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Knock-for-Knock Indemnities and their Application in Oil and Gas Contracts in Argentina

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ABSTRACT

Although knock-for-knock contractual indemnities (otherwise known as 'mutual hold harmless' or 'bury your own dead' indemnities) are common to oil and gas contracts worldwide, their usefulness in oil and gas contracts in Argentina (and in most Latin American countries to that extent) is not always fully understood. Failure to comprehend the extent and aim of these indemnities and their particular interplay with liability caps, consequential loss exclusions and insurance provisions will likely cause an incorrect evaluation on contractual risk. Additionally, recent oil rig disasters have put these clauses into the spotlight, and questions have been raised regarding their enforceability, especially in a civil law country such as Argentina.

1 Introduction

An indemnity may be defined as "*[a] duty to make good any loss, damage or liability incurred by another*," or alternatively "*[t]he right of an injured party to claim reimbursement for its loss, damage or liability from a person who has such duty*."[1]

Indemnity clauses are used differently amongst a large numbers of commercial contracts. As it is not possible to define, in general, the exact content of indemnity clauses, the extent of their effects shall be strictly linked to the contractual wording and content itself, and not by a clause being labelled as "indemnity clause".

For the purposes of this paper, we will focus only on a specific form of liability: the one covered by clauses where each party agrees to indemnify the other against liability that the other may have against him. Within the oil and gas industry, the use of agreements containing reciprocal indemnity clauses between the parties is vastly common. This way, each party bears the risk of loss or damage to its own property, or injuries or death suffered to its personnel, without regard to the person that caused the damage.

The use of indemnity clauses as a contractual provision aims at distributing such risks stemming from the transaction. Indemnification is the right of one party who is legally responsible for a loss to shift that loss to another party. In addition to representing an actual shifting of liability that would otherwise be the responsibility of one of the parties, indemnity clauses may represent a confirmation of pre-existing liability that, for various reasons, needs to be more precisely or additionally addressed. Basically, indemnity clauses serve the purpose of allocating liability for damages, losses and costs – among others - in a contractual relationship between certain parties, regardless of financial viability of said parties, or whether insurance will respond.

In common contractual language, the party agreeing to indemnify the other is referred to as the indemnitor or the indemnifying party, and the party being indemnified is usually

[1] *Black's Law Dictionary*, 8th Ed. (West Group, 2004)

addressed to as the Indemnitee or the indemnified party. Further on, we will see how even this (most) simple definition could lead to the creation of unwanted liabilities for a party, when not properly drafted.

Although "indemnify" and "hold harmless" are often used synonymously, one could argue (for several reasons) that they are not entirely similar, as far as contractual practice goes.

Firstly, and as general contractual rule dictates, the use of different words in a contract should be construed as to assign different meanings to such words. In that vein, while an indemnity is a voluntary agreement of one party to compensate the other (reimburse by payment, repair or re-perform an obligation) and, usually but not always, used when referring to third party claims, "Hold Harmless" is a direct relationship between the two contracting parties, where one will not pursue compensation from the other and will pay defense costs (usually up-front).

In a "mutual hold harmless" provision, also referred to as a "knock-for-knock" clause, both parties agree to be responsible for claims and losses and/or to indemnify each other from damage to their own property or injury of death to their own personnel, irrespective of fault, provided that, typically, third party damages are excluded, or covered by an different type of indemnity (plus the usual insurance coverage).

In English law, the two terms have long been held to be synonyms. Etymologically the word "indemnity" derives from the Latin word "*indemnis"*, meaning "harmless", combined with "*facere*", meaning "to make".[2] Black's Law Dictionary defines hold harmless as *"[t]o absolve (another party) from any responsibility for damages or other liability arising from the transaction; INDEMNITY*." [3] This, of course, is a very similar definition to the term indemnify, and could indicate that the two terms are synonyms.

By contrast, American law seems to have a slightly different approach towards the two terms. In that vein, the courts have stated that "the terms are synonymous, and mean the same thing." Consequently, in American contractual practice "indemnify" is generally used as a synonym of "hold harmless."[4] However, when specifically distinguished from "hold harmless," indemnify is defined as to "reimburse for any damage." This can be interpreted to be narrower than the definition of "hold harmless," as "hold harmless" would then include risk of loss as well as actual loss, while "indemnify" would only include reimbursement for actual loss. Theoretically, this is a distinction which could have a practical impact.

From a practical standpoint, we could say that a "hold harmless" clause will have the same effect (or not) and impact as an indemnity clause, depending on the broadness of the wording used in any indemnity clause (actual losses covered, definition of claims and losses, reimbursement mechanism, etc.).

2 Knock-for-knock Indemnities. How do they work?

2.1 The Basics

Traditional knock-for-knock indemnity principles provide certainty and make the responsibilities and liabilities of the parties clear and simple from a risk and insurance perspective. Each party will cover, obtain insurance or self-insure the risks related to injury to its personnel and damage to its property. Consequently, the basic approach in a

[2] See http://www.jus.uio.no/ifp/english/research/projects/anglo/essays/bjerketveit_abstract.pdf.
[3] *Black's Law Dictionary*, 8th Ed. (West Group, 2004)
[4] See http://www.jus.uio.no/ifp/english/research/projects/anglo/essays/bjerketveit_abstract.pdf.

"knock for knock" provision is: "I'll take care of mine and you take care of yours." However, what is "mine" and "yours" can be quite confusing[5].

In Anglo-Saxon law, knock for knock indemnities are interpreted restrictively, meaning that in the case of any ambiguity, the clause will be construed in the "manner least favourable to the party seeking its protection."

Under a knock for knock indemnity, each party assumes complete responsibility for its own personnel and property, regardless of fault. Thus, if an employee of the contractor is injured and files suit against the company, the contractor must defend and indemnify the company regardless of who was at fault for causing the damage or injury. For example, if a blowout occurs as a result of the company's negligence and an employee of the contractor is injured and sues the company, the contractor must pay for the defense and any liability that the Company incurs – even though the explosion was purely caused by the company's negligence. Thus, the contractor's obligation to defend and indemnify the company exists even though the injury to the employee may have been caused entirely by the company's negligence, gross negligence or willful misconduct.

Similarly, if the contractor is sued by an employee of the company, the company is required to defend and indemnify the contractor – even if the injury or damage was caused by the contractor's negligence.

Knock-for-knock indemnities are extremely common to the oil and gas industry, and, upon a negotiation, parties are usually unwilling to accept modifications, save for certain industry and service-specific indemnities relating to catastrophic events (loss or damage to hole, loss of well, damage to reservoir, contamination or pollution below the surface, etc.) and to particulars of each service rendered (for rig operations, for example, there are many exclusions relating to fishing operations, lost in hole equipment and downhole tools, et al), which we will later address.

*2.2 **Benefits of Knock for Knock Clauses***

2.2.1 **Reduced Costs.**

Even without complications, the search for oil and gas is expensive and always involves risk. Litigation inevitably increases the cost of the effort. Accordingly, one of the primary benefits of reciprocal indemnity agreements can be a reduction in cost to both parties.

When parties enter into a knock-for-knock agreement, potential liability is established at the time of contract for both parties through the contract. If an accident occurs causing an injury to the employee of either party to the agreement, the parties can avoid disputes between themselves regarding their relative responsibility for the accident. As between the two parties to the contract, the reciprocal agreement will have already established liability--Company A will be responsible for all claims made by its employees, and Company B will be responsible for all claims made by its employees--regardless of who is at fault. The parties can, therefore, avoid costs that might otherwise be incurred to establish their respective responsibility.

Furthermore, a reciprocal indemnity agreement allows one party to take over responsibility for both contracting parties and retain one lawyer to defend both parties[6]. For instance, if an employee of a contractor for "Company A" is injured as a result of an accident caused by both "Company A" and "Company B", the third party contractor employee would generally bring suit against both companies to determine liability. Thus,

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[5] Henry A King - *Contractual Indemnities – Getting the Other Guy to Pay Your Legal Liability*.

[6] Peter Cameron - *Liability for Catastrophic Risk in the Oil and Gas Industry* - International Energy Law Review – Issue 6, 2012.

mutual indemnity agreements not only diminish the need for litigation between the contracting parties, but can also reduce overall litigation costs, should suit arise.

2.2.2 Certainty

These knock for knock indemnity provisions allow the parties to pre-determine their exposure when entering into any contract, thus allowing them to achieve better project planning and better management of costs as a direct consequence of this enhanced certainty. Henceforth, knock-for-knock indemnities help decrease friction between the contracting parties, not only by establishing liability of both parties at the time of contract, but also by establishing a level of certainty to both parties with regard to their liability exposure.

An oil rig is often times a common workplace for employees of several different companies and, without a reciprocal indemnity agreement, each party is potentially liable for claims by any of the other companies' employees[7]. Accordingly, while each company can help protect itself from liability by properly training and managing its own workers, there is often little it can do with regard to the employees of other companies. Uncertainty about liability exposure can translate into higher costs for all parties involved.

2.2.3 Elimination of redundant insurance.

As the parties´ liability regarding loss or damage to property or injury or death of personnel is only limited to its own side, the retention of appropriate insurance coverage is simpler and more effective, eliminating the expenses related to over compensation to cover for unknown third-party liabilities that could arise in any project. Under a knock-for-knock scenario, each party can easily determine the amount and cost of the insurance they will need for the job by simply knowing how many people and property will be at the work site under the contracting party's scope of liability. A contracting party with fewer workers or property at the site for whom the party is legally responsible will have a relatively smaller exposure than a company that has many workers or property at the site who might be injured or might be lost or damaged if an accident occurs.

2.2.4 Reduced Litigation.

This practice of pre-setting liability reduces friction between parties by decreasing the likelihood of future litigation between the parties. The parties are free to concentrate more on their business relationship without worrying about having a dispute if something goes wrong and an employee of either party is injured.

2.3 Disadvantages of Knock for Knock Clauses

The mutual hold harmless allocation of liability has multiple advantages as explained above, but does not solve all existing problems or address all risk allocation issues. The main argument against the knock-for-knock provisions lies directly in their nature. Since the contracting parties agree to cover losses of their own personnel and equipment in the case of accident, they may be liable even without being even remotely responsible. The issue seems even more unfair when the indemnified party acted with gross negligence or willful misconduct. Such constructions may thus force parties to deal with claims they may otherwise never be involved. This could generate additional costs and be time-consuming.

This is the reason why sometimes parties try to include provisions restricting the scope of .knock-for-knock clauses. Such action may on the one hand reduce the possibility of claim, particularly when the other party is at fault. On the other hand, when the accident

[7] Christopher L. Evans and F. Lee Butler - *Reciprocal Indemnification Agreements in the Oil Industry: The Good, the Bad and the Ugly* – Defense Counsel Journal – International Association of Defense Counsel – April 2010, Volume 77, No. 2.

occurs, an additional investigation is required to determine the responsibility of each party, which both takes time and generate extra costs.

Also, it is often claimed that since the knock-for-knock clauses contains exclusions of liability even in the case of gross negligence or willful misconduct, the responsibility for safety issues are so reduced that it might led to accidents. It may be thus argued that if the indemnified party is not liable for his own action, he may use less care to avoid injury or loss, because he will not be responsible for his own fault.

Even if knock-for-knock provisions may seem unfair at first sight (especially by non-lawyers) the benefits described in this chapter will most often prevail over these disadvantages.

In my opinion, this is the reason why these clauses are so commonly used and worldwide recognised, especially in the oil and gas industry, where huge capital sums and liability exposure are involved.

3 Use of knock-for-knock indemnities in the Oil & Gas industry

3.1 Use in the Oil & Gas industry

As we have mentioned before, knock-for-knock indemnities have been used in the oil and gas industry (and other capital intensive industries) for quite a long time. Certain publications date first discussions regarding mutual hold harmless clauses back to the early 1950´s[8].

Nowadays, and for the last 40 years or so, most of the service contracts dealt with in the industry contain a knock-for-knock / mutual hold harmless general provision, albeit with specific exceptions that address the particulars of each service and project.

Most of the "supermajors", such as Chevron, Shell, Total, ExxonMobil, ConocoPhillips, BP, etc., have their own standard form contract which contain a general knock-for-knock indemnity provision, most of them being fairly similar in scope and wording.

On the other hand, industry-specific organizations have also published and distributed model form service agreements (only for certain key services), such as the 2002 Model Well Services Agreement published by the Association of International Petroleum Negotiators (AIPN), or the Standard Drilling Contract published by the International Association of Drilling Contractors (IADC), among other examples.

3.2 Basic provisions of knock for knock clauses

As a rule of thumb, the parties will accept being responsible for reasonable, measured risks associated with their activities and in line with the potential risk/reward ratio and generally accepted industry standards. Any parties´ liability for punitive, indirect, consequential, pollution, reservoir and other damages with catastrophic potential should be brought in line with the potential risk/reward ratio by liability exclusions or damage limits, as we will explain further on.

For all liabilities and indemnities falling within normal areas of operations and not within specific area of exclusion that we mentioned above, the core principle of liability allocation should be based upon the knock-for-knock principle, which states that each party shall be responsible for injury/damage to its personnel and property (including its other contractors/subcontractors´ people and property), regardless of who was at fault.

This fairly simple scheme is the core principle of the mutual hold harmless principle.

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[8] Cary A. Moomjian - *Drilling Contract Historial Development and Future Trends Post-Macondo: Reflections on a 35 Year Industry Carreer*.

Additionally, some contracts also include under the same general knock for knock principle any losses or damages originating from either party´s violations of the applicable law of the contract, to the extent that such violation is not covered by another specific indemnity provision in such contract.

Furthermore, and also for enhanced risk allocation purposes, neither party should be liable to the other for punitive, incidental, consequential, or indirect damages nor for any loss of profits or business interruption. These losses are inestimable and are likely to be out of all proportion and it is unlikely that either party could obtain insurance to cover these losses on any reasonable terms.

Likewise, any third party property which is in the possession or control of the either party should be covered by that party´s indemnity hold harmless provision. This is commonly covered under the definition of each party´s "Group", such as subcontractors, third-party equipment, etc.

3.3 Clause examples

Below are a few examples of typical wording found industry-wide in various agreements, such as drilling rig, drilling services, oilfield services, general services, technical services, etc.:

Example 1

"Indemnity in Favor of the Company. Except as and to the extent otherwise expressly provided elsewhere in this Clause, the Contractor agrees to fully release, indemnify and defend the Company Group from and against, and hold each of them harmless from, all Claims and Losses, including those attributable to the negligence, Gross Negligence, Willful Misconduct, strict liability or other fault, whether sole, concurrent, active or passive, of any member of the Company Group, and without regard to the cause or causes thereof (including blowout, fire, pre-existing conditions, breach of warranty or breach of agreement), brought by or arising in favor of any member of the Contractor Group (including the heirs, representatives or successors of same) , in respect of:

a) bodily injury, disease, sickness, death of any member of the Contractor Group in connection with this Agreement; and

b) damage to, or destruction or loss of any property, wherever located, of the Contractor Group in connection with this Agreement.

The Contractor agrees to fully release, indemnify and defend the Company Group from and against, and hold each of them harmless from, all Claims and Losses, including those attributable to any violation of any Applicable Law or this Agreement committed by any member of the Contractor Group related to the performance of the Work or this Agreement."

Example 2

"Mutual release, defense and indemnity among company's contractors and their subcontractors. Contractor shall release, defend and indemnify company's other contractors and their subcontractors against all damage to or loss of property of contractor and its subcontractors. However, the obligations of contractor in this article 8.1.2 (i) shall only be applicable to the extent that any such other contractor of company or its subcontractor has agreed to a reciprocal provision in favor of contractor. Such reciprocal provision may be in the form of this article 8.1.2 or any other form or wording so long as the substantive nature of the clause is similar to this article.

Contractor shall include a provision similar to article 8.1.2 (i) in its subcontracts to the effect that contractor's subcontractors grant such release, defense and indemnity to company's other contractors and their subcontractors."

Example 3

"Contractor agrees to release, protect, defend indemnify and hold company group harmless from and against all claims, without limit, on account of bodily injury, sickness, disease or death, or loss of or damage to property of contractor group allegedly or actually sustained during, or directly or indirectly arising out of, or in any way connected with or incidental to, this agreement or the operations contemplated thereby, including any loading, unloading, ingress, or egress of cargo or personnel, regardless of negligence or other fault of company group."

3.4 Common exceptions to knock-for-knock provisions

As described above, certain situations and activities of the day-to-day operations of an oil and gas company need to be addressed in a specific manner, and are not to be covered by the general mutual hold harmless rules explained. This difference lies in that these particular activities involve more serious risks and liabilities for both operator and contractor, which may not be adequately covered under the generic knock-for-knock provision. Moreover, the gravity and potential consequences of these specific cases deserve to be addressed as separate situations with specific risk allocation provisions, to provide appropriate incentives to both parties to avoid their occurrence at all costs.

3.4.1 **Indemnity for Third Party Claims.**

This is the very first and most commonly found exclusion to the knock-for-knock regime in most oil and gas contracts. The reason behind this carve-out is that, as it happens with consequential and indirect damages, losses are not estimable at the beginning of the contract, thus being impossible to either include as contingency or cover it by including in the price of the service (from each side, this could cause a serious loss of competitiveness) or to insure them on any reasonable terms. For purposes of this clause, a third-party shall be any party that that is not either a part of the contractor group or the operator group (as we have explained the scope of these definitions herein).

Under this exception, both parties should accept liability for damage claims made by third parties to the other party to the contract, to the extent of their negligence or fault, provided such claims do not arise from a statutory or contractual breach from contractor under the corresponding contract (though this *proviso* is not always found in all contracts). Degrees of fault may vary from contract to contract, but it is common to find that most contracts include negligence, gross negligence and willful misconduct of each party as a trigger. Often, some contracts may also include a fixed limit of liability applicable to contractor for this specific provision tied to the remuneration or reward received by contractor under the contract. No such cap exists for the operator.

3.4.2 **Indemnity for Loss of Downhole Tools.**

Typically, the loss of downhole tools[9] below the rotary table[10] in any well will be on the operator´s account, provided, however that any loss of downhole tools attributable to contractor´s fault, shall be at contractor´s responsibility.

Regarding the degrees of fault commonly found, it is fair to say that simple negligence is not always accepted by contractors in these types of specific indemnities, raising the standard to gross negligence and willful misconduct. However, under special circumstances, sole negligence may also be accepted.

On the other hand, it is also common to see clause-specific liability limitations for this indemnity (either per event, per contract, per year, etc.), and –many times- carve outs regarding loss of third-party downhole tools, which should be covered by each party´s general mutual hold harmless clause.

3.4.3 **Indemnity for Fishing Operations.**

This provision is always intimately tied with the loss or damage to downhole tools clause, and many times, also dealt with jointly.

In this case, and consistent with the clause explained above, fishing operations originated in a lost in hole event, will be the operator´s responsibility, to the extent not caused by the

[9] Meaning any tools or equipment that go into into the wellbore.

[10] A rotary table is a mechanical device on a drilling rig that provides clockwise (as viewed from above) rotational force to the drill string to facilitate the process of drilling a borehole.

contractor´s fault, gross negligence or willful misconduct. The operator will run and direct the fishing efforts, and decide when to stop the attempts to recover a lost in hole item.

Fishing operations may add up to large sums and cause several days of downtime and – potentially - loss of production. Henceforth, careful consideration on how costs and expenses arising from these fishing operations are distributed is paramount.

When fishing operations are not due to contractor´s fault, the situation is simple, because the operator must pay all costs and expenses relating to this situation, including the cost of the tools (usually, unless we are dealing with a very expensive or specific tool, at a depreciated replacement cost) and any compensation due to the contractor during the performance of these fishing operations.

However, when the fishing operation is originated in contractor´s fault, the situation is completely different. In this event, contractor shall not be entitled to receive any rates or compensation for the whole duration of the fishing operations, the company shall not be liable for the cost of the downhole tool lost in hole and contractor shall typically reimburse the operator for the costs incurred regarding the fishing efforts.

Discussions always arise regarding the reimbursement of costs, as most contractor´s will claim not to have any control on the fishing operations, thus, not being able to "stop the clock" on the fishing costs. In this line, a liability cap could be added, to the extent this cap is consistent with the costs that the operator will need to recover should this event occur.

Finally, and from the operator´s side, any loss of production incurred as a consequence of the performance of fishing operations, even when contractor is at fault, is not recoverable under these indemnity provisions to the extent these losses are considered as indirect damages, which are reciprocally waived in all industry contracts, as explained above. This fact is also applicable to all the other exceptions to the general knock-for-knock principle that we are explaining in this chapter.

3.4.4 Contamination and Pollution.

The main principle in this carve-out is that, apart from specific exceptions, the contractor will be responsible for any contamination or pollution arising from its equipment above the surface, while the operator shall be responsible for any contamination or pollution arising from below the surface of the earth.

Contractor may also be liable for subsurface pollution in the event such pollution is caused due to contractor´s gross negligence or willful misconduct (simple negligence is not considered in these events) and provided it is caused by any equipment or personnel under contractor´s control.

Liability for contamination typically includes the costs of clean-up and disposal arising therefrom, as well as any other claim and loss stemming from this catastrophic event (such as litigation, fines, investigations, et al). In general, and given that damages arising herefrom are inestimable, specially to contractor, a specific limitation of liability is often included, to limit the costs to be paid by contractor upon the occurrence of each event of this nature.

3.4.5 Indemnity for Loss of Well Control.

In line with the exceptions to the general knock-for-knock principle described in these paragraphs, losing control of a well and all operations leading up to bringing a well under control are typically on the operator´s side, to the extent not caused by contractor´s gross

negligence or willful misconduct (simple negligence is also not considered in these events).

When negotiating these clauses, many discussions arise regarding the extent of contractor´s responsibility for well control operations´ costs, even when contractor is at fault, mainly due to contractor´s lack of control and foresight on these well control operations.

Generally, the parties may agree to limit contractor´s liability to the loss of any compensation during well control operations and, in some cases, to collaborate at its own expense to bring the well under control, under the operator´s direction. Also, in some cases, as the costs arising from these operations may be very high and sometimes inconsistent with contractor´s compensation under the contract, the parties may also agree to further limit contractor´s liability, including a cap applicable to each well control event (or in some cases a sole amount for the whole duration of the contract is included, regardless of the amount of events occurred).

3.4.6 **Indemnity for Damage or Loss of Well.**

Should a damage or loss of any well occur, the operator will indemnify and hold contractor harmless from any claim and loss arising therefrom, provided such loss or damage to the well is not attributable to the contractor´s gross negligence or willful misconduct (once again, simple negligence is also not considered in these events).

Remedies under this indemnity are the real discussion. Similarly to the case explained in point 3.4.5 above, the costs arising from the damage caused to a well or, even more, the loss of a well could result in astronomic figures (costs of re-drilling a well from scratch, for example) which may prove to be inconsistent any sometimes even higher than contractor´s compensation expected for these services.

While operators will want the contractor at fault to cover the costs of re-drilling a well (in the event of a loss of well) or to restore the well to its original conditions before the occurrence of this event, in addition to not paying contractor any compensation until the well is restored to its original condition, contractors will want to limit their liability to only not receiving their compensation due, and including a limitation of liability per event to cover for this losses. However, in some cases, drilling contractors may agree to re-drill a well to its original condition as sole remedy for the occurrence of this event, when at contractor´s fault.

3.4.7 **Indemnity for Loss or Damage to Reservoir.**

This indemnity is always on the operator´s side, as it is an intricate part of the risk of doing business for the operator, and the costs arising from a potential damage to an operators reservoir or subsurface formation could neither be estimated by any contractor nor included in what any contractor reasonably charges for its services.

Thus, in this event, the operator shall indemnify contractor from any damage occurred to the reservoir or subsurface formation, irrespective of contractor´s fault or negligence.

4 Civil Law provisions that may affect these indemnities. The Argentina example.

4.1 Argentine Law and Knock for Knock provisions

Argentine law is based on civil rules, and indemnities are governed by the Argentine civil code. A basic principle of Argentine civil law (similar to many other roman-based civil law systems) is that any person who causes damage to another must indemnify the aggrieved party in a form proportional to the damage suffered. Additionally, the

Argentine Civil Code provides that each party shall be fully responsible for the acts of its dependents[11].

Under section 1109 of the Argentine Civil Code, any party that by its fault or negligence causes damage to another party shall repair such damage, subject to the provisions of said code. Moreover, section 1083 of the Argentine Civil Code stipulates that the remedy for the occurrence of damages shall be to restore things to their original state, or, if not possible, to asses a compensation in money to cover for these damages, at the victim´s option. These are the main provisions regarding remedies for damages under the Argentine Civil Code.

By virtue of the above legal provisions, service providers may be fully liable for the damages suffered by their clients, the only exception being damages caused by force majeure[12].

Under Argentine law, private agreements are regulated by the principle of 'free will', whereby the parties are free to create legally binding agreements. It means that any person or entity can be bound in an agreement with another party, as long as the contract terms are not prohibited by law and are not contrary to public order rules. In this regard, individuals as well as private entities are free to agree on the scope of an indemnity arising under a contract and can obtain insurance to cover any risks or liabilities.

Based on this principle, where the parties agree to accept liability for their own losses or damages arising from any cause or circumstance, and to hold safe and harmless the other party from any claim originating from such losses or damages, the parties can agree a knock-for-knock provision, which will be –in principle- recognized by Argentine law.

Finally, it is important to note that, in Argentina, damages to property or injuries can also lead to a criminal liability[13], to the extent caused by the willful misconduct (or in some very specific cases, also gross negligence) of a party. In principle, criminal liability cannot be waived and therefore it is important to consider that when loss or damage is caused by the willful misconduct of a party, a criminal liability could result, notwithstanding the existence of a contractual knock-for-knock provision.

4.2 Interpreting Indemnities under Civil Law

4.2.1 General rules.

a) As we have mentioned above, indemnity clauses are a "convention" under Argentine law. Thus, general rules that govern the interpretation of other contracts apply in construing an indemnity provision.
b) Contracts have the force of law between the parties[14], and the courts are bound to interpret them according to the common intent of the parties, provided such contracts do not contravene the provisions of Argentine law.
c) If the words of the contract are clear, unambiguous, and lead to no absurd consequences, the court should not look beyond the contract language to determine the true intent of the parties, provided that the courts may look at the general use given to such conventions[15].

[11] Section 1113 of the Argentine Civil Code.
[12] *Force Majeure* is defined under Section 514 of the Argentine Civil Code as an act which is unforeseeable, or, if foreseeable, unavoidable.
[13] For example, under Sections 79-108 of the Argentine Criminal Code (Crimes against Life); Sections 162-185 of the Argentine Criminal Code (Crimes against Property) and Sections 186-208 of the Argentine Criminal Code (Crimes against Public Safety); among others.
[14] As per Section 1197 of the Argentine Civil Code.
[15] Section 217 of the Argentine Commercial Code

d) If any ambiguity exists in the contract, the courts shall look for the common intention of the parties rather to the specific wording of the clause.
e) Each provision in a contract must be interpreted in light of the other provisions – which are not ambiguous- so that each provision is given the meaning suggested by the contract as a whole.
f) Clauses with more than one possible interpretation, one of which could result in the invalidity of the clause discussed and the other that would result in the validity of the clause under question, should favor the interpretation towards the validity of these provisions. If both interpretations would grant validity to the clause, the interpretation which most "enlightens the nature of the convention or the rules of justice" shall be favored. Of course this interpretation would be highly debatable and subjective in appreciation.
g) Also, the actions of the parties following the execution of the contract –always relating to the subject matter- shall be the best explanation of the parties´ intentions upon the execution of the contract.
h) Uses and customs are also considered under Argentine Law. The Argentine Commercial Code clearly states that the generally accepted uses and practices in any given industry, in similar cases, and specifically in the place in which the convention is to be executed, shall prevail above any interpretation that the parties may wish to give such convention[16].
i) Finally, in the event of doubt which cannot be interpreted as per the principles described above, the ambiguous convention shall be interpreted in favor of the debtor, favoring the release or discharge of the obligation in doubt.

4.3 Main differences with Common Law Systems

4.3.1 **Assessment of damages.**

When assessing claims and losses covered by an indemnity obligation, once again the interplay between the general principle of contractual free will and certain opposing statutory provisions begins to be of importance.

On the one hand, the principle of contractual free will at its fullest shall apply when defining which claims and losses shall be covered under the indemnity provision, subject, of course, to the typical limitations included in industry-wide contracts, such as a reciprocal exclusion of consequential and special damages. Once again, precision in writing becomes paramount when expressing which damages the parties are allowed to recover under the contract.

On the other hand, as we have explained herein, Argentine Law includes several statutory provisions which limit the enforceability of these provisions. In that line, in the event of litigation brought up under these indemnity provisions, the courts may also look beyond the express wording of the clauses to evaluate the fairness of such provisions, taking into considerations the contractual relative "weight" of the parties, the excessiveness or unfairness in the compensation resulting from a word-by-word application of these clauses, the relevant practice in the corresponding industry and location in which the provision is seeking enforcement, etc.

Should the courts consider the ultimate outcome of this analysis to be unfair or excessively burdensome to any of the parties, they might opt to mitigate the assessment of damages, considering the particulars of each situation.

[16] Section 218 of the Argentine Commercial Code

Accordingly, and without digging further into a subject that could lead up to a lengthy discussion, when dealing in Argentina, one should take these enforceability issues into account when negotiating the choice of law and jurisdiction provisions.

4.3.2 No *contra proferentem* interpretation.

In common law countries, an indemnity clause will also be subject to the rule known as *contra proferentem*. This means that such clauses, in the case of unclear contract wording, will be "*construed against the party putting it forward as the basis for escaping liability which would otherwise be incurred*."[17] This approach has been taken by the courts towards indemnity clauses and exemption clauses because of the presumption that it is unlikely that a party would intend to exempt or indemnify the other party from liability.

In fact, and as seen from general rules of construction detailed in point 4.2.1 above, the potential solution under Argentine law may lead to the exact opposite of this principle.

4.3.3 No equity relief.

Equity is a very typical source of relief in common law countries in the event any damage is caused to any party in a contractual relationship. However, and although common uses and practices are duly recognized under Argentine Law as a source of the law, equity is not recognized as a direct source of relief.

In this sense, parties seeking relief outside of the contractual provisions (assuming this is possible and not limited by sole-and-exclusive remedy type limitation in the contract), may only look to the statutory provisions of Argentine Law. This is fairly common to most civil law based systems.

4.4 Acceptance of knock-for-knock clauses in Argentina

It will be clear from the above that the principles adopted by Argentine law are quite different from the principles set out in the standard knock-for-knock clauses. Notwithstanding, Argentine law accepts freedom of contract[18], which means that the parties are free to establish the clauses and conditions of the contracts as long as such terms and conditions do not contradict matters of public order or affect third parties' interests.

Although Argentine courts could find a knock-for-knock clause to be valid if the contract was freely negotiated between the parties, the clause could contradict matters of public order or affect third parties' interests. For example, a limitation of liability clause which excludes the consequences of willful misconduct from any of the parties could be considered void and null.

It is worth noting that, as far as relevant and industry-wide known cases concern, Argentine courts have never been asked to review and consider a knock-for-knock clause. First and foremost because most of the major service contracts are not subject either to Argentine law or to the jurisdiction of Argentine courts. Secondly, for the other cases involving both Argentine law and Argentine jurisdiction, most cases in which these indemnities could have been discussed have been mostly settled outside of the courts.

4.5 Enforceability issues under Argentine Law

Even if the indemnitee has done all he can do to protect himself and has skillfully drafted and negotiated the indemnity provisions, the agreement may still be unenforceable due to public policy or statute. Given the constantly shifting nature of the law, as well as the

[17] See http://www.jus.uio.no/ifp/english/research/projects/anglo/essays/bjerketveit_abstract.pdf.
[18] As per Argentine Civil Code Section 1197 which regulates the main principle of contractual free will.

multitude of ways in which these agreements are invoked, parties are often faced with application of these clauses to scenarios that may or may not be what the parties intended.

4.5.1 Coverage for Gross Negligence or Punitive Damages.

As an initial matter, a party seeking indemnity for gross negligence or punitive damages must use absolute clarity in the contract. Even where the intent is sufficiently expressed, however, the law is not entirely settled as to whether public policy permits indemnification or insurance coverage for gross negligence of the indemnitee or for punitive damages assessed against the indemnitee. The answer, as is common in this area, may depend upon which law applies to the agreement.

Under Argentine law, gross negligence is not a term defined under a specific statute or law with general application to all contracts. In fact, the sole reference in Argentine Law that even approaches a definition of gross negligence is given by the Argentine Insurance Law, which is fairly old and applies only to insurance contracts.

Thus, one should be very careful and extremely clear when drafting an agreement so as to include a very specific definition for gross negligence, taking into account that if such definition is close in its terms, wording or scope to the definition of willful misconduct, it could be considered invalid by Argentine courts.

4.5.2 ***"Solve et Repete"*** **principle.**

The "*solve et repete*" rule is a Roman law principle, present in many civil law jurisdictions, which states that the debtor of an obligation shall pay this obligation first, and then claim its reimbursement to its creditor. It is mainly used in fiscal claims, but has been also known to apply to indemnity obligations in certain cases.

As we have discussed in previous chapters the difference between the terms "indemnify" and "hold harmless", courts have ruled in several different cases that general indemnity obligations under Argentine law require a damage to have occurred to trigger the indemnity obligation from the indemnifying party.

Although also many times parties have sought (any sometimes succeeded) this principle to be declared unconstitutional (under the constitutionally protected due process guarantee[19]), when applied to contracts. In this sense, once again we must stress the importance of careful and precise drafting of the indemnity provisions. As far as the contractual principle of free will stands, mutual hold harmless provisions are perfectly valid, provided, however, that their wording, scope and extent is clear, precise and not ambiguous. Otherwise, courts might interpret them within the general construction rules for all conventions and under the principle that all damages shall be remedied. That is, when any damage effectively occurs, and not sooner, as a mutual hold harmless clause would set forth.

4.5.3 No exclusion for willful misconduct.

As mentioned in this chapter, a limitation of liability clause which excludes the consequences of willful misconduct from any of the parties could be considered void and null. This consideration originates not in an interpretation by the courts or local scholars, but from an express statutory provision found in the Argentine Civil Code, which clearly states that the "*willful misconduct of the debtor may not be discharged upon entering into an obligation*"[20].

Accordingly, the parties should be aware of this situation when negotiating the terms and extent of a mutual hold harmless clause, given that notwithstanding that the knock for

[19] Article 18 of the Argentine Constitution and Article 8 of the San Jose (Costa Rica) Convention.
[20] Section 517 of the Argentine Civil Code.

knock clause will typically exclude even the willful misconduct of the party at fault, the courts will most likely limit this exclusion in light of the above referenced provision. Hence, the clause will suffer an enforceability issue which may not be resolved under Argentine Law.

Therefore, when applying Argentine Law (or for that case, any law that voids the exclusion of willful misconduct), both parties should know this circumstance way in advance, to avoid unpleasant surprises.

5 Interplay with Insurance Provisions

We will only briefly address this issue, as this is a major topic that should be probably further explained in an article on its own. However, it is necessary to at least explain the fundamentals of this relationship, for the readers´ better understanding.

As it has been said before in this article, one of the main benefits of knock-for-knock indemnities is the elimination of potential overlapping in insurance coverage, because of the certainty in the scope of the personnel and property under the umbrella of the indemnity obligations. For consistency purposes, ideally, the limits of insurance should match the intended limits of the indemnity clauses in the agreement[21].

The question is: how do these provisions relate with the insurance provisions and coverage under any agreement?

5.1 Coverage and Exclusions

5.1.1 Basic Coverage.

At first hand, a civil general liability policy will typically cover third-party personal injury, bodily injury or property damage, which is consistent with the typical coverage provided in knock-for-knock clauses. Additionally, other more specific insurances such as equipment insurance (i.e. Rigs, Heavy Machinery, etc.) could -- and should -- be added for additional coverage. It should be noted that for purposes of insurance coverage, the definition of third party will differ from the one found in the relevant contract, as it will include the opposing party and its "group".

A typical general liability policy will cover direct damages legally obligated to pay for tort liability assumed under contract; and will exclude punitive and exemplary damages, damages in excess of those awarded in tort, damages imposed as punishment, liquidated damages, fines and penalties.

This general liability policy will usually cover the defense for the insured (or, if any, the additional insured), provided such claim effectively triggers the policy, under its specific provisions. By contrast, the policy will not cover the defense for suits that do not trigger this policy. However, since the insured has promised in the contract to do so, he'll be defending this claim out of pocket.

5.1.2 Exclusions.

In line with the provisions of most industry-wide contracts, losses alleging damages other than direct damages are not covered (i.e. pure financial loss, breach of contract), and excluded under the reciprocal exclusion of consequential damages.

It is important to point out that any response by the insurer under the general liability policy will be subject to policy conditions and exclusions. Consequently, this limitation

[21] Glenn Legge and Alexander Papandreou - *Contractual Indemnity, Warranty and Additional Insured Provisions–Yours, Mine and Ours* – 7th Annual Advanced Contract Risk Management Conference for Oil and Gas - May 26-27, 2010 - Houston, Texas

will evidently collide with the wording commonly used in knock-for-knock indemnity provisions, which states that each party will respond to "any and all claims" brought under the contract. In this case, and as we have stated above, the insured party´s liability insurance must respond first and then such party must honour its contractual indemnity obligation.

Other relevant exclusions included in each service contract, such as the exclusions and carve-outs explained in point 3 of this article, should be properly addressed and included in the policies, to properly support the indemnity agreement included in such contracts.

Regarding industry-specific exclusions, we could include:

a) Loss of contractor downhole tools, as this risk is usually lies on the operator´s side (save for specific agreed carve-outs, such as contractor´s gross negligence or willful misconduct), this risk should be typically included in the appropriate policies to cover operator´s additional exposure.
b) Loss of reservoir or formation, where the operator also takes full responsibility for the well and any underground damage, including to the reservoir. All prudent operators retain type of coverage because self-insuring this risk is not always possible nor it is recommendable due to the potential exposure of the company should a loss of reservoir event occur. In this vein, it is important to understand the extent and value of the reservoir and to ensure that the limits of the insurance available for each reservoir are adequate[22].

6 Practical advice on how to draft effective Knock-for-Knock indemnity clauses

In order to effectively allocate risk as the parties originally intended to, an indemnity agreement must be enforceable, even where the indemnifying party is negligent or otherwise at fault. Enforceability issues will be -- in most cases and provided no statutory limitation applies -- determined at the time of drafting the relevant indemnity provisions. The following pointers are only but a few of the issues any practitioner will need to consider when negotiating and drafting contractual indemnity provisions.

6.1 "Clear and Unequivocal" assumption of negligence

To indemnify a person against his or her own negligence, the parties must ensure that the agreement states this intent expressly, expressed in "clear and unequivocal" terms. Although in common law countries this requisite alone may be enough to solve the enforceability problem[23], in a civil law environment such as Argentina -- as we have detailed herein -- statutory limitations will still pose enforceability questions which should be dealt from a different angle.

6.2 Specificity as to the extent of fault assumed

While the above analysis also makes clear that any negotiator should specifically reference "negligence" in any contractual indemnity provision seeking indemnification for losses arising irrespective of fault, consideration should also be paid to issues of sole and concurrent fault, as well as to various other non-negligence claims for which indemnification is sought. Further, any negotiator should also consider expressly including in a contractual indemnity provision specific language providing coverage for claims beyond negligence, such as claims for strict liability and breach of warranty, to the extent permitted under the applicable law.

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[22] Leanne McClurg and Juniper Watson - *Insurance issues in drilling contracts* – Piper Alderman.
[23] Michael A. Golemi and L. Etienne Balart - *Indemnity in Deep Water: Indemnity Agreements Offshore and the Deepwater Horizon*.

*6.3 **Choice of law***

As stated above, these statutory limitations on contractual indemnity provisions make choice of law considerations of critical importance in negotiating and drafting the contractual indemnity provision. Any negotiator should be extremely cautious in selecting the jurisdiction most beneficial to his or her client's interests, whether those interests lie on the side of the potential indemnifying party or the potential indemnified party. As explained throughout this article, this choice will have a significant impact on major issues such as enforceability of the knock-for-knock clause, extent of damages covered, construction of definitions, among others.

*6.4 **Other Important Considerations***

Although the sections above are aimed towards providing any negotiator with specific issues requiring attention in the negotiation and drafting of knock-for-knock indemnity provisions, the following core concepts should not be overlooked:

- It is critically important to specifically define who are the parties covered by the indemnification provision and whether each individual party's officers, directors, shareholders, stakeholders, successors, assigns, affiliated entities, contractors, subcontractors, and so on are also included in this coverage. By broadly defining the "indemnified" group, the scope of persons entitled to indemnity may be increased significantly.
- Imprecise or narrow language in the indemnity provision may also result in a court finding that a loss is not encompassed by an indemnity[24].
- Careful consideration on the differences between an "indemnify" type wording and a "hold harmless" type wording should be taken. This will affect mainly the mechanism in which the Indemnifying Party shall pay for damages and costs (including defense costs).
- Is there an applicable standard of conduct to be complied with by an indemnified party for the indemnity obligation to apply?
- How are notice requirements defined regarding when a demand for defense and/or indemnity must be made by the indemnitee, so as to avoid the possibility of prejudice on the indemnifying party in providing such defense and indemnity?
- Is the indemnified party going to be allowed to choose its own defense counsel under the indemnity clause, at the indemnifying party´s expense? Will the indemnifying party or the indemnified party select counsel if the indemnification provision includes only a duty to defend?
- Should provisions regarding enforcement be included in the indemnity provision?
- How long after the completion of the underlying work should the indemnification provision survive? Will this survival be limited to a certain period of time after the contract is expired or will it run with the course of the statute of limitations?
- Should alternate dispute resolution methodologies, such as binding arbitration or other technical mediation, be included?

[24] Henry A King - *Contractual Indemnities – Getting the Other Guy to Pay Your Legal Liability*

7 Conclusions

After analyzing the general knock-for-knock principle and running down though most of the generally used exceptions and carve-outs, we can see how these clauses help to attain a more straightforward and simple approach to risk allocation -- limiting the risk to a level that is acceptable to the parties and avoid having to obtain multiple and overlapping layers of insurance --, and we can evidence why these clauses continue to be used in the oil and gas industry after many years and to this date.

In any contract negotiation involving knock-for-knock provisions, the shifting of liability between the parties, particularly regarding the specific exclusions from the general knock-for knock principle, will become an arm-wrestling contest between them, in which both of their interests and liabilities should be carefully considered in order to obtain the best possible (and realistic) indemnity coverage for both parties, attempting to avoid unfair situations or unrealistic risk allocation practices.

There is no point in "winning" a negotiation by imposing all costs to a particular party when by doing so this party may be extremely burdened by this unbalanced risk allocation, which could lead to default and --eventually -- bankruptcy, causing the other party to be unable to cover any expense or indemnity at all, absolutely defeating the original purpose of the indemnity.

Properly understanding these indemnity provisions and providing the appropriate advice and approach in its negotiation remains key not only to avoid the many issues and problems that we have discussed in this paper (increased costs, overlapping insurance, unenforceability, unintended scope of the indemnities, etc.) but also to achieving a successful and rewarding business relationship between contracting parties, based on a realistic and industry-specific approach to risk allocation.

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Sinopec Argentina Exploration and Production Inc. is a Chinese-owned oil & gas company, focusing on E&P in Argentina, operating 17 areas in the Provinces of Santa Cruz, Chubut and Mendoza. It remains the third largest operator in Argentina in terms of production. The Company is a wholly-owned subsidiary of the Sinopec Group (or China Petrochemical Corporation), a super-large petroleum and petrochemical enterprise group established in July 1998 and headquartered in Beijing. Sinopec Group is a state-owned company solely invested by the Chinese State, functioning as a state-authorized investment organization in which the state holds the controlling share. The Sinopec Group is listed on stock markets in Hong Kong, New York, London and Shanghai and was ranked the 5th in Fortune Global 500 in 2011.