TURNING TURTLE ON KNOCK-FOR-KNOCK?

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The bedrock underpinning the allocation of contractual liabilities in the offshore industry is the knock-for-knock regime under which the parties attempt to prescribe in advance which of them bears liability for what and to provide for a mutual sharing of the risk involved, usually on the broad principle that each bears its own loss. But however laudable and commercially sensible such a contractual regime may appear to the parties, it is still merely a contractual regime and subject to the ordinary rules of contract construction, as Mr Justice Flaux said (and the Court of Appeal endorsed) in *Seadrill Management v Gazprom* (2010): *"The starting point is that the court must construe the contract as a whole, without preconceptions, but applying established English law principles of contract construction."*

This is by no means necessarily a bad thing for knock-for-knock, as the recent decision (also of Mr Justice Flaux) in *AstraZeneca UK Ltd v Albemarle International Corp.* (AstraZeneca) demonstrates.

By way of background: two particular principles of construction have come up in the recent cases on industry standard knock-for-knock clauses, which since they exclude liability, which would otherwise exist at law, are treated by the court as exemption clauses. The first supports the knock-for-knock regime. This is that there is no rule of law by which exemption clauses are to be deemed inapplicable in cases of 'fundamental breach' or the breach of a 'fundamental term': the question is simply whether the clause, on its true construction, extends to cover the obligation or liability that it is sought to exclude or restrict, and nothing prevents the parties from excluding or limiting liability for deliberate (and hence repudiatory) breaches of contract. The second principle pulls the other way. This is that an exemption clause may be so widely drawn and general in its scope that it must be restricted, since, if it were applied literally, it would defeat the main purpose of the contract that the parties had in mind and, in the court's words, would "deprive one party's stipulations of all contractual force" and make them "a mere declaration of intent".

In *Internet Broadcasting Corp. v Marhedge* (2009), the court considered, in a non-offshore context, a 'no loss of profit or consequential loss' clause very similar in drafting to the standard BIMCO offshore contract model. It held that it was to be presumed that the clause did not apply to repudiatory breaches of the contract since it would need clear and express language to achieve that result (e.g. 'even if due to repudiatory breach'). That aspect of the decision sounded alarm bells and seemed to be directly contrary to the first principle, especially where the modern BIMCO clauses refer to 'any breach of contract' (e.g. Towcon 2008, clause 25(c)) or to loss 'arising out of or in connection with the performance or non-performance' (Supplytime 2005, clause 14(c)).

In *A Turtle Offshore SA v Superior Trading* (A Turtle) (2009), a case on the pre-2008 'Towcon' form, a similar approach was taken to the standard exemption of the tugowner's liability for damage to the tow. The judge held that the clause applied so long as the tugowner was actually performing its obligations under the contract, albeit not to the required standard, but not when he had ceased to do anything at all in the performance of its obligations. While he accepted that the wide words of clause 18 were capable of applying to all breaches (a point emphasised in the 2008 revision, which now refers to 'any breach'), he held it did not apply to what he described as *'radical'* breaches. The *A Turtle* decision also sounded alarm bells (perhaps rather louder ones given that it concerned the BIMCO regime) and the references to 'radical' breaches conflict with the first principle. But it is to be noted that the court's reasoning also relied in part on the second principle: that if all damage to the tow was excluded, then purportedly it effectively allowed the tugowner to render no performance at all.

Mr Justice Flaux in *AstraZeneca* has firmly restored the first principle to its rightful place as the lynchpin of the modern construction of exemption clauses, be they knock-for-knock, consequential loss or otherwise. He rejected the approach taken in *Internet Broadcasting* as fundamentally misconceived and inconsistent with authority:

"the judgment ... is heterodox and regressive and does not properly represent the current state of English law. If necessary, I would decline to follow it. Even if the breach ... of its obligation to deliver ... had been a deliberate repudiatory breach ..., the question whether any liability ... for damages for that breach was limited ... would simply be one of construing the clause, albeit strictly, but without any presumption. Since it states: 'No claims ... of any kind, whether as to the products delivered or for non-delivery of the products' it seems to me it is sufficiently clearly worded to cover any breach of the delivery obligations, whether deliberate or otherwise."

That approach is welcome and strongly supports a similar result under the standard BIMCO knock-for-knock clauses, especially as worded in the latest revisions from 2008 onwards. *AstraZeneca* also significantly undermines at least that part of the approach taken in the *A Turtle* that was akin to adopting a presumption against construing the clause as applying to 'deliberate' or 'radical' breaches.

However, while it removes that problem, *AstraZeneca* confirmed the second principle (and in fact applied it so as to restrict the exemption clause before it). It therefore remains open for argument whether a knock-for-knock clause, if given a literal meaning, is such as to defeat the object of the contract or render it a mere declaration of intent. That result was doubted on the old 'Towcon' clause 18, by Mr Justice Clarke in *Alexander G. Tsavliris Ltd v OIL Ltd* (*The Herdentor*) in 1996 (not cited to the court in the *A Turtle*), but the point plainly remains open for further argument. Watch this space!