Clarity of Drafting

Exclusion and indemnity as well as “knock for knock” provisions* are commonly found in offshore contracts. In Farstad Supply v Environco (The “Far Service”) the UK Supreme Court recently considered the scope of such provisions and how an exception and indemnity clause in a charterparty governed by English law should be interpreted.

The Circumstances

On the 7 July 2002 the offshore supply vessel “Far Service” was damaged by fire whilst alongside in port. Farstad, as owners, sued a third party tank cleaning company (Environco) in tort alleging that the negligence of Environco’s employees caused the fire. Environco, who were contracted by charterers (Asco), pleaded that any award for damages should be apportioned between themselves and Asco as joint tortfeasors pursuant to s.3(2) Law Reform (Miscellaneous Provisions) (Scotland) Act 1940. S.3 of the Act is entitled “Contribution amongst joint wrongdoers”. Subsection (2) provides that a defendant who has been held liable and pays damages to the suing party has a right to recover as the court deems just from “any other person who, if sued, might also have been held liable in respect of the loss or damage on which the action was founded.”

At first instance it was held that Environco was not entitled to a contribution from Asco, a decision which was later overturned by majority on appeal. Farstad then appealed to the Supreme Court to reinstate the first instance decision.

Exception and Indemnity Clause

The charterparty between Farstad and Asco contained an exception and indemnity clause (clause 33). Farstad argued that on the true construction of clause 33(5) both parties agreed that Asco would not be liable in respect of loss or damage, irrespective of whether such loss or damage was caused by Asco’s own negligence. In determining whether “if sued” by Farstad, Asco would be found liable, their lordships had to consider the language of clause 33(5) and its context within the charterparty as a whole. Clause 33(5) provided:

“Subject to Clause 33.1, the Owner shall defend, indemnify and hold harmless the Charterer, its Affiliates and Customers from and against any and all claims, demands, liabilities, proceedings and causes of action resulting from loss or damage in relation to the Vessel (including total loss or property of the Owner, including personal property of Owners’ Personnel) or of anyone for whom the Owner may be responsible on the Vessel, irrespective of the cause of loss or damage, including where such loss or damage is caused by, or contributed to, by the negligence of the Charterer, its Affiliates or Customers.”

It was unanimously held that clause 33(5) acted to exclude the liability of Asco. In the leading judgment Lord Clarke commented that the word “indemnify” could in some contexts be construed as meaning to indemnify a third party. However, in this instance, when construed in its context as part of clause 33, the term ‘defend, indemnify and hold harmless’ was sufficiently wide to exclude the charterers’ liability in respect of damage caused to the vessel by its own negligence. To the extent that there exists any doubt as to the interpretation of a word, the court argued that the true interpretation is found in the context of the charterparty as a whole.

Although most in this instance, their lordships also contemplated what the position would have been if clause 33(5) was construed not as an exception clause but a narrow indemnity clause. Had this been the case Lord Clarke found that even where Asco was in principle liable to Farstad, it would immediately be entitled to be indemnified by Farstad who would be bound to repay the amount of the liability. Any claim from Farstad would be met with a defence of circuity of action by Asco and there would be no court order demanding Asco to pay damages. It was further argued by the court that to interpret clause 33(5) as an indemnity would be contrary to what the contract was drafted to achieve.

On the scope of clause 33(5), Lord Mance opined that it “operates as a series of indemnities against third party exposure combined with exclusions of direct exposure to the other contracting party. This is what the wording of clause 33 [Exceptions and Indemnities] and what common commercial sense would lead one to expect under a scheme clearly intended to divide risk between the contracting parties.”

Consequently, Asco, “if sued” would have a defence under the charterparty irrespective of whether clause 33(5) is construed as an exception clause or an indemnity clause. It would not be possible for Asco to have a judgement against it and it therefore follows that Environco would not be entitled to a contribution from Asco under s.3(2) of the 1940 Act.

Commentary

By incorporating “knock for knock” provisions into the charterparty, each party agrees to bear responsibility for its own property and personnel without recourse to the other party to the contract. They are a pre-determined method of apportioning risk between parties which allow the parties to insure their risks more effectively and also serve to avoid lengthy disputes and costly litigation.

This decision gives efficacy to such provisions and demonstrates that where one party to a contract clearly and intentionally allows the other party to contract out of liability for negligence, such a provision is likely to be upheld by the English courts.

Farstad Supply A/S v Environco Ltd and Another (The “Far Service”) [2010] UKSC 18

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*See earlier website article Indemnity Agreements in Offshore Contracts for further discussion on this subject