RISK SHIFTING AGREEMENTS IN MARITIME CONTRACTS
Issues Considered
Issues Considered

- Risk Shifting Provisions in Marine Service Contracts
- Validity of Risk Shifting Provisions
- Other Considerations of Validity
- Defenses to Enforcement
Introduction

- Maritime contracts often contain clauses that shift the risk of loss from one contracting party to another. These clauses are important to identify because one party to the contract may have agreed that another party cannot be held liable for its own negligence, limit responsibility for damages, provide a waiver of subrogation rights or agree to provide insurance or another form of indemnity. Such clauses can also be advantageous for the insurer when the insured shifts its risk to another party. They can also adversely affect an insurer’s ability to subrogate. Thus, it is important to know how to identify and apply these clauses and understand their enforceability and impact on your coverage.
Typical Risk Shifting Provisions

- Exculpatory Clause
- Limitation of Liability
- Waiver of Subrogation
- Indemnification
- Reciprocal Indemnity
- Provision of Liability Insurance
Risk Shifting

An example often seen, and frequently addressed by courts, is a maritime contract arising from vessel repairs in shipyards. The potential for a loss increases when a vessel is in a shipyard compared to typical navigation or dockage. The shipyards themselves often seek to shift as much of the risk onto the vessel owner by utilizing these clauses, sometimes seeking to absolve themselves from liability for defects in their own workmanship or the material provided, or in connection with negligence of the shipyard while performing the work.
Risk Shifting

- Such clauses are also seen in contracts between marinas and vessel owners. Dockage contracts frequently seek to shift the risk of loss onto the vessel owner. Marinas may operate rental businesses including personal water craft, kayaks and scuba diving, and require the renter to release the marina from liability related to the condition, use and operation of the craft.
Types of Clauses
Types of Clauses

- Waiver of subrogation
- Exculpatory clauses
- Limitation of Liability
- Indemnification
- Provision of Insurance
Federal maritime law applies to contracts that are maritime in nature. This is determined by the nature and character of the contract, not its place of execution or performance. Thus, a contract relating to a ship’s use, to commerce or navigation on navigable waters, to transportation by sea or to maritime employment is subject to maritime law. *Alex v. Wild Well Control, Inc. et al.*, 2009 U.S. Dist. LEXIS 73151 (La. E.D. 2009). A claim for an open account and attorney’s fees under a state statute was dismissed because an examination of the circumstances under which the contract was formed led to a determination that it was a maritime contract subject to federal maritime law, not state law. *Jambon & Assoc. v. Seamar Divers LLC*, 2009 U.S. Dist. LEXIS 62377 (E.D. La. 2009).
In opining that a contract between parties was governed by federal maritime law, the U.S. Supreme Court noted that the circumstances under which the contract was drawn had a “salty flavor.” *Kossick v. United Fruit Co.*, 365 U.S. 731 (1961).

Conversely, state law will apply to contracts determined to be non-maritime in nature. *Jones v. Berwick Bay Oil Co.*, 697 F.Supp. 260 (E.D. La. 1988). Thus, a determination on how each state enforces risk shifting clauses would be necessary with a wide variety of results. This discussion addresses maritime contracts under federal maritime law jurisdiction.
Waivers of Subrogation
Waivers of Subrogation

Example: Any and all of the Parties' insurance policies provided under the provisions of this Contract or which may be used in relation to this Contract shall contain provisions that the insurers shall have no right of subrogation against the other Party Group, it being the intent of the Parties that the insurance policies shall protect both Party Groups.
Waivers of Subrogation

Subrogation clauses are often found in first party property policies (such as a yacht policy) and govern the relationships of insurer and insured when subrogation against a third party has been waived.

Some hull and machinery policies specifically authorize the insured to waive subrogation.

Waivers of subrogation, when properly drafted, are generally enforceable under general maritime law.
Waivers of Subrogation

The 5th Circuit has held that a maritime contract may contain a waiver of subrogation clause. Such a clause does not equate to a total exculpation from liability and is therefore not contrary to public policy. *Fluor Western, Inc. v. G&H Offshore Towing*, 447 F.2d 35 (5th Cir. 1970).

The 2nd Circuit has held that a waiver of subrogation may exist either by contract or through conduct inconsistent with the right of subrogation, thus, where an insured settled and released a third party from liability, the subrogation right may be destroyed. *Gibbs v. Hawaiian Eugenia Corporation*, 966 F.2d 101 (2nd Cir. 1992).

The 9th Circuit has held that a clear provision waiving subrogation is enforceable. *Dant v. Russell, Inc. v. Dillingham Tug & Barge Corp.*, 877 F.2d 1404 (9th Cir. 1989).
Exculpatory Clauses

Example: I hereby release, waive and forever discharge Inland Water Sports, or Camp Cayuga, its owners, directors, officers, employees and its agents from all liability for any and all loss or damage, and any claim or demands therefore on account of injury, death or property damage or loss, now and forever, arising out of or related to participation and/or instruction, activities of any other related diving operations that may occur, whether caused by the negligence of releasees or otherwise.
Exculpatory Clauses

Example: I hereby agree to release, discharge and hold harmless Southport Marina, its owners, directors, officers, employees and its agents from all liability for any and all loss or damage, and any claim or demands therefore on account of injury, death or property damage or loss, now and forever, arising out of or related to the use of the docks, premises or any other related marina operations that may occur, whether caused by the negligence of releasees or otherwise.
Exculpatory Clauses

(1) Limitation of liability
(a) The Yacht Owner consents to carriage of the Yacht on deck, at the Yacht Owner's sole risk. Neither the vessel nor the Carrier shall be liable for any loss or damage or liability of any nature no matter how caused or by whom caused, including, but not limited to any unseaworthiness or want of fitness. In case of carriage to or from the United States and only insofar as COGSA and/or Harter Act applies, neither the Carrier, the Vessel nor any and all of their respective Servants shall in any event be or become
Exculpatory Clauses

The benchmark case on the exculpatory clause is *Bisso v. Inland Waterways Corp.*, 349 U.S. 85 (1955). There, the U.S. Supreme Court ruled that an exculpatory clause was void because it was contrary to public policy. The Defendant in *Bisso* was a towing company that included in the towing contract a clause that all movement was at the “sole risk” of the Plaintiff. The Court opined that such a clause in towing contracts was unenforceable because, (1) negligence must be discouraged by making wrongdoers pay damages and (2) towing companies have the ability to overreach and drive hard bargains, as well as act as a monopoly, based on the need for their services.
Exculpatory Clauses

Exculpatory clauses seek to completely absolve a party from liability. There exists a split in circuit courts on whether exculpatory clauses under admiralty law are enforceable. *Sander v. Alexander Richardson Investments*, 334 F.3d 712 (8th Cir. 2003).

Because exculpatory clauses are intended to avoid all liability, even for a party’s own fault, they are closely scrutinized by courts and generally considered against public policy. However, if properly drafted, in some circuits they can be enforced, resulting in no recourse against the exculpating party for loss.
Exculpatory Clauses

The 9th Circuit, in *Royal Ins. Co. v. Southwest Marine*, 194 F.3d 1009 (9th Cir. 1999) determined *Bisso* applied only to towing contracts and enforced an exculpatory clause, although it noted a party cannot shield itself from gross negligence or misrepresentation. In *Hall-Scott Motor Car Co. v. Universal Insurance Co.*, 122 F.2d 531 (9th Cir. 1941), where a vessel was destroyed by fire in a shipyard and a jury found for the vessel owner, the court reversed noting the “right of private contract is no small part of the liberty of the citizen” and determined an exculpatory clause did not infringe on public policy.
Exculpatory Clauses

The 8th Circuit, in *Sander v. Alexander Richardson Invs.*, 334 F.3d 712 (8th Cir. 2003) allowed total exculpation of liability because the clause was unambiguous and there was no evidence of unequal bargaining power or overreaching. In *Sander*, the Court distinguished a dockage contract from the towing contract in *Bisso* holding that because there was not the possibility of a monopoly by one party (such as towing companies may have) or unequal bargaining power, the *Bisso* reasoning did not apply.
Exculpatory Clauses

However, the 11th Circuit will not enforce a clause calling for total exculpation of a party for its own negligence and follows Bisso determining such a clause is contrary to public policy. Diesel Repower Inc. v. Islander Invs., Ltd., 271 F.3d 1318 (11th Cir. 2001).

The 5th Circuit has also not enforced a clause calling for total exculpation, instead allowing clauses that limit a party’s liability to a certain amount. Alcoa S.S. Co. v. Charles Ferran & Co., 383 F.2d 46 (5th Cir. 1967).

Limitation of Liability

Example: Furthermore, we undertake to perform work and/or provide public or private berth, wharfage, towage, and other services and facilities ONLY upon the condition, expressly acknowledged by Customer, that we shall not be liable in respect to any one vessel or job, directly or indirectly in contract, tort, or otherwise, to its owners, charterers, underwriters, or representatives for any injury, loss, or damage to such vessel, its cargo, equipment or movable stores, or for any consequences thereto, to said owners, parties in interest, or any third party unless such injury is directly caused by our negligence or the negligence of our employees, and in no event shall aggregate liability to all such parties in interest for damages sustained by them, as a result of such injury, or such defective workmanship or material, exceed the sum of $300,000.00.
Limitation of Liability

- While the 11th Circuit held consistently that exculpation clauses are unenforceable, it has allowed parties to limit their liability in maritime contracts, that is, to determine a maximum amount a party may be required to pay. *Edward Leasing Corp. v. Uhlig & Assoc.*, 785 F.2d 877 (11th Cir. 1987). The Court determined that the concerns of Bisso, (1) that negligence must be discouraged by making wrongdoers pay damages and (2) to prevent overreaching by parties who have the ability to drive hard bargains, are satisfied by a limitation provision. However, such a limitation clause must be clear and unequivocal and there must exist equal bargaining power between the parties. *Diesel Repower Inc. v. Islander Invs., Ltd.*, 271 F.3d 1318 (11th Cir. 2001).

- The 1st Circuit generally follows this rationale. *La Esperanza v. Perez y Cia. De Puerto Rico, Inc.*, 124 F.3d 10 (1st Cir. 1997).
Limitation of Liability

The 5th Circuit in *Alcoa Steamship Co., Inc. v. Charles Ferran & Co., Inc.*, 383 F.2d 46 (5th Cir. 1967), upheld a limitation clause which limited liability to $300,000 noting this was a sufficient deterrent for negligence.
Indemnification

Example: The Owner and/or Owner’s heirs agree to hold the marina harmless and to indemnify it for any and all loss, damage or liability of any kind, whether claimed by reason of acts or the failure to act on the marina’s part, relating to the space and further agrees to hold the marina harmless from loss, damage or liability incurred by Owner (or Owner’s boat) while it is moored at and/or is being transported and/or delivered to the dock or while the vessel is being transported from the dock to any destination Owner may specify or request.
An indemnification clause holds a party harmless and indemnifies it from liability to a third party, putting the responsibility on the other party to the contract.

A properly drafted and specific indemnification clause will generally be valid, however, courts look at these clauses similarly to how they look at exculpation clauses, particularly if they provide indemnification for the shipyard’s own negligence.

The 5th Circuit has held that to be enforceable, indemnity clauses in a maritime contract that exempt a party from liability for its own negligence must be “specific and conspicuous.” *Orduna S.A. v. Zen-Noh Grain Corp.*, 913 F.2d 1149 (5th Cir. 1990). Conspicuous is when a reasonable person against whom the provision is to operate should have noticed it. *Coastal Iron Works Inc. v. Petty Ray Geophysical*, 783 F.2d 577 (5th Cir. 1986).
Indemnification

Indemnity provisions can also be encountered in personal injury contexts. In *Lanasse v. Travelers Insurance Co.*, 450 F.2d 580 (5th Cir. 1971) an indemnity provision was invoked related to the responsibilities of the parties to crewmembers under a time charter. In *Fontenot v. Mesa Petroleum Co.*, 791 F.2d 1207 (5th Cir. 1986), a charterer owed indemnification to an owner for an injury onboard based on such a clause.
Indemnification

- The 7th Circuit has held that an indemnity provision will be enforced only when it is clear, complete, unambiguous and not the result of an unfair or superior bargaining position. *Gillen v. U.S.*, 825 F.2d 1155 (7th Cir. 1987).

- As with exculpation clauses, under general maritime law it is against public policy to allow a party to be indemnified for its own gross negligence. *Royal Insurance Co. v. Southwest Marine*, 194 F.3d 1009 (9th Cir. 1999).
Reciprocal Indemnity Clauses

- Each party accepts responsibility and liability for the death or personal injury of its own personnel... whether or not caused by the negligence or gross negligence of the other party... Each party further agrees to indemnify and hold harmless the other party, as regards both liability and legal costs, in the event the aforesaid personnel or their dependents pursue claims for death or personal injury against the party who is not responsible for them under this contract.
Reciprocal Indemnity Clauses

- Reciprocal Indemnity Agreements, often called knock-for-knock clauses, are indemnifying clauses in which the parties stipulate and agree that each party will bear its own losses and will hold the other party harmless, regardless of which is negligent.
Reciprocal Indemnity Clauses

- Where each party agreed to indemnify and defend the other party for any claims arising, such a clause is enforceable. Thus, when an employee of one party was injured and sued the other contracting party, the first party was obligated to indemnify and defend the other contracting party. *Lively v. Diamond Offshore Drilling Inc.*, 2004 U.S. Dist. LEXIS 15135 (E.D. La. 2004).

- Such agreements are enforceable even if the burden of one party differs from that of the other. *Nigeria National Petroleum Corp. v. Seabulk Merlin*, 2005 U.S. Dist. LEXIS 11298 (Fla. S.D. 2005).

- Such clauses are examined similarly to indemnity agreements, they must be unequivocal and unambiguous, clearly setting forth the intent of the parties.
Provision of Insurance Clauses

- Example: It is further agreed that each such policy, other than workers’ compensation policies, shall name Strangle Point Marina as an Additional Insured with respect to Owner’s obligations hereunder.
Provision of Insurance Clauses

- Many contracts require a party to list the other party as an additional insured, commonly referred to as an insurance procurement provision. Ultimately, such provisions can have the effect of waiving subrogation because the other party claims “insured” status and the common law states that an insurer cannot recover from its own insured.
Provision of Insurance Clauses

Insurance procurement provisions are generally enforceable, having been recognized in Florida as well as the 11th, 9th, 5th and 3rd circuits. A unilateral insurance procurement provision is enforceable. *Tullier v. Halliburton Geophysical Servs.* 81 F.3d 552 (5th Cir. 1996).

However, when a contract contains both an insurance procurement provision and an indemnity provision, the insurance limits under the procurement provision must first be exhausted for the indemnity provision to apply. *Sonat Exploration v. Falcon Drilling*, 85 F.Supp. 2d 649 (W.D. La. 1999).
Provision of Insurance Clauses

- When a party agrees to list the other contracting party as an additional insured, and fails to do so, a claim for breach of contract under general maritime law may proceed. *Elevating Boats LLC v. Devon Louisiana Corp.*, 286 Fed. Appx. 118 (5th Cir. 2008).

- However, parties listed as an additional insured on a marine insurance policy generally can only recover insurance for liability stemming from incidents that arise from the common endeavor of the two parties. *Saavedra v. Murphy Oil U.S.A., Inc.*, 930 F.2d 1104 (5th Cir. 1991).
Provision of Insurance Clauses

- Other maritime contracts require a contracting party to obtain a specific type of insurance in a specific amount naming the other party as a named insured.
- Failure to provide such for the other party under such a policy may not only give rise to a claim for breach of contract but also a claim for indemnity.
- Although not stating so explicitly, such an agreement may be construed as tantamount to defend and hold the other party harmless to a specified amount on the happening of certain events.
Provision of Insurance Clauses

- Such an undertaking is essentially what an insurer agrees to do for an insured.

- Accordingly, the other party, if they fail to provide the agreed insurance, may find themselves as the insurer/indemnitor up to the amount of the agreed insurance they failed to provide.
Validity of Risk Shifting Provisions
Validity of Risk Shifting Provisions

- The validity of risk shifting clauses in maritime contracts is governed by the General Maritime Law of the United States.
- Close scrutiny by courts to insure sufficient incentives against negligence.
- Courts balance these incentives against freedom of contract between parties with relatively equal bargaining power.
Validity of Risk Shifting Provisions


- Towing contract provided a clause that towage was at the “sole risk” of the barge owner.
- Exculpation clause held contrary to public policy:
  - Negligence is discouraged by making wrongdoers pay damages; and
  - Towing companies can overreach where there is limited competition.
Limitations On Risk Shifting
Limitations On Risk Shifting

- Some Provisions Routinely Enforced:
  - Provision of Insurance
  - Indemnification
  - Reciprocal Indemnity
  - Waiver of Subrogation

- Some Provisions Receive Greater Scrutiny:
  - Limitation of Liability: Moderate Level of Scrutiny
  - Exculpatory Clauses: Significantly Greater Scrutiny
11th Circuit Limitations

- Valid Risk Shifting Provisions:
  - Provision of Insurance
  - Indemnification
  - Reciprocal Indemnity
  - Waiver of Subrogation
  - Limitation of Liability

- Unenforceable Risk Shifting Provisions
  - Wholly Exculpatory Clauses
5th Circuit Limitations

- Valid Risk Shifting Provisions:
  - Provision of Insurance
  - Indemnification
  - Reciprocal Indemnity
  - Waiver of Subrogation
  - Limitation of Liability

- Unenforceable Risk Shifting Provisions
  - Exculpatory Clauses
2nd Circuit Limitations

- Valid Risk Shifting Provisions:
  - Provision of Insurance
  - Indemnification
  - Reciprocal Indemnity
  - Waiver of Subrogation
  - Limitation of Liability
  - Exculpatory Clauses
9th Circuit Limitations

- Valid Risk Shifting Provisions:
  - Provision of Insurance
  - Indemnification
  - Reciprocal Indemnity
  - Waiver of Subrogation
  - Limitation of Liability
  - Exculpatory Clauses
Drafting Risk Shifting Clauses

- Risk Shifting Provisions General Requirements:
  - Relative Equality in Bargaining Power
  - In Writing
  - Clear and Unambiguous
**Drafting Risk Shifting Clauses**

**Indemnity:** Under federal maritime law, a “contract of indemnity should be construed to cover all losses, damages, or liabilities which reasonably appear to have been within the contemplation of the parties.”

More strictly construed for losses not expressly identified or reasonably inferred.

Gross Negligence

Generally, both state and federal courts define gross negligence as a conscious disregard of a particularly foreseeable harm.

- Farrell v. Fisher, 578 So. 2d 407 (Fla. 4th DCA 1991)
- Ambrose v. New Orleans, 639 So.2d 216 (La. 1994)
- Santa Barbara v. Superior Court, 41 Cal.4th 747 (Cal. 2007)
Gross Negligence

- Clauses limiting liability in any form will be inapplicable to acts of gross negligence under maritime law.

- “Pinpointing the exact meaning of gross negligence under federal admiralty law proves surprisingly difficult.”

- Federal courts most often look to state law.
  - See also Royal Ins., 194 F.3d 1009 (9th Cir. 1999)
Defenses to Enforcement

- Requirements for enforceable risk shifting provisions are not limited to Bisso concerns

- Provisions are also subject to traditional rules of contract interpretation
Rules of Construction

- **Contra Proferentem**
  - Ambiguities to be construed against the drafter.

- **Plain Meaning**
  - The meaning that a person of average intelligence, knowledge, and experience would deem reasonable.

- **Definition/Description**
  - If a term is defined or described, that meaning is given to the term wherever it appears in the agreement, unless the context clearly requires otherwise.
Rules of Construction

- Custom and Usage
  - Words have a technical meaning not ordinarily associated with common language.
  - Extrinsic evidence (including opinion testimony) has been permitted to explain and interpret terms when the meaning depends on trade practice.
Response of Marine Insurers
Response of Marine Insurers

- The clear trend in the marine service industries is toward shifting risk away from the actor.

- The risks involved in an extensive yard period differ greatly from navigational risks.

- Has the marine insurance industry implemented responsive changes?
  - New terms, conditions, and/or rates?
Historically, hull policies have had no coverage restrictions on yard periods or the work to be completed

- **American Yacht Form R.12**
  - Contains no provision regarding yard periods

- **American Institute Hull Clauses**
  - Covers “negligence of repairers”
  - May designate or veto a yard post casualty

- **International Hull Clauses (Institute Time Clauses)**
  - Covers the “negligence of repairers”
Refit and Repair Clauses

- Reliance on *uberrimae fidei* is uncertain and requires policy provisions to protect insurers.
- Refit, Repair, and Hot Work Clause impose duties on the owner to:
  - Notify the insurer of such work
  - Insure adequate SRLL coverage
  - Refrain from agreements impairing insurer rights
Exemplar Refit and Repair Clauses

It is a condition of this Policy that You will, whenever the Vessel is Contracted to undergo any refit, repair or Hot Work:

i. give notice to us in advance of arrival at yard or commencement of works (as applicable);

ii. insure that the yard and/or other contractors carry current and operative liability insurance indemnifying the yard and/or others in respect of all liabilities towards You and the Vessel up to at least the lesser of the Insured Value of the Vessel or €5,000,000 (or equivalent) (€2,000,000 in the case of other contractors), and provide evidence of such coverage to us in the form of a copy of the relevant valid insurance certificate or other evidence of coverage satisfactory to us; and

iii. insure that the yard and/or other contractors impose no contractual exclusions or limitations of liability, nor any waiver or other limitations of our subrogated rights of recovery;

provided that if we are given notice in accordance with (i) above, we may, at our discretion, waive (ii) and/or (iii) above on terms to be agreed
Other Hull Policy Restrictions
Other Hull Policy Restrictions

Exclusion

- This insurance does not cover: Loss, damage or expense whilst under refit or repair other than normal maintenance. Any Hot Work during normal maintenance must be notified in advance.
Liability Cover for Marine Service Providers

- Traditionally, liability cover for marine service providers does not address risk shifting provisions.

- However, the actual risk assumed by the insurer can be dependent on risk shifting provisions in marine service contracts.
Liability Cover for Marine Service Providers

It is a condition of this cover that You must incorporate Your Standard Terms and Conditions into the agreement with the owner of the Watercraft or, their authorised representative prior to commencing repair, service and/or maintenance which exclude Your liability for loss or damage whatsoever, however caused.
Conclusion
Conclusion

Waiver of Subrogation: A clause in which a party, including an insured vessel owner, waives its insurer’s right to seek amounts paid out for a loss from a third party. These clauses are generally enforceable.

Exculpatory Clauses: A party’s attempt to absolve itself from all liability. There is a split among U.S. circuits as to the enforceability of such clauses and they are heavily scrutinized. The 11th Circuit, following the Supreme Court’s decision in *Bisso*, will not allow for total exculpation. Other jurisdictions allow such clauses, however, they must be unequivocal and unambiguous.
Conclusion

**Waiver of Subrogation:** A clause in which a party, including an insured vessel owner, waives its insurer’s right to seek amounts paid out for a loss from a third party. These clauses are generally enforceable.

**Exculpatory Clauses:** A party’s attempt to absolve itself from all liability. There is a split among U.S. circuits as to the enforceability of such clauses and they are heavily scrutinized. The 11th Circuit, following the Supreme Court’s decision in *Bisno*, will not allow for total exculpation. Other jurisdictions allow such clauses, however, they must be unequivocal and unambiguous.
Conclusion

**Limitation of Liability:** Instead of a total exculpation for liability, this clause institutes a cap on the damages recoverable, typically $300,000. These clauses are generally enforceable.

**Indemnification:** A clause in which one party agrees to hold harmless and defend the other from any claims from third parties. These clauses are generally enforceable.

**Provision of Insurance:** A provision where one party insures the other through its policy which limits the right to seek subrogation. The additional insured can only recover from incidents stemming from their common endeavor with the insured. These devices are generally enforceable.
Andy Anderson

- **Miami Office**
  200 S. Biscayne Boulevard
  Suite 300
  Miami, FL 33131
  TELEPHONE: 305 372 9044
  FAX: 305 372 5044

- **Fort Lauderdale Office**
  1500 Cordova Road
  Fort Lauderdale, FL 33316
  TELEPHONE: 954-522-0274
  FAX: 954-463-8752

For more information about our attorneys, our practice areas, our offices and more, please visit our website:

www.chartwelllaw.com