

Offshore Contracts

'Knock-for knock' framework and insurance implications in its absence

23 June 2015



Background and purpose of 'knock for knock'

A 'knock for knock' clause is the well-established core of the offshore contracts and traditionally has been used by the offshore industry for a clear allocation and apportionment of liability between the parties. The intention is that each contracting party should assume their own responsibility for any damage or loss to its own property, or for an accident or injury to its own staff without bringing any claim against the other party, regardless of the other party's negligence or failure to perform the contract i.e. even if the other party is at fault.

The origins of this practice for each party bearing their own responsibility for losses goes back to the motor insurance business, where it was considered uneconomical and impractical for the motor insurers to negotiate large numbers of small road traffic accident claims between them. By projection to the larger scale of offshore projects, a similar arrangement was introduced with the aim to avoid complex litigation between the parties involved in a long term exploration or production project. As a consequence, this arrangement would save time and expense in connection with the casualties and most importantly, would simplify the insurance arrangements for the parties involved.

'Knock for knock' clauses which address the liabilities and indemnities for each contracting party are incorporated in all the standard market offshore charterparties such as BIMCO's Supplytime2005 (clause 14(b)), TOWCON2008 (clause 25) and TOWHIRE2008 (clause23).

The principal purpose for these clauses is to limit the substantial risks involved in large scale offshore projects to a level acceptable to most contractors involved in a project. Accordingly, another aim is to avoid the need for multiple or overlapping layers of insurance between the parties. With this arrangement, each party takes out insurance to cover their own equipment and

personnel rather than the damage this equipment and personnel can cause to their contracting parties.

The critical element for the efficiency of this clause is that the indemnity would apply irrespective of negligence or who is at fault. Under the 'knock for knock' concept, each party is obliged to meet any claims arising out of damage to its property and personnel even if the damage is caused by fault of others.

Deviation from full 'knock for knock' and P&I cover implications

In general, the P&I Clubs approve cover for 'knock for knock' contracts provided that these contracts are balanced and well drafted. However, it is quite common that bespoke contracts are used in the offshore industry. Often, the changes insisted upon the standard terms and conditions of an offshore/towage contract may result in disproportionate liabilities for a vessel owner. As even a small amendment to the wording may result in large exposure, vessel owners need to be careful that the additional risks they assume are covered by their P&I Club.

One of the common amendments that the P&I Clubs see to the 'knock for knock' clause is the words 'even if such loss, damage [...] is caused wholly or partially by the act, neglect or default of... ' are amended to read: 'unless such loss, damage [...] is caused wholly or partially by the act, neglect or default of...'. This completely changes not only the meaning of the clause but also the original intention of the 'knock for knock' which is designed to apply irrespective of gross negligence or willful misconduct.

Another example is where the assumption of responsibility is one-sided i.e. where a vessel owner is required to take on responsibility for the property and personnel of a charterer/contractor with no similar commitment for liability by the charterer towards the vessel owner.

How your broker and P&I Club can assist

Such amendments which fundamentally alter the nature of the 'knock for knock' principle and may jeopardise your P&I cover are generally inadvisable. However, bespoke contracts with amendments to the full 'knock for knock' are common in the commercial reality and P&I insurers are aware that vessel owners are often required to enter into contracts which include them. Brokers and P&I Clubs are therefore prepared to assist their clients in two fronts.

From a very early stage during the contract negotiations, it is highly recommended that your broker and P&I Club are involved in the contract review in order to assist with identifying potential problems with the bespoke drafting. Further, they are in a good position to propose alternative wordings which may better protect a vessel owner's position whilst they may also be acceptable to the charterers. Contracts should be balanced, clearly drafted and comprehensive with neither party disproportionately exposed to commercial risks and liabilities.

In addition, where additional contractual liabilities are assumed under an offshore contract, the P&I Clubs offer extensions to the traditional P&I cover which are designed to account for any impaired 'knock for knock' terms. By purchasing the appropriate extended cover for contractual liabilities, P&I cover becomes tailor made to the specific needs of the offshore contract and operation in question. Any potential gaps to the insurance cover are minimized and the vessel owner and the rest of the co-assureds can have peace of mind during the operations. It is worth noting at this point that where the contract terms are not 'knock for knock' and extension to the P&I cover is purchased, the named co-assureds under the insurance policy will enjoy the same protection of the extended contractual liability clauses to the same extent as the principal assured i.e. the vessel owner.

In conclusion, the 'knock for knock' provision is an essential tool of the offshore contract to clearly allocate and apportion responsibilities for the property and personnel of the contracting parties.

However, it is very often that such amendments to the provision are agreed which may result in increased risk exposure for the vessel owner.

It is therefore of utmost importance that from an early stage in the contract negotiation, advice is sought from your broker and P&I Club about both the proposed contract wordings as well as the additional insurance covers that may be required for the full protection against any increased contractual liabilities that a vessel owner takes on.

Further information

If you would like further information please contact:

Kallina Gougouli

Tel: +44 (0) 20 73750002
kallina.gougouli@pacifics.co.uk

www.pacifics.co.uk