach, Glenn helps clients achieve commercial solutions by negotiating contracts, minimizing disputes, and resolving them through litigation or arbitration. He has represented clients in the English High Court and arbitrations under LCIA, LMAA, and ICC rules. His international practice spans the UKCS, U.S. Gulf of Mexico, West Africa, Brazil, the Middle East, and the Far East.

Glenn has handled landmark cases, including securing a London arbitration award exceeding $400 million for a European drilling contractor in a dispute with a South Korean shipyard and obtaining a $270+ million judgment for Seadrill Ghana Operations Ltd. in an English High Court force majeure case.

As head of Haynes Boone's UK oil and gas team, Glenn is recognized by The Legal 500 (2024-2025) for his "unrivaled knowledge and experience." Clients and peers alike commend him as a true expert, with his work featured in prominent outlets like the Financial Times.



TEENA GREWAL
Counsel
T +44 (0)20 8734 2850
Teena.Grewal@haynesboone.com

Teena Grewal provides practical legal advice on oil and gas exploration and production projects, with extensive experience in floating production storage and offloading units (FPSOs) and drilling contracts. She has worked on major FPSO projects across the UK Continental Shelf, Brazil, Australia, South America, and West Africa, offering a deep understanding of contract nuances and the political sensitivities of various jurisdictions.

Teena guides clients through every stage of their transactions, from strategic planning to detailed contract negotiations. She is known for her ability to manage lengthy, complex, and high-value projects, many worth billions of dollars.

Her clients benefit from her prior experience as in-house legal counsel for a major international oil and gas company, where she advised on offshore pipeline systems, field development projects, and a broad range of procurement contracts. Teena also has expertise in acquisitions, disposals, and joint ventures, gained from roles in both private practice and as in-house counsel for an independent power producer.

METTE DUFFY
Counsel
T +44 (0)20 8734 2853
Mette.Duffy@haynesboone.com

Mette has a broad practice spanning transactions and dispute resolution in the energy, offshore, shipping, and renewables sectors. Her transactional work includes drafting and negotiating tenders, EPC(IC), shipbuilding, and conversion contracts, as well as related project documentation for complex, high-value projects in the FPSO, FLNG, LNG, drilling, and renewables industries. She advises on all stages of asset lifecycles, from construction, conversion, and operational arrangements to sale, purchase, and recycling, leveraging her dispute resolution expertise to mitigate risks effectively.

On the dispute resolution side, Mette handles complex international cases in arbitration (LCIA, ICC, LMAA) and litigation in the English High Court, as well as alternative dispute resolution. Her technical and legal acumen has made her a trusted advisor in high-stakes proceedings.

Mette co-authors the chapter on English law-governed shipbuilding contracts in *Lexology Panoramic – Shipbuilding*. Before joining Haynes Boone, she was a Managing Associate in the Energy & Infrastructure Group of a leading international law firm.

About Haynes Boone

Haynes Boone is a full-service law firm with a national presence and an international reach.

With more than 700 lawyers located in Texas, New York, California, Chicago, Denver, Washington, D.C., London, Mexico City, and Shanghai. Haynes and Boone, LLP entered the London market in 2016 by merging with Curtis Davis Garrard LLP (CDG) and is known as Haynes and Boone CDG, LLP in London. The merged firm possesses enhanced global capabilities in the energy, maritime, financial services and corporate sectors.

Founded in 1996, CDG built a significant reputation serving the shipbuilding and offshore oil and gas sectors globally. Ship building clients consist of shipowners, charterers and shipyards covering the entire spectrum of commercial shipping, including the international superyacht sector. On the offshore side, clients include major oil and gas companies with worldwide development interests, smaller independents, offshore contractors providing a range of exploration and production services, and specialist suppliers of oilfield services and equipment, including shipyards.

The office provides clients with substantially enhanced English law capabilities, including an experienced litigation and international arbitration team that has handled numerous claims in the English High Court and before major arbitral bodies. The office also includes partners with decades of experience handling international business and projects transactions, providing clients with an important and unique bridge between the interconnected energy and energy finance related markets of London, New York, Houston, Shanghai, and Mexico City.

The firm's deep relationships and capabilities in this sector provide our clients with an unprecedented ability to make direct connections and access resources in some of the world's largest energy markets.

Our firm's progressive, entrepreneurial spirit is the impetus for our unrelenting commitment to remain forward-thinking and continually evolve to address the dynamically changing world of business law. It is this fortitude that allows us to serve clients in global business transactions and dispute resolutions around the world, including 20 percent of US Fortune 500 companies. We have long served clients' global business activities by building cross- border practice capabilities, strategically adding international legal experience and establishing working relationships with leading law firms throughout the world. We have assisted clients in more than 100 countries with lawyers who are fluent in 17 languages.

Lawyers
+700

Offices
+18

Major Legal Practice Areas
15760

Offices

With more than 600 lawyers in 18 global offices and 40 major legal practice areas, we retain our historic commitment to fairness, respect and camaraderie.

AUSTIN
600 Congress Avenue
Suite 1300
Austin, TX 78701
United States of America
T +1 512.867.8400

CHARLOTTE
620 S. Tryon Street Suite 375
Charlotte, NC 28202
United States of America
T +1 980.771.8200

CHICAGO
180 N. LaSalle Street
Suite 2215
Chicago, IL 60601
United States of America
T +1 312.216.1620

DALLAS
2801 N Harwood
Suite 2300
Dallas, TX 7501
United States of America
T +1 214.651.5000

DALLAS - NORTH
6000 Headquarters Drive
Suite 200
Plano, TX 75024
United States of America
T +1 972.739.6900

DENVER
675 15th Street
Suite 2200
Denver, CO 80202
United States of America
T +1 303.382.6200

FORT WORTH
301 Commerce Street
Suite 2600
Fort Worth, TX 76102
United States of America
T +1 817.347.6600

HOUSTON
1221 McKinney Street
Suite 4000
Houston, TX 77010
United States of America
T +1 713.547.2000

LONDON
1 New Fetter Lane
London, EC4A 1AN, GB
T +44 (0)20 8734 2800

MEXICO CITY
Torre Chapultepec Uno
Av. Paseo de la Reforma 509
Piso 21 Col. Cuauhtémoc
Alcaldía Cuauhtémoc
CP 06500, CDMX
T +52.55.5249.1800

NEW YORK
30 Rockefeller Plaza
26th Floor
New York, NY 10112
United States of America
T +1 212.659.7300

NORTHERN VIRGINIA
8000 Towers Crescent Drive
Suite 900
Tysons Corner, VA 22182
United States of America
T +1 703.847.6300

ORANGE COUNTY
600 Anton Boulevard
Suite 700
Costa Mesa, CA 92626 United States of America
T +1 949.202.3000

PALO ALTO
525 University Avenue
Suite 400
Palo Alto, CA 94301
United States of America
T +1 650.687.8800

SAN ANTONIO
112 East Pecan Street
Suite 1200
San Antonio, TX 78205
United States of America
T +1 210.978.7000

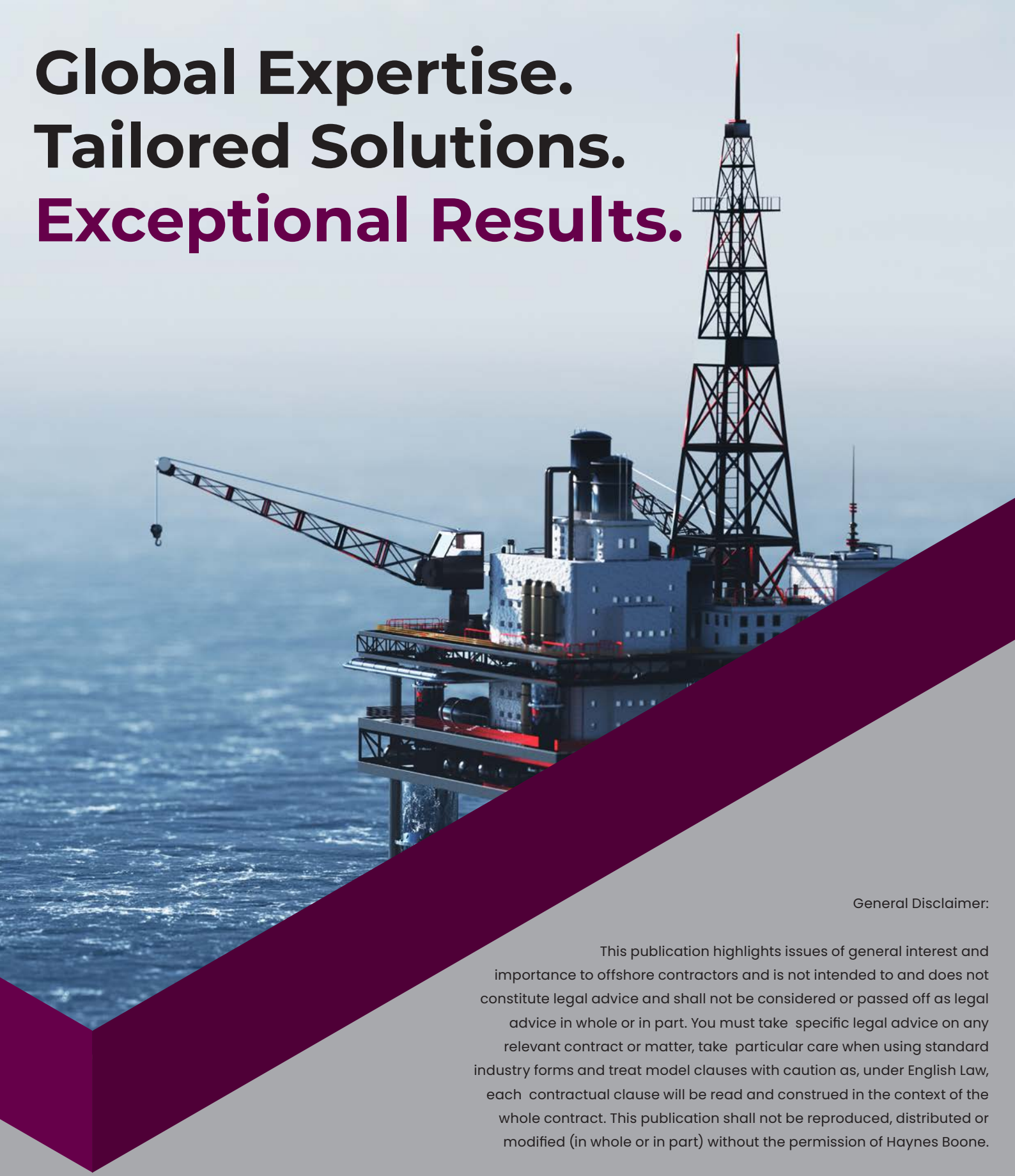
SAN FRANCISCO
275 Battery Street
Suite 1850
San Francisco, CA 94111
United States of America
T +1 415.293.8900

SHANGHAI
Shanghai International Finance Center, Tower 2 Unit 3620, Level 36
8 Century Avenue, Pudong
Shanghai 200120
P.R. China
T +86.21.6062.6179

THE WOODLANDS
10001 Woodloch Forest Drive
Suite 200
The Woodlands, TX 77380
United States of America
T +1 713.547.2100

WASHINGTON, D.C.
800 17th Street NW
Suite 500
Washington, D.C. 20006
United States of America
T +1 202.654.4500

Global Expertise.
Tailored Solutions.
Exceptional Results.



AUSTIN | CHARLOTTE | CHICAGO | DALLAS | DALLAS - NORTH | DENVER | FORT WORTH | HOUSTON
LONDON | MEXICO CITY | NEW YORK | NORTHERN VIRGINIA | ORANGE COUNTY | PALO ALTO
SAN ANTONIO | SAN FRANCISCO | SHANGHAI | THE WOODLANDS | WASHINGTON, D.C.