Limitation of liability clauses in maritime contracts – do they bind the court?

Allocation of risk and liability is an essential feature in contractual and legal regulations governing the shipping and offshore industry. This is a result of the generally large risk of damage which shipping and offshore players are faced with, and the fact that losses and subsequent claims may be considerable. Ship owners in particular have long and well established traditions for limiting their liability towards other contracting parties. Contractual clauses to this effect include liability caps, limitation to direct damages, knock-for-knock clauses, liquidated damages and limitation of available remedies. The rules in chapter 9 and 10 of the Norwegian Maritime Code provide examples of statutory liability limitations, covering e.g. liability for shipping disasters and oil pollution.

Although the practice of limitation of liability is commonly used and widely accepted in the shipping and offshore industry, the result may in certain situations turn out to be highly unreasonable for one of the parties – either as a consequence of one or both parties’ intended regulation of the contractual relationship, or as an unexpected result of the same. In these situations, practice from the Norwegian courts indicates that the exemption clause in question may be revised or set aside.

Under Norwegian law, the parties’ intentions, good business practice and other considerations of reasonableness are given a significant role in the courts’ approach to construction and interpretation of contracts compared with other jurisdictions, such as particularly the UK and the US. Although Norwegian courts rarely revise contracts between professional parties, it is important
Under which circumstances may the Courts revise or set aside limitation of liability clauses?

Contractual freedom is a main principle under Norwegian law, giving contracting parties the freedom to accommodate any special regulation they may find suitable for their contract. Particularly when it comes to commercial contracts, the courts’ revisions of such clauses are reserved for exceptional circumstances. In rare situations where a contracting party would otherwise be discharged from liability for loss caused intentionally or with gross negligence, or where the result would otherwise be particularly unreasonable for one of the parties involved, the Norwegian courts may, however, revise or set aside the contract or a particular clause.

Circumstances which affect the assessment of whether or not the clause or contract in question should be revised include the nature of the contract and the contractual relationship. A court will view an agreed document negotiated between various parties within the same industry and an individually drafted contract differently, as an agreed document is generally considered to be more balanced. In respect of individually drafted contracts, on the other hand, the courts may place emphasis on the bargaining power of the drafting party (i.e. a David and Goliath situation) when assessing whether a contract or a contract clause is reasonable. Other important factors which may affect the courts’ assessment include the parties’ ability to obtain protection from liability through insurance and whether the contract as a whole provides the necessary balance of risk and obligations between the parties.

Below, I will discuss in more detail some of the relevant circumstances which may result in a revision of contract.

Agreed documents vs. individual contracts drafted by one party

When the courts consider whether a contract clause is acceptable or not, one aspect which is given a lot of weight is whether the contract is an agreed document or individually negotiated by the parties.

Generally, agreed documents would be expected to contain a reasonable and balanced allocation of rights and obligations between the parties which reflects the industry’s opinion of an appropriate regulation. Consequently, the courts maintain a more reserved approach when it comes to revision of the terms of such contracts. In practice, such revision would only be relevant where the parties have made material amendments to the original document, or the agreement was originally drafted to be governed by another jurisdiction than the one chosen by the parties, and this is not accommodated in the rest of the document.

Where, on the other hand, the contract is individually drafted by both or one of the contracting parties, the courts will consider the risk of one of the parties having taken advantage of its bargaining power – i.e. a David and Goliath situation – and are more inclined to revise the contract. Nevertheless, a clause which clearly favours the party drafting the contract may be regarded as acceptable where such clause is commonly accepted in the industry. Such acceptance is normally reflected in the commercial terms of the agreement, such as the parties’ considerations or insurance coverage. Furthermore, contractual clauses drafted by one of the contracting parties may occasionally reflect the background rules of law in a particular legal area. In such situations, the courts will be more reluctant to revise the contract.

In general, the courts seem to be more willing to revise an exemption clause which appears to be unusual or surprising in any way, whereas the general rule will be the opposite – particularly in commercial contracts – where the contracting parties had a clear understanding of the content of the clause.

Balanced allocation of risk and liability in the contract as a whole

Whether or not a limitation of liability clause will be upheld by the courts depends on an overall assessment of the clause in question and the contract as a whole. Based on this, one highly unreasonable clause may be “neutralized” by other clauses of the contract. A good example of this is “knock-for-knock clauses”, which may seem highly unreasonable if considered independently from the rest of the contract.

Where the contract as a whole contains a reasonable allocation of the liabilities between the parties, the courts will normally avoid revision of the seemingly unreasonable clause.

The relevance of the parties’ insurance options

The parties’ insurance options are another relevant aspect which the
courts consider when determining whether a contract clause may be revised or set aside. A good example would be “knock-for-knock clauses”, where there is a direct connection between the allocation of risk and liability and the explicit obligations to insure. For instance in a decision from the Gulating Court of Appeal (LG-2012-7728), the courts focused more on the insurer’s right to claim recourse from one of the parties, than the reasonableness of the contract clause itself. The same reasoning is given a lot of weight in the Norwegian Marine Insurance Plan.

The courts’ revision of limitation of liability clauses
Where the Courts revise or set aside exemption clauses, they normally apply one or more of the following methods; (i) restrictive interpretation of the wording of the clause or contract in question in favour of the otherwise injured party, (ii) emphasising the intention of the parties behind the clause more than the wording itself, (iii) maintaining that the clause in question was never legally agreed and entered into by both parties, or (iv) limiting the content of a clause pursuant to the rule of “standard of reasonableness” in the Norwegian Contract Act 1918 Section 36.

Which method the court applies depends on the contract and clause in question, the relationship between the contracting parties and the alleged reasons why the clause should not be upheld. In practice, however, the above-mentioned rule of “standard of reasonableness” is the method most commonly applied. This assessment is based on the general rules of contract interpretation, and arguments such as the parties’ relative strength, the circumstances under which the contract was made, the relationship and any former agreements between the parties, the object of the agreement and clause in question, and any reasons the parties may have had for entering into the agreement which are not expressly included in the wording, are relevant.

Revision of contract clauses re. limitation of liability for gross negligence – an absolute rule?
A situation which is frequently discussed in practice is revision of a contract clause where a contracting party would otherwise be discharged from liability for damage caused intentionally or by gross negligence. Historically it has been held that these types of limitation clauses are unenforceable under Norwegian law, based on the view that a party “cutting corners” should not be entitled to protection for its gross negligence. More recent practice shows, however, that this reasoning alone might not be sufficient to automatically set aside the exemption clause, particularly in contracts between professional parties.

Other aspects which might affect the court’s assessment of such a limitation clause are, among others, the need for predictability under a contract, the parties’ insurance options and the need
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for corresponding international regulations. Furthermore, the grounds for revision of exemption clauses regarding gross negligence are clearly more relevant where the parties’ relative strength might have influenced the scope of the limitation clause, compared with situations where the clause in question complies with a generally accepted practice in the industry. Hence, the distinction between agreed documents and individual contracts is relevant in this respect as well.

Considering all the aforementioned factors, it seems that revision due to gross negligence cannot be regarded as an absolute rule. Nevertheless, one should be aware that the courts maintain a rigorous view on limitation of liability for intentional or gross negligence, and are more inclined to set aside such exemption clauses.

Another relevant question in this respect is whether the same general rule applies in situations of fundamental breach of contract. There is no clear answer to this question under Norwegian law; however, relevant legal theory and case law (e.g. the Trans Tind case (ND 1984 p. 384, see p. 404)) indicate that the courts are slightly more reluctant to revise or set aside an exemption clause regarding fundamental breach of contract than gross negligent damage.

Gross negligence – who is the contracting party?
Where there is a question of liability for damage due to gross negligence or intent, case law shows that acts or omissions by the management of the company in general will result in liability for the company. Based on the decision from the Norwegian Supreme Court Rt. 1994 s. 626 (the “Kaiinspektør” case) and an Arbitral Award referred to as the “Merland 7” case, cited in ND 1988 s. 263, it furthermore seems that certain employees outside the management may also incur liability on behalf of the company. This is particularly relevant for employees holding positions with decision-making authority in one particular field covering an independent function in relation to the fulfilment of the contract. Examples of positions which may fall on either side of this level of responsibility include section leaders or technical superintendents.

Final remarks
Based on practice from the Norwegian courts over the last century, limitation of liability clauses drafted with a wide and general scope are interpreted in a restrictive manner, even in commercial contractual relationships.

The right to limit one’s liability seems to depend on the nature of the contractual relationship and relevant breach of contract, as well as the nature of any negligence. Consequently, the courts will in general be more reluctant to revise or set aside exemption clauses in international and other established contractual standards and agreed documents, compared with individually drafted contracts. Except for the situation in the “Kaiinspektør-case”, it seems that there are no Norwegian judgements in which a limitation of liability clause is upheld where gross negligence is established against a contracting party, regardless of whether or not such negligence may be attributed to the management of the company. Furthermore, case law confirms that exemption clauses which would discharge a contracting party from liability for a considerable breach of contract are revised or set aside, regardless of any negligence.

In general it is fair to conclude that the contracting parties in an individually drafted contract should be aware, and take into consideration when drafting the contract, that the courts in Norway may revise or set aside limitation of liability clauses if the court finds the clause highly unreasonable.

Where the contract as a whole contains a reasonable allocation of the liabilities between the parties, the courts will normally avoid revision of the seemingly unreasonable clause.