

The knock-for-knock agreements in the offshore sector under the United States and Norwegian law.

The problem of gross negligence and wilful misconduct.



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Submission deadline: 05.11.2012

Word count: 17,961

Acknowledgement:

I would like to express my deep gratitude to Professor Trine-Lise Wilhelmsen, my research supervisor, for her very valuable and constructive suggestions during the development of this research work. Her patient guidance and useful critiques gave final shape of this thesis and have been very much appreciated.

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1. Introduction and definition of the problem

This thesis will present the main aspects connected with the knock-for-knock clauses (the terms: knock-for-knock clauses, mutual hold harmless clauses and indemnity clauses are used here as synonyms) and will focus on how these provisions are treated in the United States (US) and Norwegian legal systems. Under the mutual hold harmless indemnity regime, each party to the contract (as 'indemnitor') agrees to take responsibility for, and to indemnify the other (as 'indemnitee') against, injury and loss to its own personnel and property and its own 'consequential losses'. Such provisions, setting up the cross-indemnities mechanism, are ordinarily intended to be effective even if the accident and related losses are caused by negligence, breach of statutory duty or breach of contract of the party protected by the indemnity regime¹. The knock-for-knock agreements are very often used in the offshore business due to some specific feature characterizing this activity.

First of all, it should be noted that the offshore industry is very risky and hazardous business with huge capital sums invested and large potential liability. The accidents can and do happen – the recent Deepweather Horizon oil spill catastrophe is the best example. Moreover, the upstream oil and gas sector is moved gradually to the deeper and more unsafe regions, with heavy weather conditions and a lot of factors must be taken into consideration in the risk-management process.

Another feature of such activity is the involvement of many contractors and subcontractors – for example the Piper Alpha disaster led to claims against 24 different contractors, where of those on board the platform who were killed, 134 were employed by contractors and 31 by operator; of those who survived 55 were employed by contractors and 31 by the operator². Such situation is a common characteristic of North Sea Oil exploitation, so the clear distinction between the scope of liability of each enterprise engaged in this activity is highly required.

Since the need for foreseeability is very strong in the offshore business, it is thus not surprising that the industry during several years has developed the mechanisms of risk allocation, known as 'knock-for-knock' agreements. Such disclaimer of liability is often based on the different criteria than would have followed from the general liability rules. The primary aim of mutual hold harmless clauses is to establish a systematic liability and insurance system throughout all the contracts involved in the same project where all risk for damage is financed

1 T. Hewitt, op.cit., p. 182

2 *Caledonia North Sea Limited v London Bridge Engineering Limited and Others („Piper Alpha”)*, 2000 S.L.T. 1123

by insurance effected by the contractual party sustaining damage (the main principle of the knock-for-knock provisions is that damage should stay where it occurs)³. This system will often set rules concerning also a liability toward third parties – however, in this case there is commonly an exception to the extent of the negligence of the other party and sometimes the exception is expressed to apply only in the case of the sole negligence of that other party⁴.

It must be noted that despite of the wide application of the knock-for-knock agreements, the particular mutual indemnity clauses may be interpreted differently in various countries – it concerns especially their enforceability in the case of gross negligence/wilful misconduct of one party. If a responsibility regulation includes a full exemption from liability for tortfeasor even in the case of his gross negligence or intentional act, this may come into conflict with the principles like fairness and reasonableness⁵. This problem will be the main issue analysed in this thesis where the various censorship in the US and Norwegian legal system will be presented together with the various arguments that are submitted in their favour. Norway and the US were chosen, because these two countries have nowadays very strong position in the offshore business⁶ and they have developed specific solutions concerning enforceability of mutual hold harmless clauses which will be discussed below. On the one hand, the courts are sometimes not willing to accept that the party will be release from liability if he acted with gross negligence or wilful misconduct. On the other hand, modification of such provisions may have a very wide-ranging impact, sometimes not intended by the parties and might also reduce the benefits of mutual hold harmless clauses as such. This is why it is so important to know in which circumstances the knock-for-knock agreements will be upheld.

At the beginning, the short introduction concerning relevant tort and insurance law will be given since these two branches of law are closely connected with the problem of knock-for-knock agreements.

Then, the general characteristic of the knock-for-knock clauses will be given. In this part, the general rules concerning construction of mutual hold harmless formulas as well as indemnity and insurance issues will be discussed.

Afterwards, the advantages and disadvantages of such provisions will be presented.

In the last two chapters the enforceability of the knock-for-knock provisions in the US

3 T.-L. Wilhelmsen, *Liability and insurance clauses in contracts for vessel services in the Norwegian offshore sector - the knock-for-knock principle*, Conference paper for the Oslo/Southampton/Tulane Conference in Oslo 2-3 October 2012, p. 4

4 T. Hewitt, *op.cit.*, p. 184

5 H.J. Bull, *Tredjemannsdekninger i forsikringsforhold*, 1988, p. 336

6 The third system which is relevant in the context of offshore activity is English legal regime, however, it will stay outside the scope of this thesis.

and Norway will be analysed in detail. In the context of the US legal regime the main focus will be put on the different solutions included in the anti-indemnity statutes in Texas and Louisiana since law of these two states will apply the most often to the offshore contracts in the US waters and the very specific limitations concerning the knock-for-knock agreements are included in their anti-indemnity statutes. In the Norwegian context the main problem will be the enforceability of knock-for-knock clauses in the context of general contract law. In this part the enforceability of the mutual hold harmless provisions will be analysed with reference to the NL 5-1-2 and the Norwegian Contract Act section 36.

2. Legal sources

The analyse of knock-for-knock clauses in two different legal systems raises a number of particular legal sources and methodology which will be addressed below.

First of all, it must be noted that the US and Norwegian legal systems belongs to rather different legal traditions. The US legal regime is the part of so called “common law” where the customary law and case law is considered a very important source of law (however, it must be noted that in contrast to English common law, the American legal system has increasingly introduced legislation in various jurisdiction, also in the context of contract law). Since the US is a federal state, its legal system consists of many levels of codified and uncodified forms of law. This is the reason why both federal and state law must be considered here. When the problem of enforceability of knock-for-knock clauses will be analysed, three legal regimes which may apply in the case of offshore activity, will be taken into consideration: the general maritime law of the US and the Outer Continental Shelf Lands Act (OCSLA) as a federal law, and the Texas and Louisiana legislation⁷ as a state law (these states are relevant, because they are the adjacent states for the most of the offshore activity in the US waters). Moreover, because the US law system is based on case precedent, the focus will be put on the courts decisions which has a potential of establishing the rule that must be followed by other courts.

In the contrast to the US system, the Norwegian regime is often referred to the “civil law” family, however, some specific solutions have been developed here. In the context of Norwegian law the enforceability of the knock-for-knock agreements will be analysed based on the general contract law. The NL 5-1-2 (*Kong Christian Den Femtis Norske Lov av 15. april 1687*) and the Norwegian Contract Act section 36 (*Lov 31. mai 1918 nr 4 om avslutning av avtaler, om fuldmagt og om ugyldige viljeserklæringer (avtaleloven)*) will be thus in the

⁷ Texas and Louisiana Anti-indemnity Acts (TEX. CIV. PRAC. & REM. CODE ANN Section 127.00 1, and LA. REV. STAT. ANN Section 9:2780)

focus of an attention. The first statute forbids those agreements which are against law and morality (“*imod Loven, eller Ærbarhed*”), the second one gives the courts a possibility to modify or disregard agreements which are found to be unreasonable, unfair or contrary to good business practice.

Since Scandinavian legal systems are based on the same principles and the Norwegian section 36 is a result of Nordic legislative cooperation with identical rules in all the Nordic countries⁸, the references to Danish and Swedish preparatory documents to their Contract Acts and to relevant case law will be also done.

3. Overview over the relevant tort law and insurance law

3.1. Tort law

The knock-for-knock clauses are the provisions in which one party to the contract agrees to indemnify the other party against liability in tort. This is the reason why the short overview of the tort law is necessary before the broader analysis of the mutual hold harmless clauses will be done.

Torts is a large subject area in litigation, in which a victim (e.g. plaintiff) seeks a remedy from some defendant (e.g. person, corporation, government) who harmed the victim⁹. The tort must be thus differ from breach of contract and criminal act. The common thread interweaving most torts is the notion that socially unreasonable conduct should be penalized and those who are its victims should be compensated. Of course, determining what is unreasonable is a formidable task, but the overall goal is to balance the plaintiff’s need for protection against the defendant’s claim of freedom to pursue his own ends¹⁰.

According to Norwegian tort law, a person is liable for damage to another person if three conditions are fulfilled: there must be a legal basis for liability, there must be an economic loss, and there must be legally relevant causation between the act or the omission of the injurer and the loss. These rules are mainly developed and stated in court practise and not reflected in general legislation¹¹. The same principles existed also under the US tort law¹²

When we talked about the liability in tort – the three main basis of liability can be

8 T.-L. Wilhelmsen, op.cit., p. 25

9 R.B. Standler, *Elements of Torts in the USA*, <http://www.rbs2.com/torts.pdf>

10 L.L. Edwards, J.S. Edwards, P.K. Wells, *Tort Law, Fifth Edit.*, 2012, p. 4

11 T.L. Wilhelmsen, op.cit., p.5

12 Restatement Second of Torts §§ 281, 328A (1965); W. Keeton edit., *Prosser and Keeton on The Law of Torts*, Fifth edit. (1984) § 30; See also *Leake v. Cain*, 720 P.2s 152, 155 (Colo. 1986), where the court held that to recover for the negligent conduct of another, a plaintiff must establish: 1) the existence of a legal duty owed to the plaintiff by the defendant, 2) breach of that duty, 3) injury to the plaintiff, 4) actual and proximate causation

divided – liability for negligence, strict liability and vicarious liability. The main principle of tort law is that some kind of fault of tortfeasor is required to invoke the liability for damages (fault means here ordinary negligence, gross negligence or intentional act). No fault (such as negligence or tortious intent) is, however, needed in the case of strict liability, however, it will normally require an act of legislation¹³. The vicarious liability is a combination of the negligence and strict liability – this term is used to indicate legal responsibility for other people's actions, especially those of employees or customers¹⁴. For example, a company may be held liable for the actions of an employee, or a parent may be held liable for injury caused by a child.

It should be noted that tort law often goes beyond compensating individuals and considers more broadly, the interests and goals of society at large – these interests are often referred to by the courts as public policy concerns¹⁵. This idea is the most important in the context of US law since the US courts often refer to the public policy principle when they analyse the enforceability of mutual hold harmless provisions.

3.2. Insurance law

The main purpose of the knock-for-knock regulation in the contract is to benefit from the insurance cover effected by the respective parties. This is the reason why the short overview of relevant insurance law should be done before the proper analysis of the knock-for-knock principles will be done.

Insurance in Norway is regulated by the Insurance Contract Act (ICA).¹⁶ The provisions of the ICA are mandatory (Section 1-3), however there are several exclusion of this rule – section 1-3 subparagraph (c) and (e) states that ships, offshore units and goods in international transit, including transportation to and from the Norwegian Continental Shelf are excluded from mandatory application of ICA. As a starting point therefore, the insurer and the parties to the charter parties or the drilling contracts have full contractual freedom in relation to the content of the insurance contract¹⁷.

The most of the marine insurance contracts in Norway are regulated by the Norwegian Marine Insurance Plan 1996 Version 2010 (NMIP)¹⁸. The NMIP is an agreed document,

13 See f.e. The Norwegian Petroleum Act chapter 7, which comprehensively regulates who shall be liable for pollution damage. Section 7-3 of this chapter states that “*the licensee is liable for pollution damage without regard to fault*”.

14 Cambridge Dictionaries Online, <http://dictionary.cambridge.org/dictionary/business-english/vicarious-liability>

15 L.L. Edwards, op.cit., p. 4

16 Act no. 69 of 16 June 1989 relating to insurance contracts.

17 T.L. Wilhelmsen, op.cit., p. 7

18 It should be noted that with the effect from 1. January 2013 the common regulation for all Scandinavian countries will be introduced – the Nordic Marine Insurance Plan of 2013 (Based on the NMIP 1996, Version

similar to private legislation. It is thus non mandatory regulation, however, most of the insurance contracts in Norway referred to it. The NMIP is a comprehensive document, which included inter alia provisions concerning hull insurance for ocean going ships and off shore units, however, the P&I insurance stays outside its scope. In the context of knock-for-knock agreements chapter 18 (regulating insurance for Mobile Offshore Units) of NMIP is highly relevant, as it contains some special rules concerning subrogation and co-insurance, relevant in our analysis.

In the US, insurance was not considered "commerce" up until 1944, and ipso facto it was not subject to federal regulation. This situation was changed when in *United States v. South-Eastern Underwriters Association*¹⁹, the Supreme Court held that Congress could regulate insurance transactions that were truly interstate. The ruling held that the insurance industry could be regulated by federal law, rather than only state laws. The following year, however, Congress passed the McCarran-Ferguson Act (Public Law 15), overruling the Supreme Court decision and prescribing that insurance regulation was a matter for the states and not the Federal government. The McCarran-Ferguson Act exempted the insurance industry from most Federal regulation, including anti-trust laws²⁰. This Act, broadly speaking, gives states the power to regulate the insurance industry. While state insurance statutes override most federal laws, some portions of federal law (like federal tax laws) are always commanding. Therefore, when researching whether a particular law governs, a good rule is to ask whether the inquiry is related to the "business of insurance" (where state law governs), or whether it is related to peripherals of the industry (labour, tax law, securities – where federal law governs)²¹.

2010)

19 322 U.S. 533

20 *United States v. The South-Eastern Underwriter Association*,
<http://www.investopedia.com/terms/u/united-states-v-the-southeastern-underwriter-association.asp>

21 Legal Information Institute, <http://www.law.cornell.edu/wex/insurance>

4. Knock for knock – general characteristic

Before the proper analysis of the knock-for-knock agreements, the short presentation concerning the offshore activity must be given since mutual hold harmless provisions are commonly used in this field.

4.1. Petroleum offshore sector – general presentation, parties of the offshore contracts

The oil and gas sector may be divided between an upstream and downstream aspect. In turn, the upstream oil and gas contracts can be subdivided into a number of different types, depending on the nature of the parties to the contract and the nature of the activities to be undertaken. The first category of agreements includes contracts between the operator of an oil and gas license or concession (the 'Operator/Company') – normally an international oil company or a national oil company, and a contractor that provides services to the operator (the 'Contractor') in relation to exploration (such as seismic acquisition or drilling), field appraisal and development (appraisal and development drilling, production and offtake facilities construction) and field operation and production – 'services contracts' (well services, facilities hire and operations and maintenance). The second broad category of contracts is the Joint Operating Agreement (JOA) – a contract between the operator and its co-ventures or equity participants in the relevant licence, concession or area of cooperation²². The knock for knock clauses are commonly used in the upstream phase – mostly in the drilling contracts.

The mutual hold harmless provisions are also commonly included in the standard charterparty for offshore service vessels like Supplytime 89 and its newer version Supplytime 2005, where the liability is divided between the Owner and the Charterer.

4.2. Knock-for-knock clauses – content, 'liability zones' and concept of 'groups'

The contracting parties are generally free to establish their relations according to their will if the contract is within the law. In every case, the final shape of the contractual relationship will depend on the parties respective negotiating position in the changing market situation and circumstances concerning each similar project²³.

Customary practice in the offshore drilling industry provides that the Contractor bears risk of personal injury or death of its personnel and generally assumes liability for rig and

22 T. Hewitt, *Who is to Blame? Allocating Liability in Upstream Project Contracts*, 26 J. Energy Nat. Resources L. 177 2008, p. 179 – 180

23 Toby Hewitt in his article presents the list of the losses where the allocation of risk is usually made, see: T. Hewitt, *Who is to Blame? Allocating Liability in Upstream Project Contracts*, 26 J. Energy Nat. Resources L. 177 2008, p. 180

associated contractor equipment loss or damage (contractor's zone). Conversely, the Operator normally accepts liability for its own personnel and property and, in daywork contracts, generally assumes responsibility for well related risks (including pollution, wild well control, well damage or loss) and reservoir damage (operator's zone)²⁴. Nevertheless, it must be noted that despite of fact that the contracting parties have a broad possibility to disclaim liability between each other, they do not have contractual freedom to regulate the tort position of an injured third party, since this kind of losses are regulated by tort law and the victim (third party) position against the party who caused the loss cannot be changed by contract in which the victim is not a part in²⁵. This problem will be discussed below.

As was mentioned before, the offshore activity marks the involvement of multiple contractors and subcontractors. The indemnity regime has developed to deal with this problem and actually it is common for each party to indemnify the other not only against its own losses but also against those of members of its group, as defined in the contract. In the case of Contractor, the group would include persons who might be affected by an accident on the facility but who do not have a contractual relationship with the Operator or with other contractors (this group might include the contractor's employees, affiliates, agents and subcontractors). In the case of the Operator/Company, its group would normally include the company's employees, affiliates, co-ventures and the other contractors engaged by the company to provide services in relation to the relevant area of operations²⁶. The contracting party, Operator or Contractor, then seeks back-to-back indemnities from those other members of its group (other than employees) to ensure that the principle of absorbing one's own losses is extended down the contractual pyramid. The concept of 'groups' is thus based on the understanding that the relevant party hiring such services might negotiate the terms of engagement and should thus require the subcontractor or the service company to contractually extend an indemnity for injury and death of its own personnel. This solution reduced the number of potential "third parties" claims as most of them will be included in the group definition. As a result, the number of cases, where the inquiry concerning the degree of fault would be necessary, is significantly reduced. A similar result is achieved in circumstances where a separate "mutual hold harmless" agreement is entered into between the drilling contractor and the various service companies and subcontractors involved in the operations. These "round robin" agreements generally apply the knock-for-knock approach and require each signatory to assume liability and hold the other signatories harmless for their respective

24 C. A. Moomjian Jr, op.cit., p. 20

25 T.-L. Wilhelmsen, op.cit., p. 4

26 T. Hewitt, op.cit., p. 184

personnel and property²⁷.

How important are those additional agreements indicates the example below. According to the Norwegian law, the parties may agree to waive a claim for liability for damage to other person's property or persons what will then constitute a promise not to make any claim against a third party. However, the parties may not in their contract enforce the other members of the respective groups to accept a similar regulation. It means that if similar regulation is not provided all through the contractual chain, a contractual party without a knock-for-knock regulation may refuse to accept responsibility for damage to his property and personnel and instead make a claim against the injurer²⁸.

The scope of the particular 'groups' is often the subject of considerable disagreement with the larger oil companies in particular being reluctant to extend their indemnities to cover damage and injury caused to all of their contractors and their property. This reluctance reflects the administration required, the extent of the risk involved in obtaining "back to back" indemnities from these contractors and in some cases the complexity of field ownership structures²⁹.

4.3. Freedom of liability, indemnity and subrogation

The contracting parties are generally free to regulate the risk for causing damage to each other, hereunder limit liability for damage caused to the other party and waive the right to claim damages from the other party. However, the parties to the contract do not have contractual freedom to regulate the tort position of an injured third party, since this kind of losses are regulated by tort law and the victim (third party) position against the party who caused the loss cannot be changed by contract in which the victim is not a part in³⁰.

The extending scope of knock-for-knock provisions, including also the members of 'parties' groups' (see above), reduced the number of potential "third parties" claims as most of them will be included in the groups definition. To extend the effect of knock-for-knock clauses to third parties outside the groups and all the employees, the indemnity must be used. Thus, if the Operator harms an employee E of the Contractor or cause damage to Es property, this damage shall according to the contract be compensated by the Contractor. However, E does not have to accept that the Contractor shall pay the claim. He may direct his claim to the Operator instead. If so, the knock-for-knock principle is obtained through a subrogated claim from the Operator against the Contractor after E is compensated. If E accepts compensation

27 C. A. Moomjian Jr, op.cit., p. 21

28 T.-L. Wilhelmsen, op.cit., p. 10, See also H.J. Bull, op.cit., p. 341

29 C. D. Garrard, *United Kingdom: The Hidden Dangers Of „knock-for-knock” Indemnities*, <http://www.mondaq.com/article.asp?articleid=83204>

30 T.-L. Wilhelmsen, op.cit., p. 4

from the Contractor, the regulation further implies that the Contractor does not have a right to claim recourse from the Operator, even if the Operator is at fault³¹. The liability regulation in the knock-for-knock principle is therefore constructed partly as liability clauses, partly as indemnity and recourse clauses³².

4.4. Insurance

As was written before, the offshore activity is very risky business where the potential losses are very high. This is the reason why the insurance must be acquired by each of contracting parties. Also, the understanding underlying the allocation of liability is that insurance will be obtained by each party to cover the losses that that party might suffer – the knock-for-knock clauses are of no value if the Indemnitor has insufficient assets to back-up the Indemnity.

The contractual allocation of liability is not effective if the party (A) does not obtain specific rights under the other party's (B) insurance – this means that A must be granted a protection against subrogation where he has caused damage to the B's property covered by the insurance, as well as a right to claim the B's insurance if A has had to cover liability for which the B was meant to be responsible. If the liability would be judged according to the general tort law, the insurer should have a right to regress against the tortfeasor, after having paid compensation for the casualty. In such case, the whole idea of contractual allocation of liability will be undermined. This is why the knock-for-knock provisions are commonly accompanied with the clauses concerning waiving all insurer's rights of subrogation against the tortfeasor or naming the other party as a co-insured.

As an example of the first possibility the section §18-9(1) of the Norwegian Marine Insurance Plan (NMIP) which considers a waiver of the insurer's right of subrogation might be invoked. If the insurance contract is governed by the NMIP, the insurer does not have any right of subrogation against a person who has caused damage if such third party has been granted contractual protection against recourse, provided that such contractual regulation is regarded as customary in the activities in which the structure is involved. The NMIP does not express the scope of such waiver, however, according to the Commentary this right is not absolute – the limitation can be found in the background law (section 36 of the Norwegian Contracts Act).

The other possibility is more indirect as the operator or contractor who is a third party to the insurance contract is becoming a co-insured under the insurance. The main content of co-insurance is that a third party with owner interest, security interest or other economic

31 See: *Ibidem*, p. 12, see also H.J. Bull, *op.cit.*, p. 347

32 T.-L. Wilhelmsen, *op.cit.*, p. 5

interest in the insured property is insured for this interest under an insurance effected by the “main owner” or “assured”³³. What is the most important in the context of knock-for-knock agreement, it is that the co-insured has so called indirect liability protection. In Norway, this is not regulated directly neither in the NMIP nor in the ICA, but it is presumed in the preparatory documents to the ICA that the co-insured as injurer will have the same protection as the assured if he causes damage that constitutes an insured event under the casualty insurance effected by the assured. This protection means that the co-insured has the same protection against the insurer as he would have as assured being responsible for causing an insured event through a breach of the so called duties of due care³⁴. According to the NMIP, if the insurance is explicitly effected for the benefit of a named third party, the insurance also covers his interests, but the insurer may invoke the rules relating to identification in §§3-36 to 3-38 (§8-1). Moreover, §18-9 par. 2 NMIP states that the insurance is effected for the benefit of anyone who is contractually entitled to be co-insured under the insurance, provided that such contractual regulation is regarded as customary in the activities in which the structure is involved. The regulation is thus similar in wording to the provision concerning right of subrogation.

It should be noted that sometimes the existence of additional insured provisions can undermine a reciprocal indemnity agreements³⁵ - it happens particularly when indemnity and insurance requirements are in conflict. In *Tullier v. Halliburton Geophysical Services (HGS)*, the court held that a party (McCall), who has entered into a contractual indemnity provision but who also names the indemnitor (here HGS) as an additional assured under its liability policies, must first exhaust the insurance it agreed to obtain before seeking contractual indemnity³⁶. The judge referred to *Ogea v. Loffland Brothers Co.*, where it was stated that the insurance procurement and indemnity provisions of a drilling contract "*must be read in conjunction with each other in order to properly interpret the meaning of the contract.*"³⁷

In the US the liability insurance may be alternative to prohibited indemnity (f.e. in Louisiana) or limits of liability insurance policies may limit indemnities (f.e. In Texas). This issue will be discussed in chapter 6.

The structure of the knock-for-knock principle is thus a combination of freedom from liability/acceptance of not making a claim, a basis for recourse from the party having paid the claim according to tort law, and a bar to recourse from the party having paid the claim even if

33 Ibidem, p. 14

34 T.-L. Wilhelmsen, op.cit., p. 14

35 Ch. L. Evans, op.cit., p. 230

36 81 F.3d 552 (5th Cir. 1996)

37 *Ogea v. Loffland Brothers Co.*, 622 F.2d 186 (5th Cir.1980), at 190

he was not liable according to ordinary tort law³⁸.

5. Advantages and disadvantages of knock-for-knock clauses

5.1. Advantages of knock-for-knock agreements

While it might seem inappropriate at first to protect the party guilty of negligence or wilful misconduct, a fundamental purpose of risk allocation, i.e. creation of clear demarcation line of liability, cannot be obtain in another way. Despite the fact that such allocation of liability, based not on the fault of liable party, but rather on who makes the claim, is contrary to the traditional system, such agreements may be very beneficial for both parties. It is confirmed in practice by popularity and worldwide recognition of knock-for-knock provisions. The specific benefits enjoyed by the parties will often depend on the circumstances of the particular contract, however, some common advantages may be distinguished.

A. Reduced costs

As was written before, the offshore business characterizes the high level of sum invested and related risks. The search for oil and gas, even without accidents, is expensive and the costs of insurance and possible litigation are significant. By using the mutual hold harmless clauses, the allocation of liability becomes clear and simple matter of contract. If the system would be based on traditional regime, in the case of accident giving rise to losses, the lengthy and complex litigation to establish liability based on the general law principles will be necessary. Hereby by using an indemnity provisions the parties could safe their money, as the investigation into which party was at fault is not required any more.

The reduction of costs has also another aspect. A knock-for-knock agreements allows one party to take over responsibility for both contracting parties, which enable to retain one lawyer to defend both of them. For instance, if an employee of a contractor for Company A is injured as a result of an accident caused by both Company A and Company B, the third party contractor employee would generally bring suit against both companies to determine liability. In maritime cases, where the employer is not protected by workers' compensation laws, suit is often filed directly against both companies by their own employees. In either case, without a reciprocal agreement, both companies would have to hire their own attorneys and incur the cost of separate defences. However, if the parties had in place a reciprocal indemnity

38 Ibidem, p. 12

agreement, one attorney would be able to defend both parties³⁹. The knock-for-knock agreements allow thus not only to decrease the need for litigation between the parties but also cut down the overall litigation costs.

B. Certainty

Another benefit connected with knock-for-knock agreements is establishment of the clear level of certainty to both parties with regard to their liability exposure. In the absence of the reciprocal indemnity regime, each contractor would need to insure against the risk of destroying the entire facility (and, in some cases, group of facilities) and the risk of injuring or killing all the people on it⁴⁰. Even if the contractor were able to insure against such risks, the premium involved would most likely be prohibitively expensive for smaller contractors and would, in any event, be an inefficient use of financial resources – in this regard, the contractor would be likely to seek to pass through the increased cost of insurance to the project's operator⁴¹.

Moreover, without risk allocation, each party must purchase liability insurance to cover potential liability for damages during the project. This will then be an addition to casualty insurance covering damage to and loss of property and loss of income, and insurance covering personal damage and death of employees. In case of an accident this would easily result in double insurance, where for instance damage to and loss of property is both covered by the injured party's casualty insurance, and by the injurer's liability insurance⁴².

The main purpose of a knock-for-knock regulation in the offshore contract is thus to benefit from the insurance cover effected by the respective parties. Moreover, with each party taking responsibility for damage or loss to their own property the parties' need for third party liability cover is reduced⁴³.

C. Good business relations and safety

The indemnity regime allows parties to work together, as they can focus on building up their business relationship without worrying about the dispute if something goes wrong. When the contractual parties have not in advance agreed their scope of potential liability, the

39 Ch. L. Evans, F. Lee Butler, *Reciprocal Indemnification Agreements in the Oil Industry: The Good, The Bad And The Ugly*, 77 Def. Counsel J. 226 2010, p. 227

40 The mutual hold harmless clauses concern often the allocation of liability for injury or death of the respective employees on each side; in most jurisdiction, however, in most jurisdictions the employer is already required by law to maintain insurance covering injury or death of its personnel; each side is thus prepared to assume such risk by using the knock-for-knock provisions; a more troublesome situation arises in the case of third party claim

41 T. Hewitt, p. 183

42 T.L. Wilhelmsen, op.cit., p.16

43 D.R. Syvertsen, *Co-insurance of third parties and waiver of subrogation*, Scandinavian Institute of Maritime Law Yearbook 2011 MarLus nr 414, p.118

amicable working relationship may be quickly destroyed when an accident occurs. The offshore business characterises long lasted relations between business partners, this is why the proper atmosphere of dealing should be maintained. Trying to establish another party's responsibility in the case of incident is far away from the close working relationship. By using the knock-for-knock clauses the interested parties can work together to solve the existed problem rather, than make matters worse by blaming each other.

Moreover, establishing the scope of liability in advance let to transparency in the parties relationships, and to creation of a safer workplace for all employees. In this situation, both parties have an equal incentive to make the work place safe for all, because either party can be responsible for the accident, even if it was not their fault⁴⁴. Thus if something happened, and the mutual hold harmless clauses are in force, the parties may focus on their mutual defence and the channels of communication between the contracting parties remain open, making it easier for the defending party to obtain information regarding the accident from the other party and to provide a better defence for both⁴⁵. Without mutual hold harmless indemnity clauses, each party would conduct their own investigations, duplicated everything and hold their cards close⁴⁶. Moreover, if the parties' liability is properly diminished, they can work together to institute safety policies without concern that the party responsible for a particular safety policy will increase their relative responsibility for any potential liability that might arise if the safety policy they were responsible for is violated and someone is injured⁴⁷.

The hold harmless indemnity allows thus not only reduce the overall costs of offshore investments, but also enable building of the amicable atmosphere between the contracting parties, which contribute also in the safety issues. However, the benefits of the knock-for-knock clauses in the safety field may be achieved only when the both parties work together and trust each other.

5.2. Disadvantages of knock-for-knock agreements

The mutual hold harmless allocation of liability has multiple advantages, but does not solve all existing problems. The main arguments against the knock-for-knock regime lies directly in their nature. Since the contracting parties agree to cover losses of their own personnel and equipment in the case of accident, they may be liable even without being slightly blame. The issue seems even more unfair when the indemnified party acted with gross

44 Ch.L. Evans, op.cit., p. 228

45 Ibidem, p. 229

46 See example presented in: A. Thomas, *Knock-for-knock helps safety*, <http://www.standard-club.com/docs/mm24.pdf>, p. 10 – 11

47 Ch.L. Evans, op.cit., p. 229

negligence or wilful misconduct. Such constructions may thus force parties to deal with claims they may otherwise never be involved. This could generate additional costs and be time-consuming. This is the reason why sometimes parties try to include provisions restricting the knock-for-knock clauses. Such action may on the one hand reduce the possibility of claim, particularly when the other party is at fault. On the other hand, when the accident occurs, the additional investigation is required to determine the responsibility of each party, which both takes time and generate extra costs. Moreover, parties in such case have to insure the property and employees they might be responsible for, what will let to double-insurance. Hereby, the advantages of mutual hold harmless clauses are minimised.

Furthermore, it is often argued that since the knock-for-knock clauses contains exclusions of liability even in the case of gross negligence or wilful misconduct of tortfeasor, the responsibility for safety issues are so reduced that it might led to accidents. It may be thus argued that if the indemnified party is not liable for his own action, he may use less care to avoid injury or loss, because he will not be responsible for his own fault. This argument is, however, balanced by the other incentives concerning safety issues, described above⁴⁸.

Summing up, even if the knock-for-knock clauses may seem unjust at the first sight, the benefits described above will most often prevail over disadvantages. This is thus the reason why these formulas are so commonly used and worldwide recognised, especially in those areas where the huge capital sum is involved, i.e. in drilling and towage contracts. Even so, the main problem of their enforceability is still unsolved.

48 See also: T.L. Wilhelmsen, *op.cit.*, p. 4-5

6. The knock-for-knock clauses in the US

6.1. Introduction

The United States have been involved in the offshore business from the very beginning. Their dominant position is continued and there is no indication to change. Even the recent catastrophe – the Deepwater Horizon oil spill has not undermined their supremacy. The world consistently needs oil and gas and the availability of these reserves in the Gulf of Mexico and other US offshore waters is crucial for the global economy. That is why the analysis of knock-for-knock clauses under the US law is so important.

There are several issues which parties have to have in mind when operating in the US offshore waters. The main of them are:

1. the determination of applicable law,
2. the “express negligence doctrine”, and
3. the enforceability of knock-for-knock clauses under anti-indemnity statutes.

These problems (with the necessary introduction to each of them) will be thus respectively analysed in the following sub-chapters.

6.2. The applicable law

The first problem, which the contracting parties have to deal with when the agreement is governed by the US law, is the determination of applicable law. This issue is very important in the context of indemnity provisions, because their enforceability depends to a great extent on the law which governs the contract. This issue will be analysed below, after the short introduction to the US law system will be given.

The law system in the US originates from English common law system, but both groups has developed their specific solutions, so many differences may be noticed today. The law in this country consists of many levels of codified and uncodified forms of law. Moreover, the US is a federal state, so the federal law and the law of each particular state must be distinguished. *Graham Hughes* presented the US law system in such words:

“Each state has a large measure of sovereignty, subject to the national application of federal statutes and the requirements imposed nationally by the United States Constitution. Thus it has been inevitable that the common law has not developed in exactly the same way in different states. At one time or another a state may have a judiciary and a political climate that is relatively liberal or relatively conservative when compared with the majority of states. The economical and social interest to which the judiciary must pay attention in a

state with a largely agricultural economy may be very different from those that obtain in a highly industrialized state with a very large urban population. Thus, although a single common law was originally exported from England to America, a number of factors has led to the development of different common law rules in different states, notably in such areas as torts and criminal law”⁴⁹.

Since the various principles (depending on the applicable law) may apply to the contract concerning activity on the US offshore waters, making the mutual hold harmless provisions enforceable or void, the determination of applicable law is the first thing the contracting parties must be aware of, drafting their contract. Among the laws which may apply in particular case are:

- 1) general maritime law of the US (being the part of federal law),
- 2) the Outer Continental Shelf Lands Act (OCSLA), or
- 3) state law.

Which of them applies to the specific incident depends on the circumstances giving rise to the event causing the problem. Lack of one, consistent system, applied specifically to the offshore industry in the US waters (and, thereby, also to the knock-for-knock agreements) complicated the problem of validity of indemnity provisions. Such difficulty was acknowledged in *Walsh v. Seagull Energy Corp.*⁵⁰, where the court stated: “*Since the oil industry went offshore, the legal system has struggled to produce a body of injury law that is rational, fair, internally consistent, and acceptably productive of safety incentives. The result has been chaos.*”

Below the enforceability of knock-for-knock clauses under different law will be shortly presented, as well as some difficulties concerning the question of determination of governing law.

6.3. General maritime law

By and large, express reciprocal indemnity agreements will be enforced under general maritime law, even if they serve to protect a party from its own negligence if they are properly written and absent a statutory or judicial precedent to the contrary⁵¹. Under maritime law, a contract of indemnity must clearly and unequivocally show that the parties intended to afford protection to an indemnitee against the consequences of his own negligence; this federal

49 G. Hughes, *Fundamentals of American law*, New York 1996, p. 13

50 836 F. Supp. 411, 412 (S.D. Tex. 1993)

51 The judicial rulings in towage cases are quite different – US courts hold that a clause in a towing contract purporting to release the tug from liability for the tug’s negligence is invalid and unenforceable. However, parties now invariably achieve a similar result by arranging for cross-insurance endorsements in which the tug is named as an additional insured and subrogation is waived. See: L. Lambert, *Knock -for-knock contracts are enforceable in the US*, Standard Offshore Bulletin, October 2011, p. 10

“express negligence” rule also applies where there is concurring negligence of the indemnitor and the indemnitee⁵². In *Young v. Kilroy Oil Co. of Texas, Inc*⁵³, the court stated that federal law on indemnity provides that “[a] contractual provision should not be construed to permit an indemnitee to recover for his own negligence unless the court is firmly convinced that such an interpretation reflects the intentions of the parties. This principle... is accepted with virtual unanimity among American jurisdictions”⁵⁴.

The knock-for-knock provisions are thus typically intended to apply regardless of fault – however, federal courts applying general maritime law feel that it is against public policy to be indemnified for gross negligence or wilful misconduct. There are several judgements that acknowledged such approach, but there is also an authority to the contrary.

In this context, there should be mentioned a decision issued in April 2011 by the US District Court for the Southern District of Texas in *Energy XXI, GOM, LLC v. New Tech Engineering*⁵⁵, which addressed the problem of whether an indemnity under a master service agreement governed by US maritime law would be enforceable in the event of gross negligence. In considering the issue, the opinion stated that there is more support for the position that, under maritime law, an indemnification clause purporting to exempt a party from liability for its own gross negligence is invalid than for the position that such clauses are an appropriate means of risk shifting. Somewhat to the chagrin of many in the offshore industry, the decision concluded “that the indemnity provision in this case, to the extent it encompasses claims for gross negligence, is unenforceable.”⁵⁶ The Energy XXI decision is, however, of questionable precedential value since it was issued by lower court and focused on the wording of a specific indemnity provision. On the other hand, a recent decision on a summary judgement motion in the Macondo litigation held that the pollution indemnity in the drilling contract, which was governed by US general maritime law, would be applicable even in the event of gross negligence⁵⁷. However, according to the order from 31 January 2012, issued in relation to partial summary judgement cross-motions in the BP/Halliburton Macondo litigation, public policy would not permit indemnification in the case of fraud, given that fraud involves wilful misconduct exceeding gross negligence⁵⁸.

It must be therefore noticed that there are two contrary decisions concerning

52 J. L. Yeates, *Contract Risk Management – Use of Insurance*,
<http://www.gordonarata.com/720DE/assets/files/lawarticles/LANIER6.pdf>, p. 21

53 673 S.W.2d 236, 244 (Tex. App.--Houston [1st Dist.] 1984)

54 See also: *United States v. Seckinger*, 397 U.S. 203, 211 (1970)

55 L.P., 2011 U.S. Dist. LEXIS 41223 (US DC Southern District of Texas)

56 C. A. Moomjian Jr, *op.cit.*, p. 8-9

57 *Ibidem*, p. 9

58 The court was also mindful that “mere failure to perform contractual obligations as promised does not constitute fraud but is instead breach of contract.” see: *In Re: Oil Spill By The Oil Rig “Deepwater Horizon” In The Gulf Of Mexico*, On April 20, 2010, US DC Eastern District Of Louisiana, p. 5-6

enforceability of knock-for-knock clauses in the case of gross negligence when the contract is governed by general maritime law – one issued by the US District Court for the Southern District of Texas (*Energy XXI*) and other issued by the US District Court for the Eastern District of Louisiana in the *Macondo* litigation. We thus have two District Courts within the Fifth Circuit that are dynamically opposed in respect of their determination as to whether an oilfield indemnity that expresses an intent to be applicable in the event of gross negligence will be enforceable as a matter of public policy under US general maritime law. Moreover, the ruling in the latter case seemingly indicates that the Court would not enforce an oilfield indemnity governed by US general maritime law in the event of wilful misconduct or other intentional wrongdoing⁵⁹.

It must be noted that the federal maritime law will apply **exclusively to the contracts which are maritime in nature** – it is well established that maritime law applies only to those cases where the subject matter bears the type of significant relationship to traditional maritime activities necessary to invoke admiralty jurisdiction⁶⁰. In ascertaining whether the subject matter of the controversy is maritime in nature, the court must look to the contract to determine whether it has sufficient maritime nexus apart from the fact that the situs of performance is in navigable waters⁶¹. In the context of offshore activity, the example of the contract concerning transportation of employees to and from the platform may be invoked⁶².

6.4. The Outer Continental Shelf Lands Act

The application of the Outer Continental Shelf Land Act (OCSLA) is the other possibility the parties have to have in mind when operating on the US Continental Shelf. This act was enacted in 1953 to encourage exploration and development of oil and gas deposits, located in the submerged lands of the outer continental shelf (OCS). The OCSLA defines the OCS as all submerged lands lying outside of a line, three geographical miles distant from the coastline of each state. The OCSLA was intended to define a body of law that would be applicable to the seabed, subsoil, and fixed structures, such as artificial island, drilling rigs and platforms located on the OCS, for the purpose of exploring for, developing, removing and

59 C.A. Moomjian Jr, op.cit., p. 12

60 See: *Hunt Oil*, 754 F.2d 1223 (5th Cir. 1985)

61 See: *Hollier*, 972 F.2d 662 (5th Cir. 1992)

62 See: *Offshore Logistics, Inc. v. Tallentire*, 477 U.S. 207, 106 S.Ct. 2485, 91 L.Ed.2d 174 (1986), where two platform workers were killed in a crash on the high seas of a helicopter which had been transporting them from the offshore drilling platform where they worked to their home base in Louisiana. The Supreme Court concluded that: „admiralty jurisdiction is appropriately invoked here under traditional principles because the accident occurred on the high seas and in furtherance of an activity bearing a significant relationship to a traditional maritime activity. Although the decedents were killed while riding in a helicopter and not a more traditional maritime conveyance, that helicopter was engaged in a function traditionally performed by waterborne vessels: the ferrying of passengers from an “island,” albeit an artificial one, to the shore”.

transporting resources therefrom⁶³.

At its most basic, the OCSLA intended that federal law will apply to the OCS (but the federal law referred to, according to the US Supreme Court, **is not maritime law**⁶⁴), that the law of the closest adjacent state will apply as surrogate federal law, and that the exclusive remedy for workers injured on the OCS will be the Longshore and Harbor Workers' Compensation Act (LHWCA)⁶⁵. Section 1333(a)(1) (2)(A) of OCSLA states explicitly that:

*“To the extent that they are applicable and not inconsistent with this subchapter or with other Federal laws and regulations of the Secretary [...], **the civil and criminal laws of each adjacent State, [...] are hereby declared to be the law of the United States** for that portion of the subsoil and seabed of the outer Continental Shelf, and artificial islands and fixed structures erected thereon, which would be within the area of the State if its boundaries were extended seaward to the outer margin of the outer Continental Shelf”.*

It is thus a gap-filling statute meant to apply federal law to fixed structures on the OCS that are not covered by either maritime law or state law. OCSLA incorporates therefore the law of the state adjacent to the platform as surrogate federal law – which means that this law should govern also the offshore contracts on the OCS. For Fifth Circuit practice, an OCSLA situs in the Gulf of Mexico will be located either offshore Louisiana or offshore Texas, so the law of those states will then apply⁶⁶. It means that also the Anti-indemnity Statute of these states must be taken into consideration when the knock-for-knock provisions on OCS are discussed (it may result in the invalidation of the mutual hold harmless clauses – see sub-chapters 6.5.B.II and C below). The courts, however, have restricted the application of state law to agreements that are view as “non-maritime” in nature. Parties to maritime contracts remain thus free to enforce to indemnify themselves even against their own negligence⁶⁷.

Deciding, whether the OCSLA applies to the case at hand and what effect it can give in the context of indemnity provisions, can be very difficult, both for contracting parties and for the court. In the 2002 decision of *Demette v. Falcon Drilling Co., Inc.*⁶⁸, the United States

63 J.M. Adams, K.K. Milhollin, *Indemnity On The Outer Continental Shelf – A Practical Primer*, 27 TUL. MAR. L.J. 43, 46 (2002), p. 46

64 The Supreme Court has stated also that Congress viewed maritime law as inapposite to OCSLA structures, and admiralty jurisdiction as not extending to accidents in areas covered by OCSLA; see: *Herb's Welding, Inc. v. Gray*, 470 U.S. 421-22, 1985 AMC 1700, 1705 (1985).

65 See J.M. Adams, op.cit., p. 52

66 Ibidem, p. 58-59

67 However, the problem how to determine whether the contract is “maritime” or “non-maritime” is not easily solved; See: *Grand Isle Shipyard, Inc. v. Seacor Marine LLC*: 589 F.3d 778 (5th Cir. 2009) (en banc) (holding that the LOIA invalidated an indemnity provision in a contract providing for work on a fixed platform in the Gulf of Mexico because the contract was non-maritime) and *Hoda v. Rowan Companies, Inc.*, 419 F.3d 379 (5th Cir. 2005) (holding that an indemnity provision was valid in a contract governed by maritime law).

68 280 F.3d 492 (5th Cir.2002)

Court of Appeal, Fifth Circuit, comprehensively examined the scope of the § 1333(a)(1) situs requirement and clarified to which locations the OCSLA applies. At the same time the court asked for en banc consideration to straighten out the state of the law considering indemnity clauses on the OCS stated: *“I regret to say that our Circuit case law on “what is a vessel” and “what is a maritime contract” and what is “maritime employment” have taken on a Humpty-Dumpty approach—they are whatever a particular panel says they are. That’s a tragic circumstance because it destroys uniformity and predictability of the law; and the only ones who benefit from unpredictability and confusion are lawyers”*.

Summing up, to make a determination whether the OCSLA even applies in a given case, involves a Herculean task of sorting, sifting and applying various tests of situs, status, applicability of maritime general law or another state's law, various state anti-indemnity statutes, LHWCA, the Jones Act, contractual choice-of-law provisions, indemnity provisions, and insurance provisions⁶⁹. The problem is even more important as OCSLA is a congressionally-mandated choice of law provision requiring that the substantive law of the adjacent state is to apply even in the presence of a choice of law provision in the contract to the contrary⁷⁰.

6.5. The state law

A. Introduction

In the offshore business, dominated by the large oil companies, the financial responsibility for claims connected with offshore activity may be unfairly shifted to the subcontractors or their insurance companies. The subcontractors, especially in a construction subcontracts, are often forced to take over the whole risk for worksite accidents or other losses even if they are caused by fault or negligence of the main contractors or rig owners.

To protect the sub-contractors from the unfair contract terms, some states decided thus to introduce obligatory anti-indemnity statutes, which affected the validity of knock-for-knock clauses in the case of gross negligence or wilful misconduct. Forty-one states have now some form of law which prohibits a construction contract that requires a subcontractor to indemnify another party for its negligence⁷¹.

The most complex anti-indemnity acts were adopted in Texas and Louisiana (TEX. CIV. PRAC. & REM. CODE ANN Section 127.00 1, and LA. REV. STAT. ANN Section

69 J.M. Adams, op.cit., p. 46

70 See: *Union Texas Petroleum v. PLT Engineering*, 895 F.2d 1043 (5th Cir.), cert. denied, 498 U.S. 848 (1990)

71 But some of these states limit the application of the law, for example, only to public projects. The complete list of relevant legislation can be found in *Anti-indemnity Statutes in the 50 States*, published by Foundation of the American Subcontractors Association, Inc., <http://www.keglerbrown.com/File%20Library/Practice%20Areas/Construction%20Law/2009-anti-indemnity-manual.pdf>

9:2780). Those and similar anti-indemnity statutes might quite easily invalidate the indemnity clauses included in the offshore contracts (the Louisiana legislature has already declared certain indemnity agreements in oil and gas contracts void as against public policy in an effort to defend contractors and their employees from large oil companies that require contractors to provide indemnification in their master service contracts, even when the oil company is at fault⁷²). It should be, however, noted that despite the fact that the aim of both acts is to protect the downstream contractors from being forced to accept one-sided contractual indemnities that insulated an upstream party against virtually all risk⁷³, the Texas and Louisiana anti-indemnity acts are markedly different: Texas allows contractual indemnities in contracts that are backed by insurance and meet certain statutory requirements; Louisiana's anti-indemnity act simply voids contractual indemnities outright. These fundamentally different regulatory approaches to the same policy aim demonstrate what is at stake when a court or arbitration panel must decide whether to apply Texas or Louisiana law to a master service agreement that may cover dozens or hundreds of projects in multiple jurisdictions⁷⁴.

In the further part of this chapter, the focus will be put on the specific solutions introduced in Louisiana and Texas, as the offshore business is the most developed there, and their anti-indemnity statutes have large impact to the drilling contracts on the US waters and outer continental shelf.

B. Texas

Texas has been the centre of offshore industry in the US from the very beginning. Initially the oil production focused onshore, but gradually also the offshore part has become the significant field of the Texas industry. This is then not surprised that several novel issues regarding mutual hold harmless provisions have been recently addressed by the Texas Supreme Court, bringing some clarity and some additional problems at the same time.

When the contract is governed by Texas law, the indemnity provisions to be enforceable must be consistent with the “*express negligence doctrine*” and the Texas Oilfield Anti-Indemnity Act. These two issues will be thus discussed below in the following subchapters.

I. The express negligence doctrine

It is well established in the Texas legal system that a contract for indemnity is read as

72 Ch. L. Evans, *op.cit.*, p. 230

73 See: Tex. Civ. Prac. & Rem. Code Ann. §§ 127.001-127.008; La Rev. Stat. Ann. § 9:2780.

74 E. Cassidy, *The Three-Legged Stool: A Practical Approach to Negotiating Choice of Law Provisions by Reference to Anti-Injunction Statutes in Texas and Louisiana*, The Energy Law Advisor, http://www.cailaw.org/iel_advisor/industry_news/antiinjunction.html#_ftnref1

any other contract to ascertain the intent of the parties⁷⁵. Under principles of contract law, courts must thus ascertain and give effect to the intentions of the parties as expressed in the agreement. However, the benchmark of the Texas law concerning mutual hold harmless provisions are the “*express negligence doctrine*” and “*fair notice requirements*”. These rules were adopted by Texas Supreme Court in 1987 in *Ethyl Corp. v. Daniel Const. Co.*⁷⁶, where it was decided that for an indemnification provision to be legally enforceable under Texas law, it needs to be written explicitly in contract. The underlying concept is that, if a party is to provide indemnification for the consequences of another party’s negligence acts, the indemnity provisions should be obvious, be clearly expressed and state the intent to cover various forms of negligence. In adopting this rule of law, the Supreme Court explained:

„*The express negligence doctrine provides the parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms. Under the doctrine of express negligence, the intent of the parties must be specifically stated within the four corners of the contract*”.

Such rule was further acknowledged in *Dresser Industries, Inc. v. Page Petroleum, Inc.*⁷⁷, where the Supreme Court held that the threshold inquiry when reviewing a contractual provision that requires the indemnitee to be protected from its own negligence centres upon the “fair notice requirements of conspicuousness.” Conspicuousness, mandates “*that something must appear on the face of the [contract] to attract the attention of a reasonable person when he looks at it*⁷⁸”.

As a result of these decisions, contracts in offshore business governed by Texas law broadly provide express notice of the risk allocation provisions at the beginning of the contract, include liability and indemnity clauses in attention-getting text (often by using bold capital letters or different colours) and clearly expressing the unequivocal intention to provide indemnity even so various types of negligence or other bases of legal liability. The contracting parties, to make the indemnity provisions enforceable, include specific formula in the contract, sometimes called “magic words” or “talismanic language”. The statements similar to the following should be sufficient to express intention of the parties and enforce the indemnity provisions:

75 See: *Ohio Oil Co. v. Smith*, 365 S.W.2d 621, 627 (Tex.1963); *Spence & Howe Construction Co. v. Gulf Oil Corporation*, 365 S.W.2d 631, 637 (Tex.1963); *Liberty Steel Co. v. Guardian Title Co.*, 713 S.W.2d 358, 360 (Tex.App.—Dallas 1986, no writ), *SAFECO INS. CO. OF AMERICA. v. GAUBERT* 829 S.W.2d 274 (1992)

76 725 S.W.2d 705, 708 (Tex. 1987)

77 853 S.W.2d 505, 511 (Tex. 1993); see also: The decision in *Atlantic Richfield Co. v. Petroleum Personnel Inc.*, 768 S.W.2d 724, 726 (Tex. 1989)

78 B. Frost, *Indemnified or Not?*, The Permian Basin Petroleum Association Magazine, 15 March 2012, <http://pbog.zacpubs.com/?p=383>

“It is the intent of the parties hereto that, where responsibility or liability is assumed by either party or where either of the parties agrees to release or indemnify the other party in respect of any claim, demand or cause of action, unless it otherwise is expressly stated, such release, assumption of liability and/or indemnification shall apply notwithstanding the gross, sole, concurrent, active or passive negligence of any party hereto or any person, firm, or corporation for which such party is responsible (whether or not such negligence related to a pre-existing condition or defect), any breach of warranty or representation, unseaworthiness of any rig or vessel owned or hired by either party, or any other legal theory (including tort, strict or product liability) which otherwise may be applicable.”⁷⁹”

In the other words, the express negligence doctrine provides that parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms. There is, however, one exception to this "conspicuousness requirement" - if the language is in an extremely short document, then it could be considered conspicuous provided that the indemnitor could prove that the indemnitee had actual knowledge of the contents of the indemnity provision. The court in the *Page and Dresser* case did not elaborate on how short a document must be to constitute an extremely short document, but did give the example of a telegram being a good illustration⁸⁰.

II. The Texas Oilfield Anti-Indemnity Statute

The express negligence doctrine is not the only condition which the contracting parties must meet to enforce the indemnity provisions. In order to have a knock-for-knock agreement upheld, the companies in offshore industry must adhere also to the Texas Oilfield Anti-Indemnity Statute. The Act was introduced in 1973 and its aim was to prevent large oil owners and oilfield operators from demanding their contractors to indemnify them not only against negligence on the part of the contractor, but also any possible negligence of third parties, including their own. Such practice was judged to be not only unfair, but was seen to be placing severe strain on the contractors' bottom-line⁸¹. In effort to combat this activity, the Texas legislature passed the Texas Oilfield Anti-Indemnity Statute. § 127.003 of the Statute provides that:

“(a) Except as otherwise provided by this chapter, a covenant, promise, agreement, or

79 C. A. Moomjian Jr, *Contractual insurance and risk allocation in the offshore drilling industry (3/3)*, Drilling Contractor, May/June 1999, p. 26

80 P. S. Murphy, *The Contract You Thought You Made: The Express Negligence Doctrine*, <http://corporate.findlaw.com/litigation-disputes/the-contract-you-thought-you-made-the-express-negligence.html>; See also: *Coastal Transport Company v. Crown Central Petroleum Corporation*, et al, 20 S.W.3rd 119 (Tex. App. Â– Houston [14th District] 2000)

81 Asdza Nadleeche, *The Texas Anti-Indemnity Law – what does it mean for your business?*, <http://www.oilandgasiq.com/legal-and-regulatory/articles/the-texas-anti-indemnity-law-what-does-it-mean-for/>

understanding contained in, collateral to, or affecting an agreement pertaining to a well for oil, gas, or water or to a mine for a mineral is void if it purports to indemnify a person against loss or liability for damage that:

(1) is caused by or results from the sole or concurrent negligence of the indemnitee, his agent or employee, or an individual contractor directly responsible to the indemnitee; and

(2) arises from:

(A) personal injury or death;

(B) property injury; or

(C) any other loss, damage, or expense that arises from personal injury, death, or property injury”.

The scope of the act is thus **restricted only to those agreements for services which pertaining to a well for oil, gas, or water or to a mine for a mineral** (those services include, however, a broad range of activities; see: Section 127.003). The Texas Supreme Court has not defined the requirements of "well or mine services," but the Texas Courts of Appeal have, and they require a close nexus between the indemnity agreement and the "well or mine services." For example, in *Transworld Drilling Co. v. Livingston Shipbuilding Co.*⁸², the Beaumont Court of Appeals held that the Texas Oilfield Anti-Indemnity Statute did not apply to an agreement to repair an offshore drilling rig when the contractor performed the repairs in a shipyard.

Nevertheless, if the indemnity agreement concerns services dealing with wells or a mineral mine does not purport to indemnify a party against that party's own negligence, then the indemnity agreement is not covered by the Statute – but, ipso factum, it means that if contract does apply to those services, then even if contracting parties comply with the fair notice doctrine and the express negligence doctrine, the clause in which they attempt to be relieved from the effects of their own negligence still will not be enforceable due to the Texas Anti-Indemnity Act⁸³. It should be noted that the Texas Anti-Indemnity Act does not cover fixed facilities, purchasing, gathering, selling, or transporting of production, Joint Operating Agreements, or confidentiality agreements, since all are not agreements for services to be performed on a well or mineral mine (initially it did not apply to pipelines as well, but it has changed to the some extent since June 2011 – when the act has been amended – **HB 2093**)⁸⁴.

It must be stressed that the act contains, however, very important exception limiting its scope – it does not apply to an agreement that provides for indemnity if the parties agree in

82 693 S.W2d 19, 23 (Tex. Ct. App. 985)

83 P. S. Murphy, op.cit.

84 Also Section 127.004 contains also several exclusions, f.e. personal injury, death, or property injury that results from radioactivity.

writing that the indemnity obligation will be supported by liability insurance coverage to be furnished by the indemnitor subject to the following limitations:

- With respect to a mutual indemnity obligation, the indemnity obligation is limited to the extent of the coverage and dollar limits of insurance or qualified self-insurance each party as indemnitor has agreed to obtain for the benefit of the other party as indemnitee.
- With respect to a unilateral indemnity obligation, the amount of insurance required may not exceed \$500,000⁸⁵.

A "mutual indemnity obligation" means an agreement in which the parties agree to indemnify each other, for loss, liability or damage arising from claims of their own employees, contractors and invitees arising out of performance of the agreement⁸⁶. A "unilateral indemnity obligation" means an agreement in which one of the parties as indemnitor, agrees to indemnify the other party as indemnitee for claims, but there is no reciprocal indemnity obligation⁸⁷.

Exception from sec. 127.005 is the main difference between the Texas and Louisiana Anti-Indemnity Statutes, as the Texas Act makes contractual indemnities valid and enforceable if they are supported by insurance and meet basic statutory requirements. Parties to a contract may thus negotiate mutual hold harmless clauses, but only if these clauses are backed by insurance. Mutual indemnity is allowed when insurance is purchased „for the benefit of the other party as indemnitee”.

The Texas Act’s allowance of insurance coverage when there are mutual indemnity obligations has led to litigation in those circumstances where each party to the oilfield contract provides different levels and/or types of coverage to the other. Generally, where this circumstance exists, the party, or its insurer – from which indemnity is being sought, has argued that since the indemnity obligation is not mutual in every respect, the entire indemnity obligation and its insurance coverage are void. However, the Texas courts have rejected this argument and instead held that the lowest common denominator of insurance coverage, in terms of the dollar amount of insurance coverage and the type of coverage, provided by the parties to each other is the maximum amount and type of indemnity permitted under the Texas Oilfield Anti-Indemnity Act⁸⁸. The parties, however, do not have to purchase insurance for the same amount of coverage – but if one party has more limited coverage, any contractual

85 Sec. 127.005

86 Sec. 127.001(3)

87 Sec. 127.001(6)

88 R. Redfean, Jr., *Oilfield Anti-Indemnity Acts and Their Impact on Insurance Coverage: A Comparative Analysis*, Insurance Journal West Magazine, 22 August 2005, <http://www.insurancejournal.com/magazines/features/2005/08/22/59608.html>

indemnity obligation is limited to the amount of coverage held by the party with the least insurance. This means that contracting parties may negotiate mutual indemnification only to the extent that it is truly mutual, and no more⁸⁹.

C. Louisiana

Under Louisiana's general law of indemnity, a less stringent test than Texas's express negligence rule is used. Louisiana law follows the general rule that a party may be indemnified against its own negligence if the indemnification is clearly expressed in the parties' contract⁹⁰. An indemnity provision will be strictly construed, but neither an express reference to "negligence" nor the use of any "magic words" in such agreement is required – rather the inquiry focuses on the intent of the parties, as inferred from the language of the agreement⁹¹. The Louisiana Oilfield Anti-Indemnity Act introduces, however, important exception to this rule, based on a public policy principle.

The Louisiana Oilfield Anti-Indemnity Act (LOIA) was enacted in 1981, upon finding that *"an inequity is foisted upon certain contractors and their employees by the defense or indemnity provisions [...] contained in some agreements pertaining to wells for oil, gas, or water or drilling for minerals"*⁹². This point of view was acknowledged by the Supreme Court of Louisiana in *Fontenot v. Chevron U.S.A., Inc.*, where it has been observed that the LOIA *"arose out of a concern about the unequal bargaining power of oil companies and contractors and was an attempt to avoid adhesions contracts under which contractors would have no choice but to agree to indemnify the oil company, lest they risk losing the contract"*⁹³.

The LOIA limits the enforceability of knock-for-knock clauses by declaring that any *"provision contained in, collateral to, or affecting **an agreement pertaining to a well for oil, gas, or water . . . is void and unenforceable to the extent that it purports to or does provide for defense or indemnify, or either, to the indemnitee against loss or liability for damages arising out of or resulting from death or bodily injury to persons, which is caused by or results from the sole or concurrent negligence or fault (strict liability) of the indemnitee, or an agent, employee, or an independent contractor who is directly responsible to the indemnitee.**"*⁹⁴ The agreement in this context means any agreement *"concerning any operation related to the exploration, development, production, or transportation"* of oil, gas

89 See also: J.M. Adams, p. 82-88

90 See: *Rodrigue v. Legros*, 563 So. 2d 248, 254 (La. 1990)

91 J. Lanier Yeates, op.cit., p.4

92 J. Garner, *The Louisiana Oilfield Indemnity Act*, <https://www.hightable.com/legal-issues/insight/the-louisiana-oilfield-indemnity-act-49810>

93 *Fontenot v. Chevron U.S.A., Inc.*, 676 So.2d 557, 563 (La.1996).

94 Section 2780(B)

or minerals⁹⁵.

It must be stressed that the Louisiana Act does apply only to cases for personal injury or death, does not, however, include damage to property or economic loss. In contrast to the Louisiana Act, the Texas Anti-Indemnity Statute applies also to the property damage. Moreover, the Louisiana Oilfield Act does not allow reciprocal indemnification provisions when they concern death or bodily injury, even when these obligations are mutual and based on the satisfactory insurance. The scope of the statutes is, however, not entirely clear and this issue was several times a subject of litigation, as the statutory language leaves open the question of whether any specific indemnity agreement is “*collateral to*” or “*affects*” an agreement which “*pertains to*” a well or the drilling for minerals⁹⁶. The Fifth Circuit studied the history and intent of the Texas Statute, and concluded that it differs substantially from the Louisiana Oilfield Indemnity Act (LOIA), in that the Texas Statute defines agreements "pertaining to a well" as requiring the contractor to render "well or mine services". The LOIA, on the other hand, states that any agreement concerning oil and gas operations is an agreement "pertaining to a well". Generally speaking, the courts in Texas, Louisiana, New Mexico and Wyoming do not apply their Oilfield Anti-Indemnity Acts to agreements for general oilfield work, but only to those agreements which have a not too attenuated relation to the operation, maintenance or repair of a distinct oil, gas or other mineral well or wells ⁹⁷.

Simultaneously, The LOIA also invalidates contractual clauses requiring waivers of subrogation, additional named insured endorsements, or “*any other form of insurance protection*” that would frustrate the intent of the LOIA (Section 2780(G)). In *Babineaux v McBroom Rig Building Services, Inc.*⁹⁸, the United States Court of Appeals for the Fifth Circuit held that this section of the LOIA means that all additional insured provisions required by contract are unenforceable. However, in *Fontenot v Chevron USA., Inc.*⁹⁹, the Louisiana Supreme Court held that this did not extend to a waiver of subrogation clause in an indemnity contract, as long as the waiver did not frustrate or circumvent the LOIA. The court in the latter case held that a waiver of subrogation is invalid only when it shifts liability in favour of the oil company, and that occurs only when it is used in conjunction with an indemnification clause. The court noted that since the plaintiff had not attempted to enforce the indemnification provision, no shifting of liability had occurred. However, it must be noted that the judgement was issued after analysing the very specific facts of the case, so it should

95 Section 2780 (C)

96 This problem has been analysed by the US courts, f.e. in *Oliver Broussard v. Conoco, Inc. v. SHRM Catering, Inc.* 959 F.2d 42 (1993 A.M.C. 2404).

97 R. Redfean, Jr., op.cit.

98 806 E2d 1282 (5th Cir. 1987)

99 676 So. 2d 557 (La. 1996)

not have a precedential value.

The rule of Section 2780 (G) is also restricted in another aspect, since the courts have created a judicial exception to the Louisiana Oilfield Anti-Indemnity Act in the case of co-insurance by permitting indemnity when the party being indemnified pays for the indemnitor's insurance coverage. In *Marcel v. Placid Oil Co.*¹⁰⁰; the United States Fifth Circuit Court of Appeals considered an oilfield contract in which the plaintiff's employer (indemnitor) was required to provide insurance coverage to the defendant (indemnitee), who agreed to compensate the employer for the cost of the insurance premiums necessary to add it as a co-insured. On the other words, the additional insured (indemnitee) paid here for its own insurance coverage. The court upheld such an arrangement and found that it was not contrary to the LOIA. It noted that the LOIA was concerned with preventing the shifting of the economic burden to the contractor, a concern that was not present where the indemnitee bore the costs of the additional insurance coverage and no material part of the cost of insurance is borne by the party procuring the coverage. Thus, the indemnitee is receiving the benefit of the contractual insurance he purchased, rather than indemnity, which is prohibited by the statute¹⁰¹. This exception is known now as the "*Marcel exception*". However, if a material part of the cost of insuring the indemnitee is borne by the independent contractor, the exception does not apply¹⁰². The *Marcel* doctrine is often reflected in drilling contracts governed by the Louisiana law so as to render knock-for-knock contractual indemnities addressing personal injury and death enforceable¹⁰³. The sample language attempting to comply with the Marcel exception may be following:

- applicability of the Louisiana law: *"Notwithstanding anything contained herein to the contrary in this Exhibit "B" or the Master Service Agreement attached hereto, to the extent that particular Work performed hereunder is non-maritime and is performed in the State of Louisiana or offshore of the State of Louisiana, and maritime law is held inapplicable,...*
- consideration-premium payment: *..Contractor agrees that, in return for payment of the applicable premium by Company..*
- sharing of contractor's policy coverage: *..all of Contractor's insurance policies (with the exception of Workers Compensation coverages and applicable minimum limits required in this Master Service Agreement) shall, to the extent that Contractor has expressly assumed the risks allocated to it under the attached Master Service*

100 11 F. 3d 563 (5th Cir. 1994)

101 James Garner, op.cit.

102 See: *Amoco v. Lexington Ins. Co.*, 745 So.2d 676 (La. App. 1 Cir. 1999), where Amoco paid \$2 000 to get coverage of \$11 000 000

103 C. A. Moomjian Jr, *Drilling Contract Historical Development...*, op.cit., p. 6

Agreement..

- extends protected groups: *..name Company Group (as herein defined) as additional insureds thereunder, provide a waiver of subrogation in favor of Company Group, and be primary as respects any other coverage in favor of Company Group..*
- payment of premium: *..Contractor shall bill Company for all premiums incurred in obtaining additional Insured coverage, waivers of subrogation, and primary endorsements as described above for Company Group (as herein defined). Both parties agree that Company is paying for all material parts of the insurance protection for Company Group (as herein defined).¹⁰⁴*

As we can see, some specific problems concerning applicability of the Louisiana Anti-Indemnity Statute may easily appear between the parties in the offshore industry. That is why the careful and precision drafting is highly required. Since the Louisiana law will probably apply to the *Deepwater Horizon* case, the thoughtful observation of mutual impact is advised as the final result can change the scope and meaning of indemnity clauses included nowadays in offshore contracts.

6.6. The knock-for-knock under the US law – summary

Summing up, the rulings in litigation involving general US admiralty and maritime law have established enforceability of traditional knock-for-knock clauses even in the event of negligence or other culpability. In the *Rodrigue v. Legros*¹⁰⁵ the court stated that: *“By allowing indemnity provisions to be fully enforceable, the federal maritime law gives parties the contractual freedom to allocate risks between themselves”*. The condition, however, is that such provisions must be specific and conspicuous, so the doubts will be judged *contra proferentem*. On the other hand, the problem might be much more complicated in those states where anti-indemnity statutes were introduced, but as was presented above, those statutes have often limited scope of applicability and, as practice shows, the offshore business tries to deal successfully with difficulties they may cause.

104 Beirne, Maynard & Parsons, L.L.P, *Indemnity and Insurance: Considerations in negotiating, drafting and enforcing*, <http://www.acc.com/chapters/houst/loader.cfm?csModule=security/getfile&pageid=1256869>, p. 42-47

105 563 So. 2D 248, 255 (la. 1990)

7. The knock-for-knock clauses in Norway

7.1. Introduction

When the offshore contract is governed by Norwegian law the main problem concerns the enforceability of knock-for-knock clauses in the case of gross negligence of one party – this issue will be thus discussed in detail below. It should be noted here that it is well established in Norwegian legal tradition that the clauses disclaiming liability for party's own fraudulent or intentional breach of contract should not be upheld¹⁰⁶.

Parties operating under Norwegian law are generally free to design their relations according to their will. Moreover, the main rule is that contracts shall be fulfilled as agreed¹⁰⁷. The contractual party is therefore free to limit his liability against other party, and waive his right to claim any liability in tort from this party¹⁰⁸. Furthermore, parties are also free to waive their right to claim any liability from a third party, and thus waive such right in regard to the whole group¹⁰⁹. It means that also knock-for-knock provisions will be broadly enforced if they are in accordance with the general contract law. Nevertheless, the freedom of contract is not unlimited – there can be found several restrictions of this principle, even in commercial contracts. Due to the similarities between indemnity clauses and exclusion clauses, many of the same scruples and considerations apply to both contractual provisions – this means that, in Norwegian law, indemnity clauses are likely to be treated the same way as exclusion clauses in relation to the mandatory rules¹¹⁰.

To decide whether the knock-for-knock clauses will be enforceable under Norwegian law, the general contract law must be considered. The analysis below will thus be based on two statutes:

1. NL 5-1-2¹¹¹
2. The Norwegian Contracts Act (section 36)¹¹²

It can be said that despite of common application of knock-for-knock clauses in contracts governed by Norwegian law¹¹³, there are still several problems which are constantly

106 See f.e. O. Lund, *Standardkontrakter, bilsalg og preseptoriske regler*, Lov og Rett 1964, I. Hole,

Ansvarsfraskrivelse i massekontrakter, Norsk Forsikringsjuridisk Forenings Publikasjoner nr. 40

107 Kong Christian Den Femtis Norske Lov av 25. april 1687 (NL) 5-1-1.

108 Bull, op.cit., p. 346

109 T.-L. Wilhelmsen, op.cit., p. 11

110 A. Bjerketveit, *Indemnity- and Hold Harmless Clauses...*, p. 26

111 Kong Christian Den Femtis Norske Lov av 15. april 1687 5-1-2.

112 Lov 31. mai 1918 nr 4 om avslutning av avtaler, om fuldmagt og om ugyldige viljeserklæringer (avtaleloven).

113 See f.e. the Norwegian Fabrication Contract 2007 (NF 07) and the Norwegian Total Contract 2007 (NTK 07), where the indemnity provisions applies „regardless of any form of liability, whether strict or by negligence, in whatever form, on the part of the other group.”

discussed in legal theory. Below, the reciprocal indemnity provision will be thus discussed in the context of general contract law, with the special focus on a gross negligence problem.

7.2. NL 5-1-2

As was written before, the freedom of contract is one of the main principles in Norwegian law, however, there are several exceptions which restricted this rule. The very general one may be already found in the act from 1687 – Kong Christian Den Femtis Norske Lov. The regulation is very simple as this statute forbids those agreements which are against law and morality (*“imod Loven, eller Ærbarhed”*). Even if the wording is simple, the problem, however, remains with a definition of the term *'morality'* and as such must be interpreted by court in each particular case. It should be stressed that in this context the judges must refer to *'the general social morality'* (generally accepted moral rules) and cannot based their judgement on their own perception of ethic. Since the conceptualization of morality is continually changing and it depends on place and time, the quotation of old cases should be done with caution¹¹⁴.

The restriction derived from NL 5-1-2 is the most essential in the context of gross negligence since such exclusions may seem to be against morality. Hagstrøm points out that the responsibility for gross negligence can be compared with the non-statutory strict liability and that there is very strong constraints on where the responsibility should be placed when the party was found to be grossly negligent¹¹⁵. There can also be found some case law which approved such point of view – in Rt. 1916 p. 717 the court held that: *“The party’s guilt can be so obvious or gross that his waiver of liability should not be approved”*. The definition of gross negligence is well established both in Norwegian case law and legal theory – the Norwegian Supreme Court in one of their judgements stated that *“In order for an act to be considered as grossly negligent, it must in my opinion represent a pronounced derogation from common proper behaviour. It must be a behaviour that is strongly blameable, where the person is substantially more to blame than where an act is only negligent.”*¹¹⁶

How to interpret the term *“party’s guilt”* is the question about identification. We can thus differ between the company’s own fault and the fault of its ordinary employees. In the case where one or both of the parties are legal persons (companies), the acts of the company’s management will be identified with the company itself. It should be, however, added that courts are rather willing to exclude broad range of workers from a *“company’s management”*. In Rt. 1994 p.626 the dispute concerned whether the freight forwarder could invoke the

114 See: V. Hagstrøm, *Om grensene for ansvarsfraskrivelse, særlig i næringsforhold*, Tidsskrift for Rettsvesen 1996, p. 475

115 V. Hagstrøm, *op.cit.*, p. 473

116 M, Murray & Spens LLP and Thommessen AS, *op.cit.*, p. 27

limitation of liability in the shipping contract, despite docked inspector gross negligence. The Supreme Court ruled that the inspector should not be considered a part of the shipping company's management, and that he could not be identified with management even if he had made autonomous decisions in connection with the incident.

The courts and legal theory thus broadly accepted disclaimers of liability which covers actions taken by employees outside company's management, as being in accordance with NL 5-1-2, even if such accident is caused deliberately or with gross negligence. Lund justifies such a view writing that in practice it may be totally impossible to monitor whether the employee acted with intent or gross negligence and since they can inflict their employer significant damage, such liability could also be "extremely inconsistent and burdensome."¹¹⁷ The less certain issue is to what extent freedom of liability for gross negligence or deliberate act of the company itself may be valid.

The Norwegian Supreme Court several times have stated that indemnity clauses disclaiming liability where one party was at fault (gross negligence, intent) are not valid as being contrary to NL 5-1-2¹¹⁸ Based on these judgements, it is claimed in legal theory that limitation of liability for the company's own gross negligence is invalid as an absolute rule. Hagstrøm argues that NL 5-1-2 provides an absolute bar to indemnification for gross negligence and intent from the party himself, and that this is important as a background for interpretation of Contract Act § 36¹¹⁹. Nevertheless, this view is questioned nowadays – in the preparatory documents to the Contract Act § 36, it was claimed that the interpretation of NL 5-1-2 is uncertain in regard to limitation of liability¹²⁰. It was also argued that invalidity is merely a main rule where there is room for exceptions depending on the circumstances¹²¹. When assessing the knock-for-knock clauses in the context of morality the reasoning behind such clauses and the advantages of their application must be remembered (see: chapter 5.1). Therefore, it is difficult to see why morality should prevent an efficient development of risk sharing. Even so, the conception is still unclear as there is no Supreme Court judgement concerning this issue.

It should be stressed that not all indemnity clauses concerning the companies own fault would not be enforceable under Norwegian law – the courts to some extent have accepted the knock-for-knock provisions if they concerned ordinary negligence of company's management, however, their enforceability were rather suspended in the case of more serious carelessness.

117 O. Lund, *op.cit.*, p. 68

118 See f.e. Rt 1916 p. 717 and Rt 1926 p. 712

119 V. Hagstrøm, *op.cit.*, p. 464 and 475

120 Ot prp 1979:32 p. 19

121 T.-L. Wilhelmsen, *op.cit.*, p. 22-23

The detailed demarcation between management's and employee's fault is not so significant today, since the Norwegian Contracts Act in section 36 introduces different criteria to assess whether indemnity clause can be upheld. Kai Krüger highlights that liability regulations are now subject to control by § 36, and shows that there must be a critical question of "how far a liability clause – standard or individually designed - "seems unfair" and contrary to "good business practices" when taken respect to the total content, the parties' position and other circumstances..."¹²².

It can be thus said that the meaning of NL 5-1-2 is currently reduced and the courts will more often refer to Contracts Act to decide whether the knock-for-knock clause is valid, but NL 5-1-2 remains important rule when the judge would like to highlight a conflict with morality.

7.3. The Norwegian Contracts Act

The Scandinavian law of contract is the result of several centuries of development where the seeds of a unity of legal interest were seen to emerge from at least the middle of the 19th century¹²³. The fundamental of contract law in Norway is the Contract Act enacted in 1983, which forms a basis for discussion concerning validity of contractual provisions. The main provisions relevant in discourse concerning knock-for-knock clauses are included in section 36 of this Act.

Section 36 states:

“(1) A contract may be modified or set aside, in whole or in part, if it would be unreasonable or at variance with the principles of good faith to enforce it. The same applies to other juristic acts. (2) In making a decision under subsection (1) hereof, regard shall be had to the circumstances existing at the time the contract was concluded, the terms of the contract and subsequent circumstances”.

Despite the fact that section 36 uses the word “agreement” (*avtale*), it is clear that not only the contract as a whole can be modified, but also the particular provisions in such contract might be changed as well¹²⁴. If the clause is considered to be unfair, it is most reasonable to waive the clause and leave the background law to apply to the case at hand (also partial waiver may be possible, so that the analysed provision will be without legal effect as far as it appears unreasonable)¹²⁵. However, it should be stressed that there is no prohibition against making bad deals, so the agreement may be upheld even if one of the parties feels injustice. Moreover, it must be remembered that it is not judicial mission to modify a contract

122 K. Krüger, *Norsk kontraktsrett*, 2. opplag, 1991, p. 783

123 V. Hagstrøm, *The Scandinavian Law of Obligations*, Institute for Scandinavian Law 1957-2010, p. 118

124 G. Woxholth, *Avtalerett*, 7. utgave, 2009, p. 343

125 A. Bjerketveit, *Indemnity- og hold harmless-klausuler i norsk rett*,

<http://www.jus.uio.no/ifp/english/research/projects/anglo/essays/bjerketveit.pdf>, p. 121

in such a way to compose a new agreement which could potentially lead to the parties being bound to something that is far beyond their abilities and intentions¹²⁶.

The rules included in Norwegian Contracts Act and NL 5-1-2 are overlapping to the some extent, what means that courts have discretion to decide which statute will apply to the case at hand. The Contract Law focuses on the relations between the contracting parties (a judge have to thus consider whether those relations are unfair for one of them and shifting unreasonably the economical burden), the NL 5-1-2 considers instead the morality of the contract in general. By and large, the contract act will be chosen more often as it seems to be more neutral in its wording. In cases where both provisions are similarly applicable, judges will refer to NL 5-1-2 when they want to signify that the knock-for-knock clause does not only construct parties relationships against to good business practice, but that it is also contrary to moral principles¹²⁷. It can be said that very often the indemnity agreements which are immoral can also be judged as unreasonable for the parties¹²⁸. The argument from NL 5-1-2 can be therefore used f.e. where the parties can obtain insurance covering their part of liability (so the contract cannot be judged as unfair from their perspective), but it may be simultaneously inconsistent with the moral rule that anyone should be released from liability for his own gross negligence or fraudulent act. On the other hand, a contract may be unfair without being immoral, for instance if a change of circumstances has resulted in a shift of the risk for damage making the knock-for-knock agreement unfair for one of the parties¹²⁹.

In offshore context, the unreasonableness will be invoked to consider whether the party may be bound by its promise to keep the other party indemnified if the tort is caused by gross negligence of tortfeasor. Whether or not an exclusion of liability can be upheld will depend on an overall evaluation, based on the criteria of reasonableness found in section 36¹³⁰. It means that even if the contractual provisions analysed separately seem to be unreasonable, the court must look at the whole contract and relations between the parties to decide whether those clauses may be declared unfair and be denied. An important point is that there is a contract's overall result (i.e. its effect on a performance stage) that should be considered and since the agreement must be assessed as a whole, an unfavourable conditions may be outweighed by a condition that is favourable to the party¹³¹. The good example are knock-for-knock agreements, where particular rules analysed in isolation may seem to unfairly shifting financial responsibility, but when the contract is considered as a whole, it is clear that its

126 See: Woxholth, op.cit., p. 411

127 G. Woxholth, op.cit., p. 335, see also: Rt 2004 p. 1582

128 J. Hov, A. P. Høgberg, *Alminnelig avtalerett*, 2009, p. 324

129 T.-L. Wilhelmsen, op.cit., p. 24

130 V. Hagstrøm, *Om grensene...*, p. 630

131 Idem, *Urimelige avtalevilkår*, Lov og Rett 1994 p. 164

commitment reflects a corresponding duty of the parties. If this distribution of liability reflects a reasonable allocation of risk, the contract cannot be thus held to be unreasonable.

As was written before, a court have to look at the performance stage when an assessment is made – it is particularly important in the offshore business where the contractual relations last many years. The parties contractual arrangement and mutual connections based on a contract that runs over many years could have changed since the agreement was signed, and the § 36 should reflect and capture the development in view of what is right and wrong¹³². It means that since relations system between the contracting parties may have changed since the contract was agreed, the argument of unreasonableness must be evaluated according to the actual situation and actual perception of parties corresponding duties.

Originally, it was thought that the primary scope of § 36 should be consumer protection (however, according to the preparatory documents it was clear that the provision should also apply to professional contracts¹³³), but practice shows that the provision gradually has become more important also for contracts between professionals¹³⁴. Nevertheless, only once the provisions of section 36 have been analysed by the Norwegian Supreme Court in the context of liability in an agreement between professional parties¹³⁵. However, the litigation concerned provisions of NSAB (the Nordic Freight Forwarder Agreement) which differ to the some extent from mutual hold harmless clauses, so the judgement may only give some guidance in the field of knock-for-knock agreements. NSAB is an agreed standard contract with a long tradition and it states that the freight forwarder's liability for damage is limited unless damage is caused intentionally.¹³⁶ The Norwegian Supreme Court considering the limitation of liability in this context held that the disclaimer of liability is valid if it concerns the gross negligence of employee. The opinion could be thus different if the incident would be caused by the fault of senior employee (identified with the company's fault – see the discussion in 7.2.).

The additional guidelines can be found in Swedish and Danish legal theory and case law since these Scandinavian legal systems are based on the same principles and the Norwegian section 36 is a result of Nordic legislative cooperation with identical rules in all the Nordic countries¹³⁷. This is why the Swedish and Danish preparatory documents are highly relevant here. In Swedish preparatory document there can be found an opinion that the

132 E. Selvig, *Kontraktens rettskildelære, I: Knophs oversikt over norsk rett*, 11. utgave, 1998 p. 283

133 See: NOU 1987:24 p. 47 and p. 61, SOU 1974:83 p. 111

134 V. Hagstrøm, M. Aarbakke, *Obligasjonsrett*, 2003, p. 278

135 *Kaiinspektørdommen*, Rt 1994, p. 626

136 NSAB 2000 § 22 cf. § 5.

137 T.-L. Wilhelmsen, op.cit., p. 25

application of limitation of liability clauses shall not be limited to a specific degree of fault, but it should rather depend on a total evaluation of the specifics of the actual contract. In cases where freedom of liability is tied to financing through insurance the main purpose will be to limit recourse from the insurer, and a convenient liability and insurance regime limiting the costs of recourse processes should not be denied through strict principles of fairness¹³⁸. As a result, the indemnity provisions in professional agreements shall be treated differently than the same clauses in other contracts, especially when they are connected with insurance cover.

The Danish courts are rather hesitant to exclude or limit liability for gross negligence, however they are willing to accept such exclusions when some conditions are fulfilled. There are several judgements of Danish Supreme Court which can shed little light on the interpretation of limitation of liability clauses, however, they concerned provisions of the Nordic Freight Forwarder Agreement (NSAB), which, as was written before, might give some guidance also in the case of knock-for-knock clauses. In U 1993.851 the limitation clause was set aside by the Danish Supreme Court when the freight forwarder negligently failed to follow its own established practise for delivery of the goods. However, the limitation was accepted in newer cases, i.e. U 2005.243 and U 2006.632. In U 2005.243 the judges concluded that the provision must be accepted as written also in case of gross negligence. The U 2006.632 concerned the situation where the company had failed in the planning and performing of the service (it was not directly stated that the failure had been grossly negligent, but this seems to be presumed in the lower court, which set the limitation aside). The Danish Supreme Court referred to U 2005.243, and stated that the limitation could not be set aside according to the Contract Act §36 in the case of gross negligence. Main arguments were that the freight forwarder contract is an agreed standard contract where the limitation is part of a total liability regime which presumably rests on a total evaluation where considerations of efficient insurance played a central role¹³⁹.

The similar approach was presented by the Maritime and Commercial Court in 2004 which expressed that knock-for-knock provisions in BIMCO “TOWCON” charter party can be upheld since TOWCON is a charter party commonly used in the industry and developed with participation of and under the influence of BIMCO. It means thus that shipowning companies through BIMCO most likely must have accepted the wording of the standard clause, and the allocation of risk and liability¹⁴⁰.

On the other hand, Danish legal theory presents rather restrictive position on exclusions/limitation of liability – Gomard in “*Obligationsret*” stated that:

138 SOU 1974:83 pp. 180-181; , T.-L. Wilhelmsen, op.cit., p. 26

139 Ibidem, p. 26

140 Ibidem, p. 23

”An exclusion of liability does not include damage caused intentionally or through gross negligence [...]. Creditor does not expect debtor to behave grossly negligent and debtor has no natural need to protect himself from liability emanating from such behaviour. However it cannot always be excluded that debtor may exempt himself from liability for, or at least liability for his employees’ intent or gross negligence. It cannot as a general rule be excluded that liability even for grave mistakes made by employees, against the wishes and instruction of management, and despite reasonable control, may be exempt, however presumably not for mistakes made by managerial personnel.¹⁴¹”

The significance of section 36 in the case of knock-for-knock clauses is restricted today since these rules will rather not often apply to commercial contracts between professional parties – to the extent it will apply, the threshold must be high¹⁴². It should be remembered that business contracts are concluded to achieve profits and that the parties are aware of accompanied risks. Agreements are concluded between professionals who are assisted by expert advice and they are subject of long negotiations between the parties. Moreover, the consideration relating to predictability of contractual relations is a very important point, particularly in those sectors where the potential losses are large and where the parties must ensure their risks, such in the oil and gas industry. It must be noted that the mutual hold harmless provisions are introduced into contract to enable the parties an efficient risk allocation and that they bring more positive results than burdens (see: chapter 5.1.). It is thus generally recognised that adjusting and rewriting contracts according to the Contract Act section 36 in the oil and gas industry can only be done in very special circumstances.¹⁴³ Additionally, in the case of knock-for-knock contracts parties are required to insure themselves against the losses they might be responsible for. In such case, all potential victims are secured and it is not a contracting party who suffers financial loss, but the insurer who are obliged to cover it. When the party has such protection, contractual risk allocation can hardly be said to be unreasonable in relation to him¹⁴⁴.

The criterion of unreasonableness is thus interpreted strictly – there must be a marked departure from the standard of reasonableness before the impact of the contract can claimed to be "unreasonable". Such a restrictive interpretation emphasizes that the provision is intended to be a safety valve on the contract area. The courts are thus unlikely to openly disregard an indemnity clause in a commercial contract based on section 36¹⁴⁵. If an indemnity clause is

141 Citation from: *The Knock-for-Knock Principle under Danish Law*, <http://www.sandroos.dk/wp-content/uploads/2011/05/Presentation-30-November-2010.pdf>, p. 21

142 Rt. 2000 p. 806

143 ND 1990.204 NA Ula and ND 2000.240 NA Troll.

144 A. Bjerketveit, *Indemnity- og hold harmless-klausuler...*, p.120

145 A. Bjerketveit, *Indemnity- and Hold Harmless Clauses...*, p. 27

found to be unreasonable, it is therefore likely that the clause would rather be subject to "hidden censorship" through restrictive interpretation or strict acceptance, than that it is open modified or set aside as contrary to § 36¹⁴⁶.

7.4. The knock-for-knock agreements under Norwegian law – summary

Summing up, it can be said that the knock-for-knock clauses are generally accepted under Norwegian law, however, some limits were pointed out above. The main problem concerns liability in case of gross negligence, since it may seem against the morality or reasonableness to indemnify a party at fault. On the other hand, the consideration supporting the knock-for-knock principle in offshore contracts are so strong that the agreed indemnification may be upheld even in such circumstances¹⁴⁷.

It can be said that under Norwegian law courts tended to emphasize considerations of reasonableness more than predictability and freedom of contract, however, this practice seems to be changing today. A general impression now is an alteration in the attitude in favour of predictability at the cost of fairness, in particular in relation to later events resulting in more extensive losses than expected¹⁴⁸.

Professor Trine-Lise Wilhelmsen describes the approach to knock-for-knock provisions in Norway in the following words:

“What can be concluded here is that freedom of liability in cases where the damage is caused by gross negligence from the company itself can only be an issue if some minimum requirements are fulfilled: The contract should be agreed to secure involvement and acceptance by both parties, the freedom of liability should be tied to a systematic insurance regulation to secure that all potential victims are compensated, the liability and insurance system should reflect a thorough analyses of what combination of liability insurance and casualty insurance is most convenient for the parties, and the system should reduce transactions costs. But even when these conditions are fulfilled, the acceptance from the court is still uncertain”¹⁴⁹.

146 Idem, *Indemnity- og hold harmless-klausuler...* p. 127

147 *Knock-for-knock clauses in offshore contracts*, Wikborg Rein February 2009, p. 9

148 T.L. Wilhelmsen, op.cit., p. 24-25

149 T.L. Wilhelmsen, op.cit., p. 27-28

Summary

The knock-for-knock clauses are generally recognised and acknowledgement formulas allowing contracting parties effective risk allocation. Despite all the advantages, they are still among the most controversial aspects of the offshore contracts. On the one hand, there has been not so many litigations concerning their enforceability what indicates that this mechanism works well in practice. On the other hand, the existing cases are often contradictory and bring both some clarity and some additional problems at the same time.

When knock-for-knock clause operates under Norwegian law the mandatory nullity rules, including the principle of good faith and fairness standards included in the Norwegian Contracts Act § 36 and NL 5-2-1 must be taken into consideration. In the US, the enforceability of mutual hold harmless clauses depends to a great extent on the applicable law since different limits and requirements might undermine their meaning. Ipso factum, the same clause under Norwegian and US law may be treated differently – where the US courts are rather willing to upheld the mutual hold harmless provisions if the wording is clear and they are good marked in the contract, the Norwegian judges will look rather at the results the contract brings as a whole.

Unfortunately, when the courts seem to have become more sophisticated in their approach to mutual hold harmless provisions, the benefits of this method of pre-allocating risk are being eroded by the industry itself. More and more offshore agreements contain nowadays provisions that purport to exclude from the liability and indemnity regime losses caused by “gross negligence or wilful misconduct”. The parties may well have a clear idea in their own minds about the meaning of this term, but the practice shows that it is very difficult to ascertain the proper application which the courts will assign to the words “gross negligence”. As a result, the most important benefit of knock-for-knock clauses – certainty of risk allocation – is highly reduced. When the parties decide to include “gross negligence” exclusion, they leave thus to the court to determine exactly what degree of carelessness they intend to encompass by the provision. This will directly lead to the costly and time-consuming litigation, the solution which the parties of drilling contracts just try to avoid by including knock-for-knock clauses.

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