HAYNES BOONE

Limiting Your Liability

Drafting Effective Limitation Clauses in Offshore Drilling Contracts

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Executive Summary

Limitation of liability clauses are a key provision in commercial contracts, but are particularly important for service providers in the offshore oil and gas industry, given the risks associated with oil and gas operations.

This guide provides a summary of the key issues relating to the drafting of limitation of liability clauses and considers how these provisions have been interpreted by the English courts in recent years.

Despite the growing trend for oil companies to seek to resist an overall financial limit, or "cap," on the contractor's liability, limitation of liability clauses remain a key provision in offshore oil & gas services contracts, particularly for drilling contractors.

Limitation of liability clauses – What are they and why have them?

When negotiating offshore drilling services contracts, drilling contractors will typically look to include an overall financial limit on their residual liability to the oil company (i.e. the field operator). This is commonly referred to as an overall "cap" or "LOL" (limitation of liability) provision. The rationale behind the cap is the contractor's desire to avoid exposing itself to losses which exceed what it stands to make under the contract (if, for example, the contractor is unable to mitigate the risk of loss by taking on insurance) and which could even jeopardise the financial stability of the contractor as a whole.

The scope and amount of the limitation of liability provisions will be a commercial issue for the negotiating parties, having regard to a number of factors such as: the particular project and its location, the likely duration of the contract, the applicable day rates or level of compensation, market practice and the commercial bargaining power of each party. The clause will usually be expressed to apply regardless of fault of the party benefitting from the limitation, and notwithstanding the contractor's breach of contract, negligence, breach of duty (statutory or otherwise) or other failure of any nature, with specified exclusions. It is designed to shield the contractor from liability for amounts over and above the cap, even where the loss or damage in question might have resulted from the contractor's breach or default.

The cap is often described as a fixed sum, although it may also be formulated as a percentage of the total contract price. The latter is less common in offshore contracts which are based on a daily remuneration model. In most offshore drilling contracts, the applicable daily rates are subject to reductions depending on various factors affecting the work. The exact duration of the contract may also be unknown at the time of contracting (as is the case with offshore drilling contracts where the work relates to a number of wells rather than a specific time period, as well as for contracts with options to extend the term), making it difficult to determine the total 'contract price' upfront. A fixed financial limit is therefore a more simple and straightforward means of restricting liability.

An aggregate cap will not normally operate so as to limit *all* liabilities owed by the drilling contractor to the field operator, and is by no means the only way in which contractors can limit their liability contractually (most notably, knock-for-knock clauses are widely used in the international offshore oil and gas industry to allocate risk and apportion liabilities between contract parties).[1] However, it is a key means of minimising the contractor's exposure under the contract – provided it is drafted effectively. This is not always easy, given that limitation of liability clauses are usually heavily negotiated by the parties and are often the last point to be agreed in the negotiations.

This briefing paper outlines some of the main principles of contractual interpretation which apply to limitation of liability clauses (as well as exclusion clauses). It also highlights some key points which drilling contractors and other contractors in the offshore industry might wish to take into account when drafting and negotiating an overall limitation of liability clause.[2]

1
For a further discussion on mutual indemnity clauses, please see our briefing paper on "knock for knock" indemnities, which also discuss issues around consequential loss.

2
This article does not cover the impact of the Unfair Contract Terms Act 1977 ("UCTA"). Parties whose contracts are subject to UCTA will also need to ensure that any exclusion or limitation of liability provisions satisfy the relevant requirements of UCTA.

Why use clear wording?

There is a presumption under English law that neither party to a contract intends to abandon any remedies which would otherwise be available to it at law. Clear words must be used to rebut this presumption. This is often referred to as the '*Gilbert-Ash* principle', taken from a 1974 judgment[3], and is now considered to be more of a principle of common-sense than a presumption: parties to a contract do not normally intend to give up their rights without making it clear that they wish to do so.

The field operator who accepts an overall limitation of liability clause in an offshore drilling contract is effectively agreeing to give up its right to recover certain losses from the contractor – i.e. those which exceed the amount of the contractual limit – where it would otherwise be entitled to so do. The limitation of liability clause should therefore explicitly and unequivocally state which liabilities and obligations of the contractor are subject to the cap (or caps) and the extent of such limitation.

What happens if the wording is unclear?

If the language of the limitation clause is unclear or ambiguous, there is potentially a risk that it could be interpreted narrowly against the contractor as the party seeking to rely on it (the *contra proferentem* rule). However, in a number of recent cases, the English courts have demonstrated an increased willingness to enforce limitation (and exclusion) clauses which have been agreed between commercial parties, calling into question the ongoing relevance of the contra proferentem rule.

In the case of *Persimmon Homes Ltd v Ove Arup & Partners* [2017] EWCA Civ 373, Lord Justice Jackson stated that the *contra proferentem* rule now has a very limited role in relation to commercial contracts which are negotiated between parties of equal bargaining power, provided that the meaning of the exclusion clause is evident. He recognised that in major engineering services and construction contracts the parties commonly agree how they will allocate the risks between themselves and who will insure against what, also stating: "*Exemption clauses are part of the contractual apparatus for distributing risk. There is no need to approach such clauses with horror or with a mindset determined to cut them down.*"

A similar statement was made in *Transocean Drilling UK Limited v Providence Resources Plc* [2016] EWCA Civ 372, where Lord Justice Moore-Bick held that "*the court's task is not to re-shape the contract but to ascertain the parties' intention, giving the words they have used their ordinary and natural meaning.*" He also reiterated the principle that clear wording will rebut the presumption that contracting parties do not intend to give up their right to claim damages for breach of contract.

In the earlier case of *K/S Victoria Street v House of Fraser (Stores Management) Ltd* [2011] EWCA Civ 904, Lord Neuberger MR said "..."*rules" of interpretation such as contra proferentem are rarely decisive as to the meaning of any provisions of a commercial contract. The words used, commercial sense, and the documentary and factual context, are, and should be, normally enough to determine the meaning of a contractual provision.*"

The recent cases of *Green v Petfre (Gibraltar) Ltd (t/a Betfred) [2021] EWHC 842 (QB)* and *Triple Point Technology Inc v PTT Public Co Ltd [2021] UKSC 29* have both supported this sentiment with a clear preference to rely on the natural meaning of the clause without using any "special" rules. As stated by Lord Leggatt in *Triple Point*, "*the development of the modern approach in English law to contractual interpretation, with its emphasis on context and objective meaning and deprecation of special "rules" of interpretation*".

In light of these decisions, offshore drilling contractors need not be overly concerned with the potential impact of the *contra proferentem* rule, provided they take steps to ensure the courts will not need to resort to such rules of construction. A key means of achieving this is to draft the limitation of liability clause using clear, express and unequivocal language and, to the extent possible, to state which circumstances do (and which ones do not) fall within the ambit of the overall cap.

> *Exemption clauses are part of the contractual apparatus for distributing risk. There is no need to approach such clauses with horror or with a mindset determined to cut them down.*

3
Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd [1974] AC 689

What is (and what isn't) covered by the cap?

If the parties' intent is for the limitation of liability to apply in all circumstances whatsoever, irrespective of cause and notwithstanding negligence, breach of duty or other failure of any nature, including in respect of claims arising in contract, tort or otherwise at law (as will usually be the case in a limitation of liability clause in offshore drilling contracts), this should be stated expressly.

It is generally considered best practice to expressly refer to negligence (as a form of tort) instead of seeking to rely upon general words. The parties might also consider dealing expressly with 'gross negligence' and 'wilful misconduct' (and whether to restrict either to that of senior managerial or supervisory personnel).

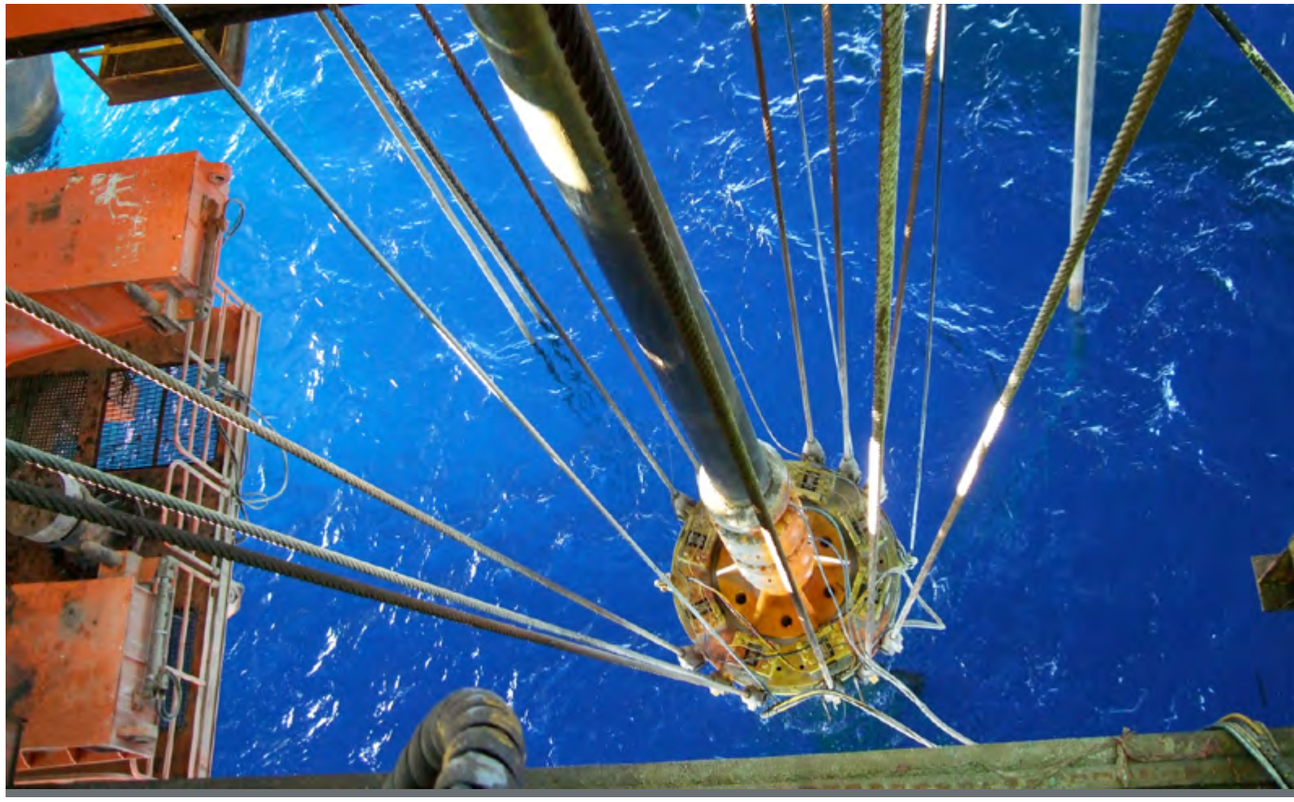
As to which of the contractor's contractual obligations will be subject to the cap, it is common for the limitation of liability clause to be described as applying to all obligations and liabilities, except for those which are expressly excluded or 'carved out'.

A typical carve-out will be the contractor's obligations under the customary 'knock-for-knock' (or reciprocal) indemnities found in offshore drilling contracts. These are usually excluded on the basis that such indemnities (which form a crucial component of the risk allocation regime between the parties) would not operate as intended if one party was denied the benefit of full recovery under the indemnity. Other exceptions from the limitation of contractor's liability will be negotiated on a case-by-case basis; these might include the contractor's obligations under the confidentiality provisions, as well as the insurance, tax, intellectual property and anti-bribery clauses.

The contractor should ensure that any proposed carve-outs are appropriate, acceptable to the contractor's insurers and lenders (if any), and will not render the cap ineffective. For example, clauses containing key obligations of the contractor to perform the works or services should be subject to the cap.

Some limitation of liability clauses will explicitly exclude liability for fraud or fraudulent misrepresentation; this is not strictly necessary, as such liability cannot be excluded or limited by law regardless of whether this is stated in the contract, but some operators prefer to include it.

It is also considered best practice to place the limitation of liability in a separate, stand-alone clause, rather than burying it within another clause of the contract. This reduces the risk that the limitation clause could be interpreted as applying only to the obligations contained within the particular clause in which it is located, or that it is hidden away. It also helps to ensure that the limitation clause is given appropriate attention by the parties to avoid its exclusion. The recent High court case of *Blu-Sky Solutions Ltd v Be Caring Ltd [2021] EWHC 2619* affirms this approach, echoing the principle summarised by Coulson LJ in *Goodlife Foods Ltd v Hall Fire Protection Ltd [2018] EWCA Civ 1371*, who stated "*a condition which is "particularly onerous or unusual" will not be incorporated into the contract, unless it has been fairly and reasonably brought to A's attention*".



Does the limitation of liability clause need to expressly refer to negligence?

In our experience, it is common for the parties to unambiguously state that an overall limitation of liability applies in the case of negligence. The use of general words, such as "any loss" or "loss howsoever caused" may not be sufficient to encompass liability for negligence.

In the interests of using clear language, we still consider it best drafting practice to explicitly contemplate that the cap provision applies in the case of negligence.

The English courts have traditionally regarded it as inherently improbable that a party to a contract would intend to absolve the other party from the consequences of that other party's own negligence.[4] A three-step approach to determining whether an exclusion clause covers liability for negligence, which is seemingly based on this premise, was set out in the case of *Canada Steamship Lines Ltd v The King* [1952] AC 192:

4 Gillespie Bros & Co Ltd v Roy Bowles (Transport) Limited [1973] 1 QB 400

1. Firstly, does the language used expressly exempt the party from the consequence of its negligence? In other words, does the clause specifically refer to negligence or words which are synonymous with negligence? If so, effect must be given to the provision.

2. If there is no express reference to negligence, are the words used wide enough in their ordinary meaning to cover negligence? If there is any doubt at this point, the *contra proferentem* rule would apply, whereby the ambiguity is resolved against the party seeking to rely on the exclusion clause.

3. If the words used are wide enough to cover negligence, is it possible that the head of damage could be based on some ground other than negligence? If so, the clause should be read as referring to that other ground and not to negligence. The other ground must not be so 'fanciful or so remote' that it would not give the party the desired protection.

Known as the *Canada Steamship* guidelines, these are still generally in use by the courts today when interpreting an exclusion (or limitation) clause, but they are now considered by the courts as just that, 'guidelines', as opposed to a strict code or set of rules.

In *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6, the House of Lords emphasised the importance of giving effect to the parties' intentions, and said that although there could be no doubting the general authority of the *Canada Steamship* principles, they should be seen as giving "*helpful guidance on the approach to interpretation and not laying down a code*". Lord Bingham noted that the guidelines do not provide a 'litmus test' which yields a certain and predictable result when applied to the terms of a contract; the court is still required to ascertain what the particular parties intended in their particular commercial context.

Similarly, in *Mir Steel UK Ltd v Morris* [2012] EWCA Civ 1397, Lord Justice Rimer noted that the *Canada Steamship* guidelines should not be applied 'mechanistically' and that they do not provide an automatic solution to any particular case: "*The court's function is always to interpret the particular contract in the context in which it was made.*"

In the *Persimmon* case, referred to earlier on page 4, the Court noted that the *Canada Steamship* guidelines are now more relevant to indemnity clauses than to exemption clauses, finding that they were of very little assistance in determining the issues in that case.

The *CNM Estates* case

In the 2020 case of *CNM Estates (Tolworth Tower) Ltd v VeCREF I SARL [2020] EWHC 1605 (Comm)*, the court was required to consider two exclusion clauses. In doing so, Mr Justice Foxton commented on the *Canada Steamship* guidelines, stating that the recent English authorities (including HIH Casualty) do not in any way diminish the relevance of the *Canada Steamship* guidelines when a court is required to consider whether liability for failure to take care has been excluded by a contract term.

The judge made use of the guidelines in analysing the contract terms the court was presented with in that case, but in doing so noted that the *Canada Steamship* framework is 'a means to an end' rather than an end in itself, by "*assisting the court in determining whether the contractual language used in context is sufficiently clear to communicate to a reasonable person that liability for negligence has been excluded.*"

When considering whether the clause in question passed the first stage of the *Canada Steamship* test (that is, whether the language of the clause expressly exempted the party from the consequences of its negligence), the judge noted that certain contractual provisions which do not expressly refer to negligence or even a synonym for negligence "*may nonetheless make it very clear that negligence is excluded, such that no further enquiry is required*". This may be the case, for example, when the clause explains that there will only be liability for limited types of conduct or in particular circumstances, with all other types or bases of liability being excluded.

In *CNM Estates*, one of the exclusion clauses in question provided that the receiver was not liable for any loss or damage "*unless caused by its gross negligence or wilful misconduct*". The judge held that as the receiver's liability was limited to a higher degree of fault (i.e. gross negligence or wilful misconduct), it followed that the receiver was relieved of its liability for (simple) negligence, even though this was not expressly stated in the clause.

The judge said that while the clause: "*does not expressly refer to liability for negligence simpliciter being excluded, that follows as a matter of inevitable implication from the express provision that there is only liability for acts or omissions of a more serious kind, namely gross negligence or wilful misconduct. I have concluded that this clause satisfies the requirement of the first stage in the Canada Steamship analysis.*"

The judge held that as the receiver's liability was limited to a higher degree of fault (i.e. gross negligence or wilful misconduct), it followed that the receiver was relieved of its liability for (simple) negligence, even though this was not expressly stated in the clause.

What about gross negligence and wilful misconduct?

We want to finish with a word on whether the overall limitation of liability clause in an offshore drilling contract should expressly state whether the cap applies in the case of the contractor's 'gross negligence', as opposed to 'negligence' (sometimes referred to as 'simple negligence' or 'negligence *simpliciter*').

Under English contract law, there is no distinction between negligence and gross negligence, therefore the term 'negligence' on its own will, unless the context requires otherwise, be interpreted to include all forms of negligence. Nonetheless, some limitation of liability clauses in offshore contracts will expressly state that the limitation applies in the case of 'negligence in any form'. This may be done as a precautionary measure, or if the contract refers to other forms of negligence elsewhere in its provisions and a distinction therefore needs to be made.

At the other end of the scale, some contracting parties may agree to explicitly exclude liability arising out of the contractor's 'gross negligence' (or, more specifically, the gross negligence of senior managerial or supervisory personnel of the contractor) from the scope of the limitation clause. If this is the case, it would be prudent to define 'gross negligence' in the contract (as well as 'senior managerial' or 'supervisory personnel', if that is the case) and tailor the definition to what the parties intend it to mean. Left undefined, it will leave scope for dispute between the parties and be open to interpretation by the courts, creating uncertainty as to contractor's liability exposure under the contract.

The same would apply where the parties have agreed that the cap should not apply in the case of the contractor's 'wilful misconduct'. While some guidance as to the meaning of that term under English law can be gleaned from the case law, it does not have a precise and settled meaning, and what is understood by the term will be a question of interpretation in each particular case. Negotiating an acceptable definition of 'wilful misconduct' within the contract, and limiting its application to specified senior managerial or supervisory personnel of the contractor, is one way of ensuring that a carve-out for wilful misconduct (however that term may be defined) will not erode the effectiveness of the overall limitation of liability clause. *Mott MacDonald Ltd v Trant Engineering LTD* [2021] EWHC 754 (TCC) raised further drafting considerations insofar as it allowed for fundamental, deliberate, and wilful breaches of the contract to be captured by the exclusion clause and liability cap contained within the agreement. It is clear from this decision that should a clause be drafted wide enough, then it is possible to exclude wilful misconduct or, at the very least, place it under a liability cap.

For more information about our offshore drilling experience at Haynes Boone, visit us here.

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Glenn Kangisser handles projects and disputes for clients in the offshore, oil and gas, and shipping industries, with a focus on upstream exploration and production and the transportation of oil and gas. A leader in the offshore drilling sector, Glenn brings substantial depth of experience and market knowledge to his projects. Clients appreciate his ability to be involved in all aspects in the lifecycle of a drilling unit, from the design and construction phase through operations and maintenance, to disposition, conversion, or recycling.

Adept at both negotiating contracts and handling disputes, Glenn helps clients find commercial solutions either to minimize the risk of potential disputes or, where these can't be avoided, to help them achieve the best possible commercial outcome. He regularly advises clients on disputes in the English High Court, as well as in arbitrations under the LCIA, LMAA, and ICC rules. With a truly international practice, Glenn has also negotiated contracts for the construction, sale, operation, and employment of drilling units in the UKCS, U.S. Gulf of Mexico, West Africa, Brazil, the Middle East, and the Far East.

Glenn is regularly involved in cases of exceptional size and significance. Recently, he led his team in the largest arbitration ever handled by the firm, obtaining a London arbitration award in excess of US $400 million for a European drilling contractor client in proceedings against a South Korean shipyard. This arose out of the disputed termination of a drilling rig construction contract. Glenn was also involved in a major force majeure case under English law, securing for Seadrill Ghana Operations Ltd. an English High Court judgment worth in excess of US $270 million, plus interest and expenses. The case related to the disputed termination of a drilling contract for alleged force majeure. Glenn has also been involved in some of the largest and most significant offshore drilling projects over the last decade.

Glenn is recommended by The Legal 500, 2022 (Legalease), where clients commented "Glenn Kangisser is a fantastic lead for the company" and note that Glenn leads a "very strong team specialising in offshore drilling contracts and shipbuilding contracts," are "experts in their field," and the team is "pleasant to deal with and go the extra mile."

About Haynes Boone

Haynes and Boone, LLP is a full- service law firm with a national presence and an international reach. With more than 600 lawyers located in Texas, New York, California, Charlotte, Chicago, Denver, Washington, D.C., London, Mexico City, and Shanghai. Haynes and Boone, LLP entered the London market in 2016 by merging with Curtis Davis Garrard LLP (CDG). The merged firm possesses enhanced global capabilities in the energy, maritime, financial services and corporate sectors.

Founded in 1996, CDG built a significant reputation serving the shipbuilding and offshore oil and gas sectors globally. Ship building clients consist of shipowners, charterers and shipyards covering the entire spectrum of commercial shipping, including the international superyacht sector. On the offshore side, clients include major oil and gas companies with worldwide development interests, smaller independents, offshore contractors providing a range of exploration and production services, and specialist suppliers of oilfield services and equipment, including shipyards. The office provides clients with substantially enhanced English law capabilities, including an experienced litigation and international arbitration team that has handled numerous claims in the English High Court and before major arbitral bodies. The office also includes partners with decades of experience handling international business and projects transactions, providing clients with an important and unique bridge between the interconnected energy and energy finance related markets of London, New York, Houston, Shanghai, and Mexico City. The firm's deep relationships and capabilities in this sector provide our clients with an unprecedented ability to make direct connections and access resources in some of the world's largest energy markets.

Our firm's progressive, entrepreneurial spirit is the impetus for our unrelenting commitment to remain forward-thinking and continually evolve to address the dynamically changing world of business law. It is this fortitude that allows us to serve clients in global business transactions and dispute resolutions around the world, including 20 percent of US Fortune 500 companies. We have long served clients' global business activities by building crossborder practice capabilities, strategically adding international legal experience and establishing working relationships with leading law firms throughout the world. We have assisted clients in more than 100 countries with lawyers who are fluent In 17 languages.

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