

OFFSHORE DECOMMISSIONING CONTRACTS – OPERATION OF THE KNOCK FOR KNOCK REGIME

Decommissioning is an integral part of the international energy transition, and of the global push to achieve net zero greenhouse gas emissions and a carbon neutral economy. Decommissioning ranges from conventional oil and gas exploitation to floating wind and solar projects. The prominence of offshore decommissioning will grow with the recent surge in offshore wind deployment, the continuing investment in offshore oil and gas projects, and the retirement of aging offshore assets and infrastructure. Global decommissioning spend for the period 2021 to 2030 has recently been forecast at approximately US\$100 billion (Source: S&P). The complexities and operational uncertainties cause multifarious challenges that must be managed throughout a project's life cycle.

This briefing considers the operation of the knock for knock regime specifically in the context of offshore decommissioning contracts and considers its efficacy in managing the risks inherent in international offshore decommissioning operations.

Offshore decommissioning often occurs in hostile and unpredictable environments. The operations are complex, costly, hazardous and fraught with uncertainty. The more hostile and unpredictable the environment, the greater the attendant risks. No two decommissioning operations are alike.

The Deepwater Horizon incident in the Gulf of Mexico in 2010 brought the potential liabilities and difficulties involved in offshore assets into sharp focus. This was preceded on 21 August 2009 by the Montara incident off the coast of Australia and the Piper Alpha incident on 6 July 1988 in the North Sea.

Before the development of standardised offshore decommissioning contracts, parties (often with unequal bargaining power) had to negotiate complex and bespoke contracts. To overcome these difficulties, and in the interests of international harmonisation, LOGIC¹ and BIMCO² have developed two standardised decommissioning contracts that have gained international acceptance.

Key issues

- Offshore decommissioning is an increasingly important area.
- The two principal standardised international decommissioning contracts are now LOGIC General Conditions and BIMCO DISMANTLECON.
- The knock for knock regime has gained acceptance in these standardised contracts as an effective (albeit imperfect) risk mitigation and management tool.
- The attributes of simplicity and certainty make the knock for knock regime particularly attractive in the uncertainty and complexities of offshore decommissioning.
- That attraction is increased when it is complemented by an effective and efficient insurance regime.
- The knock for knock regime, despite its imperfections, has withstood the test of time and remains an important feature of offshore decommissioning contracts.

¹ LOGIC (Leading Oil and Gas Industry Competitiveness) is a not-for-profit subsidiary of Oil & Gas UK.

² BIMCO (Baltic and International Maritime Council) represents the global shipping sector.

The two principal standardised international decommissioning contracts that have been developed are *LOGIC General Conditions of Contract (LOGIC General Conditions)*³ and BIMCO's *DISMANTLECON (DISMANTLECON)*.⁴ The standardised contracts employ a range of risk mitigation and management measures, including the knock for knock (or "mutual hold harmless") regime to manage risks.

The knock for knock risk mitigation regime

The knock for knock regime means loss lies where it falls, irrespective of fault and without recourse to counterparties. The Operator and Contractor are each responsible for their own property and workforce, for third-party damage due to their negligence, and pollution from their property. The main attributes of such a regime include: (a) designation of the "Company Group" and "Contractor Group"; (b) each party is liable for loss or damage to its own property and personnel, irrespective of fault, and without recourse to the counterparty; (c) mutual indemnities are provided by the parties; and (d) insurance coverage for the pre-allocated responsibilities, including a waiver of subrogation.

Members of each 'Group' are afforded the same protections as the principals. Regard should be had to any domestic legislation affecting the rights of non-signatories to claim benefits directly under a contract, and whether those provisions should be expressly excluded. For example, for contracts governed by English law, regard should be had to the Contracts (Rights of Third Parties) Act 1999, and for contracts governed by the law of Western Australia regard should be had to section 11 of the Property Law Act 1969 (WA).

Knock for knock indemnities may appear to be counter-intuitive at first instance; however, there are sound commercial reasons for endorsing such a regime as a means to mitigate and manage risk, reduce uncertainties and reduce the risk of disputes.

Common law courts have broadly enforced knock for knock clauses, although some more readily than others.

For example, in *A Turtle Offshore SA v Superior Trading Inc* [2008] EWHC 3034 (Admlty) the English Court upheld a knock for knock clause in a BIMCO contract; however, by contrast, commentators have suggested that the application of knock for knock clauses in Greece remains somewhat unclear pending completion of reforms to the Commercial Maritime Law Code, which are underway.

Nonetheless, the knock for knock regime is an established feature of offshore contracting. It is generally preferred to the fault-based regime, which requires a claimant to prove causation and culpability, and can be expensive and problematic. The knock for knock regime overcomes these difficulties by predetermining the allocation of risks, providing certainty and thus reducing costs and the risk of disputes.

The regime is not perfect – as discussed further below, a question arises as to the scope of protection actually afforded by the knock for knock regime in the standardised decommissioning contracts, and in particular how comprehensive the mutual indemnities are in light of well-established carve-

³ *LOGIC General Conditions of Contract (including Guidance Notes) For Offshore Decommissioning* Edition 1, December 2018.

⁴ Published in September 2019.

outs and limitations. Notwithstanding, the regime is an effective risk mitigation and management tool.

Knock for knock regime under LOGIC General Conditions

Designation of parties covered

"*Company Group*" means the Company, its co-venturers and their affiliates, directors, officers and personnel. This includes parties with whom the Company is in a joint operating, a unitisation or similar agreement relating to the operations for which the work is being performed.

"*Contractor Group*" is defined broadly as the Contractor, its subcontractors and their affiliates, directors, officers and personnel. It includes "*subcontractors (of any tier) of a Subcontractor*" working at the worksite, their affiliates, directors, officers and personnel.

Contractors' liabilities (Clause 22)

The Contractor is responsible to indemnify the "Company Group" against claims and losses in respect of: (a) damage to property of the Contractor Group whether owned, leased or otherwise provided by it; (b) personal injury to Contractor Group personnel; (c) third-party personal injury or property damage to the extent caused by negligence or breach of duty of the Contractor Group; and (d) the removal of a wreck if it interferes with the Company's operations or is hazardous.

Contractors may negotiate a financial cap on liability, and a temporal limitation on liability, after which they are no longer liable (Clause 35). In the absence of an agreed limit, Clause 35 specifies a default limitation sum. It should be clear whether the limitation of liability excludes the knock for knock regime. The same applies to exclusions for consequential losses.⁵

Company's liabilities (Clause 22)

The Company is liable for and indemnifies the Contractor Group for claims and losses in respect of: (a) damage to property of the Company Group whether owned, leased or otherwise obtained by it located at the Worksite; (b) personal injury to Company Group personnel; (c) personal injury or damage to third-party property to the extent caused by the negligence or breach of duty of the Company Group; and (d) damage to third-party oil and gas production facilities and pipelines and resultant consequential losses, provided the facilities and pipelines are defined in the contract, and are within a 500m radius of any working barge or vessel directly engaged in the decommissioning work.

Each of the Company and the Contractor bears the risk of pollution emanating from its own equipment. The Company must also indemnify the Contractor Group from any claim arising from pollution from the reservoir, Company Group property or from third-party property in connection with the contract. The Contractor reciprocates with similar indemnities.

Comparing the LOGIC General Conditions with those of DISMANTLECON

While the regimes under both standard form contracts are broadly comparable, there are some notable differences, including:

⁵ See *Westergenco v ATP Oil & Gas (UK) Ltd* [2006] EWHC 1164 (Comm), and *North Sea Ltd v London Bridge Engineering Ltd* [2002] UKHL 4.

- Under DISMANTLECON the "*method of work*" is part of the "Services" which the Contractor is obliged to perform. (Clause 13). There is no such provision in the LOGIC General Conditions.
- Company-supplied "*Technical Information*" and Contractor "*Assumptions*" are contained in both standard contracts. However, DISMANTLECON also provides a complex regime for Company supplied "*Rely Upon Information*". This contrasts with the simplicity of the regime under LOGIC General Conditions, where subject to the accuracy of the information and the Assumptions, the Contractor warrants it has the necessary skills and resources to complete the work for the specified price and in accordance with the programme (clause 6.1). If any error or deficiency in the Company-supplied information or any Assumption causes delays, additional expenses, or risks endangering life or the environment, the Contractor can seek a variation of the contract (clause 6.3). By contrast, under DISMANTLECON clause 2(a), the parties agree that the services (defined to include the key dates) are based on the accuracy of the Assumptions, Technical Information and the Rely Upon Information. There is no mention of the contract price depending on the accuracy of that information.
- Under DISMANTLECON the Company can appoint a Marine Warranty Surveyor (Clause 5). There is no such clause in LOGIC General Conditions.
- There is greater scope for the Contractor to seek variations under DISMANTLECON than under the LOGIC General Conditions.
- Determining if completion is achieved under the LOGIC General Conditions is complex. In DISMANTLECON, the Contractor's obligations cease on delivery of the facility. This simplicity contrasts with the complexities in the LOGIC General Conditions, which provide that completion occurs when the Contractor (subjectively) considers it has "*substantially completed*" and has "*satisfactorily passed any final test*" in the contract.

Limitation on indemnities

The indemnities in the LOGIC General Conditions are said to be "*full and primary*", applying irrespective of negligence or breach of duty by the indemnified party, and irrespective whether the indemnified party has insurance coverage for the indemnified liabilities. However, the mutual indemnities do not provide total indemnification, and do not extend to criminal sanctions. There are some express limitations that restrict the indemnity, impact on the knock for knock regime and provide a potential for disputes, including:

- The indemnity for third-party personal injury or property loss is limited to loss caused by negligence or breach of duty by the indemnifying party. Third-party property loss or personal injury which is not caused by the indemnifying party's negligence is not covered by that party's indemnity, leaving the counterparty exposed to potential liability for that loss.
- The Company's indemnity for damage to its property is limited to property located at the "worksite". The Contractor could potentially be liable for loss of Company Group property not located at the "worksite". There is no such restriction on the Contractor's indemnity for loss of its property.

- The "*Company Group*" does not cover other contractors of the Company or their subcontractors. Hence not all contractors undertaking decommissioning at the worksite are covered by the indemnity. LOGIC's Explanatory Notes suggest that Standard Contracts Committee's Industry Mutual Hold Harmless (IMHH) be used to fill this gap. This deficiency does not arise under DISMANTLECON, as the Company's other Contractors and their subcontractors "(of any tier)" (other than the Contractor Group itself) are expressly included in the definition of "Company Group" under clause 1(a).
- Express limitations apply to damage to oil and gas production facilities, and consequential losses (clause 22.2(d)): (i) the third-party production facilities and pipelines must be "*specified and defined*" in Appendix I. If they are not, the Company is not liable for damage to them; (ii) third-party property must be located within a 500m radius of a relevant vessel. These limitations could leave the Contractor exposed to potentially significant risks if damage occurs to a third-party subsea pipeline or facility outside the 500m radius; and (iii) the relevant vessel must be "*directly*" engaged in work at the time of the damage, and cannot be in transit.

Clause 33(a) of DISMANTLECON enables the Contractor to negotiate a limitation of its liability (Clause 33(b)). Clause 22(e) also expressly preserves any rights that both the Contractor and Company have to limit their liability under any statute, applicable law or convention (including as against each other). Arguably, the limitation of liability provisions under both contracts undermine the very core of the knock for knock regime.

Neither LOGIC General Conditions nor DISMANTLECON expressly exclude from the scope of the mutual indemnities loss caused by gross negligence or wilful misconduct. A question therefore arises whether the knock for knock regimes under both contracts operate in the face of a breach of the decommissioning contract or whether a defaulting party would be deprived of the benefits of the knock for knock regime in that scenario.

The parties' mutual indemnity under LOGIC General Conditions covers consequential losses they each suffer. DISMANTLECON excludes liability for consequential / indirect losses. This is another inroad into the knock for knock regime.

The benefits of "knock for knock" are exponentially increased when the regime is accompanied by an effective insurance strategy, which provides for insurance coverage against pre-allocated risks and liabilities (and no more), resulting in efficiencies, and avoids multiple coverage of the same risks.

An established regime

The global focus on energy transition from fossil fuel to renewable energy, and the push to achieve net zero emissions has renewed focus on offshore decommissioning activities, and how such activities can be conducted in a sustainable, responsible and safe manner. The knock for knock regimes adopted in the two internationally accepted standardised decommissioning contracts (LOGIC General Conditions and BIMCO DISMANTLECON) do not provide a comprehensive indemnity for all decommissioning risks.

Nonetheless, despite their deficiencies, the knock for knock regimes in the standardised decommissioning contracts are an effective and efficient risk mitigation and management tool, as they are in many other offshore contracts. There is good justification for the offshore decommissioning sector to continue

to embrace the well-proven knock for knock regime. As always, the need for careful and clear drafting remains,.

If you would like to read more on this topic, these additional publications are available:

- [Construction Blog: It's a knock-for-knock out](#) (February 2022)
- Clifford Chance Briefing: [Reviewing knock for knock indemnities: Risk allocation in maritime and offshore oil and gas contracts](#) (October 2015)

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