Offshore contracting pitfalls

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Ideally, contracts should be fair and balanced, clearly and comprehensively drafted, and reflect a realistic assumption of risk and reward. Unfortunately, not all contracts are well drafted and even small amendments to standard form contracts can result in potentially large exposures for the parties that might be uninsured. This article examines some of the potential pitfalls that can expose members to disproportionate levels of commercial risk or potential liability.

Introduction

When working in a global, high-risk industry, it is vital that offshore members negotiate appropriate contractual terms that provide as much protection as possible from disproportionate liabilities. They also need to have sufficient insurance for those contractual risks that they do assume and be able to avoid risks that they cannot insure.

Ideally, contracts should be fair and balanced, clearly and comprehensively drafted, and reflect a realistic assumption of risk and reward. Neither party should be exposed to disproportionate levels of commercial risk or potential liability.

Unfortunately, not all contracts are well drafted and even small amendments to standard form contracts can result in potentially large exposures for the parties that might be uninsured.

Offshore contract review

The Offshore Syndicate annually reviews in excess of 550 contracts for its members and has considerable expertise in all aspects of offshore contracting. The purpose of contract review is to proactively advise members on the effect of contractual arrangements they're negotiating regarding normal poolable cover and draw attention to any extra extensions to cover the contract may require.

Contracting pitfalls

During the contract review process, we see a number of pitfalls repeated, some of which are discussed below. Whilst this article looks to concentrate on drafting pitfalls, members may also incur non-pool liabilities under a contract for other reasons, perhaps because the work they are carrying out qualifies as a specialist operation or the ship is involved in drilling and production operation. If in doubt, members should contact the club for advice.

Knock-for-knock provisions

Traditionally, the offshore industry has dealt with the apportionment of liability between parties on a knock-for-knock basis, whereby each party assumes responsibility and indemnifies the other for liabilities relating to the indemnifying party's own property and personnel and those of his subcontractors, regardless of negligence.

As a general rule, the club will approve knock-for-knock contracts for poolable cover, provided they are balanced and do not expose the member to wider liabilities than those imposed on their contractual partner, and they have the right to limit liability under applicable law.

There are, however, numerous ways in which knock-for-knock clauses can be eroded or otherwise made defective so as to place the member outside poolable P&I cover; for example, where the member is required to take responsibility for the property and personnel of his contractors and subcontractors with no similar assumption of liability by the charterer.

Gross negligence/wilful misconduct

A common feature in amended knock-for-knock contracts is an exception for claims arising out of one party's gross negligence or wilful misconduct. Such amended clauses are inadvisable. The Marine Insurance Act provides that insurers will not be liable for losses arising out of the assured's own wilful misconduct. In the unlikely event that a court finds that, because of his wilful misconduct, a member cannot recover under a contract liabilities that should be for his contractual partner, he will therefore be liable for losses for which *prima facie* he is uninsured.

A further problem is that there is often either no definition of gross negligence/wilful misconduct in the contract or such definitions are poorly drafted. This means loss of certainty and clarity in the allocation of liabilities, which can lead to litigation, undermining an advantage of knock-for-knock regimes, namely the avoidance of time-consuming and costly disputes.

Third-party liabilities

Members' liability for third-party claims must be fault based in order to be poolable. Unfortunately, many contracts use language that exposes them to wider liability than they would otherwise have. The wording may simply provide that the member will be liable and indemnify the charterer for all third-party claims without reference to negligence or the position at law, or may even go so far as to provide that the member will be liable for third-party claims regardless of the negligence of the charterer or his other contractors

and subcontractors. Poolable cover will not respond if the member is liable under a contract for third-party claims arising out of the charterer's or any other party's negligence.

Members should also be wary of third-party liability provisions that are widely worded or unclear; for example, those that provide that the member will be liable for all claims caused by him or his ship. Without a specific reference to negligence, the member could be held liable for claims regardless of whether he is negligent or not; for instance, if the ship drops an anchor on a pipeline because the charterer has given the member incorrect information. Claims arising under such provisions will not be poolable if they expose the member to claims wider than those for which he would be liable in the absence of the contract.

Pollution

Clauses in respect of pollution should be carefully examined as they can expose a member to non-poolable liabilities. Normal P&I cover will respond to loss or damage caused by pollution from the entered ship and the costs of cleaning up such pollution, regardless of fault, provided that the member has not waived his right to limit liability. Clauses that allow the charterer to conduct the clean-up and bill the member for the cost and for any claims arising from the pollution may cause difficulty if the owner's right to limit is not preserved. The charterer may not be able to rely on the same limitation of liability as a shipowner, or may be unwilling to do so, but the additional exposure may not be poolable since a member should not take on contractual liability greater than he would have had in the absence of the contract.

Wreck removal

Similarly, poolable P&I cover extends to the costs of removing the wreck of an entered ship and cargo on board when required by a competent authority or because the wreck is a danger to navigation. Many contracts include clauses whereby the member also agrees to pay for the cost of removing the wreck of the ship if it interferes with the charterer's operations. If there is no wreck removal order and the wreck is not causing any danger to navigation such liability goes beyond poolable P&I cover and therefore will only be covered under an extension.

Conclusion

As outlined above, there are numerous contracting pitfalls that can expose members to disproportionate levels of commercial risk or potential liability. Even small amendments to standard form contracts can result in potentially large exposures for the parties that might be uninsured. The advantage of the club's contract review service is that we can flag contracting pitfalls before potential liabilities arise and assess if usual cover is sufficient.

As part of the contract review process, we will highlight any contractual liabilities that may expose the member to risks requiring extensions to cover. In this regard, the club can provide a number of comprehensive and tailored insurance products specifically designed for shipowners operating in the offshore oil, gas and alternative energy industry with high limits up to $1bn to meet a member's specific needs whilst minimising gaps in coverage.