

## The false economy of amending knock for knock clauses

Some charterers propose amendments to standard form knock for knock clauses in offshore contracts, which weaken the indemnity regime. Such changes can appear to be a gain for the charterer, but frequently little if any real benefit is achieved. These amendments can come at great cost in terms of delays in obtaining contract approvals and greater expense, inefficiency and lower limits in the insurance framework. They can make it difficult to have an open and collaborative environment towards accident investigation, and mean arguments about liability and quantum, experts' reports and legal wrangling, absorb the parties' valuable time and resources.

In this article, the Club will look at why the integrity of knock for knock agreements is so important, what changes Members should look out for that can undermine the regime and why all those involved should think carefully before making such amendments. Of course, the Club will always be able to step in and assist Members with arranging additional cover where an amended knock for knock cannot be avoided.



### Knock for knock — A brief history

At its most simple a knock for knock regime agrees that one side will take the 'knocks' (damage or injuries) their side receive, and the other side will take those they do. Neither will try to sue the other, even if they think the other side were to blame. The principle behind it is that if, say, half the cost of such knocks is actually fighting over who is at fault, then if we just agree not to do that, we'll all be better off.

The phrase 'knock for knock' is thought to have arisen in the U.S. car insurance industry in the early 20th Century. Automobile insurers found that they could pay for their customers' car repairs, then spend years arguing with attorneys as to which party was at fault. They began to

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enter agreements with one another that, after a collision, each insurer would simply pay their own customer and close the claim.

This type of risk allocation was also common in U.S. towage agreements. U.S. maritime law generally prohibits the operation of one-way liability exclusions, so towage in the United States was often undertaken on terms which dictated that each property owner (i.e. the tug and the tow) would bear their own risks arising from the operation.

By the 1970s knock for knock clauses were being used in some ocean or international towage agreements. In 1985 Bimco released their standard form ocean towage agreements, Towcon and Towhire, which had at their heart a knock for knock regime. This regime was refined and reinforced in the forms' 2008 revisions.

Supplytime, a time charterparty designed for supply vessel and offshore work, had been released in the 1970s, and although its original version did not have a knock for knock regime, this type of risk allocation was inserted by some parties using the form.

By 1989 Bimco had released a new version of Supplytime which contained a knock for knock as standard, and one which has been expanded and strengthened in the 2005 and 2017 updates.

Several other standard form contracts used in the offshore industry and many charterers' in-house charterparties also apply a knock for knock allocation of liabilities at their core. The concept has therefore, for half a Century or more, been widely accepted and understood as integral to the management of risk and allocation of liability in offshore operations; a fact which has been recognised in a number of court judgments in England and across the world. The insurance regimes which cover such operations are, as a result, designed with the mechanics of knock for knock in mind.



## **The benefits of knock for knock clauses**

- Poolable cover, without a fixed limit, is available
- The risk of cover only meeting part of the claim (due to limits) is essentially eliminated.
- Additional cover is not required which lowers the contractors' (and therefore overall project) costs.
- It avoids inefficient, overlapping insurance structures.
- It requires less staff time and company funds spent on investigations of responsibility

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when incidents occur.

- Fewer or no claims between the parties means lower legal fees for all and a more constructive commercial relationship.
- More documentation can be shared following incidents without fear of it affecting liability claims, which improves workplace safety and cooperation.
- It improves speed of contract negotiation and sign off, by avoiding delays caused when proposed changes are discussed, considered by owners' staff, and presented to lawyers and insurers.
- It aids contract certainty, so all parties can clearly interpret and rely on their contract terms.

## Changes to look out for

The following are examples of changes the Club has seen proposed by some charterers to standard form knock for knock arrangements. Whilst the above changes may appear superficially attractive, they generally increase costs and complexity for all parties, and erode the extensive benefits listed above.

- 'Blind' knock for knocks — This is where a Charterer provides a shipowner with an indemnity, but the indemnity operating is conditional on the existence of a similar indemnity in a contract with another party, which the shipowner usually does not have sight of.
- Limited knock for knocks — This is where a knock for knock regime is present but is modified so it only applies below or above a certain threshold (often a threshold which benefits one side only). For example, the parties indemnify each other against property damage, but the owner shall remain liable for the first US\$ 100,000 of such damage, or for such damage as exceeds US\$ 1 million.
- Negligence carve outs — Occasionally the knock for knock is said not to apply in cases of negligence, or in the presence of 'fault' by one of the parties. Occasionally we have seen this done subtly by altering just one or two words. For example, where a clause says that an owner shall not be responsible for losses 'even if they arise from negligence', the words 'even if' would be changed to 'unless'. Such amendments could be said to render the knock for knock meaningless, as a negligence-based flow of liability would have applied at common law in the absence of a knock for knock.
- Gross negligence / wilful misconduct carve outs — Knock for knock is occasionally said not to apply in cases of gross negligence by one of the parties. This term is intended to mean cases involving a very severe degree of negligence, but the term is not defined under English Law, so where it is used the contract needs to provide a clear definition. Where a definition is provided, invariably there can be arguments about whether things fall within it. The same is true of wilful misconduct, which is intended to cover intentionally damaging acts.
- Consequential loss inversions — Commercial parties almost invariably see the benefit in holding each other harmless in respect of indirect or consequential losses, which can include very large sums in respect of loss of use, loss of profit etc. Clauses excluding consequential losses can therefore be found in almost all standard form commercial contracts. These clauses are meticulously drafted to protect the contracting parties, but

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we have seen attempts to invert such exclusion clauses, making one party positively liable for the list of what would normally be identified consequential losses.

- Benefits of other insurances with detriment of their deductibles — Sometimes a contract will provide that the contractor has the benefit of another party's Construction All Risks ("CAR") insurance, but that they are liable for the deductible payable in such insurance. Such a liability would not be present in a true knock for knock, as the contractor would have no liability for the damaged property at all.
- Strict liability provisions — A general knock for knock regime may be in place but with a specific type of damage for which owners shall bear the risk, regardless of fault. For example, ' [K4K terms] ... but Owners shall be responsible for any damage arising to SBM hoses towed by the vessel'. Such a clause arguably makes the Owners' position worse than it would have been under common law, where negligence would need to be proven and defences could be raised.
- Ambiguous or vague language insertions — For example we have seen knock for knock clauses which say they shall not apply where there is 'a lack of due diligence'. Due diligence describes the action of taking reasonable steps to achieve a particular objective. You can, for example, require someone to exercise due diligence to make a ship seaworthy, or to ensure a port is safe, but the mere requirement to be duly diligent in and of itself is just a recipe for uncertainty and legal debate.

## **Conclusion**

The Club is always ready to review contracts for Members and offer cover to assist them with their particular contractual requirements, including any amendments. However, standard knock for knock terms, such as those IG clubs list as 'approved contracts' in their Rules, are finely tuned legal agreements which have been developed over decades to cater specifically for the special risks parties face in offshore contracting. P&I insurance is designed to integrate with these knock for knock terms. While parties may always need to tailor some parts of standard form contracts to suit their specific circumstances, changes suggested to inhibit the knock for knock allocation of liabilities may not benefit anyone in the long-term.

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