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The Freedom to Contract Your Terms of Business (aka Spread Costs, Consequential Damages, Knock for Knock and Contract Interpretation Principles)

By: Nigel Bankes and Heather Lilles

Case Commented On: *Transocean Drilling UK Ltd v Providence Resources Plc* [2016] EWCA Civ 372, [2016] 2 Lloyd's Rep 51, 165 Con LR 1, [2016] BLR 360

This decision of the English Court of Appeal (Civil Division) which came out earlier this year (April 2016) is well worth reading both for its treatment of the exclusion of liability for consequential damages and also for its modern approach to the interpretation of commercial contracts. As recognized by the Court, the case "raises some interesting questions about the freedom of two commercial parties to determine the terms on which they wish to do business" (para 1).

Transocean Drilling UK Ltd (Transocean), the owner of a semi-submersible drilling rig, entered into a contract with Providence Resources Plc (Providence) to drill an offshore appraisal well for Providence. On 18 December 2011, Transocean suspended drilling operations due to a misalignment of part of the blow-out preventer. Transocean resumed operations on 2 February 2012. The trial judge determined that the delay was caused by Transocean's breach of contract. There was no appeal on that point, but Transocean did appeal that part of the judge's decision in which he allowed Providence to recover the 'spread costs' that it had incurred as a result of the delay. The 'spread costs' were described (at para 10) as "the costs of personnel, equipment and services contracted [by Providence] from third parties which were wasted as a result of the delay. Examples given by the judge are well logging, well testing and cementing, mud engineers and mud logging services, geological services, diving and ROV (remotely operated vehicle) services, weather services, directional drilling services, and running casings."

Transocean argued that the contract excluded any liability for losses of this kind through its definition of Consequential Loss and a knock for knock cross indemnity provision which served to exclude liability for such losses. The indemnity clause provided that "[Providence] shall save, indemnify, defend and hold harmless [Transocean] from [Providence's] own consequential loss and [Transocean] shall save, indemnify, defend and hold harmless [Providence] from [Transocean's] own consequential loss" (para. 11). Consequential loss was defined in two branches as follows:

> ... "Consequential Loss" shall mean:
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> (i) any indirect or consequential loss or damages under English law, and/or
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> (ii) to the extent not covered by (i) above, loss or deferment of production, loss of product, loss of use (including, without limitation, loss of use or the cost of use of property, equipment, materials and services including without limitation, those provided

> by contractors or subcontractors of every tier or by third parties), loss of business and business interruption, loss of revenue (which for the avoidance of doubt shall not include payments due to CONTRACTOR by way of remuneration under this CONTRACT), loss of profit or anticipated profit, loss and/or deferral of drilling rights and/or loss, restriction or forfeiture of licence, concession or field interests

The Court began its analysis by examining the overall structure of the particular contract in question to provide (at para 5) "an important part of the context in which those clauses must be construed." The Court noted (at para 9) that the contract "contained a detailed and sophisticated scheme for apportioning responsibility for loss and damage of all kinds, backed by insurance." The Court then turned to the interpretation of the indemnity clause quoted above, a clause which, as both parties acknowledged, functioned as an exclusion clause. That said, the Court emphasised that the clause had certain characteristics which differed from a typical exclusion clause, in which a commercially stronger party seeks to exclude or limit liability for its own breaches of contract. In this case, the parties were of equal bargaining power and had entered into mutual undertakings to accept the risk of consequential loss flowing from each other's breaches of contract. The clause was an integral part of a broader scheme for allocating losses between the parties and, as a result, the Court held (at para 14) that it was not of a kind which required restrictive construction. On the contrary, the Court of Appeal held that the starting point for construing the clause "must be the language of the clause itself" (at para 14). The Court was equally dismissive of the case law based on the rule in *Hadley v Baxendale*, (1854) 9 Exch. 341, since the clause spoke to both (i) indirect or consequential losses or damages under English law (i.e. a consideration of the two branches of losses in *Hadley v Baxendale*); and (ii) losses not covered by (i). The question therefore was simply one of "whether its language is apt to encompass the spread costs which Providence seeks to recover" (at para 15). In this case the language used by the parties made it clear that they intended to give the term "loss of use" an extended meaning and (at para 17) they did so using two "without limitation" clauses.

The Court also concluded that the trial judge was wrong to invoke the *contra proferentem* principle. The Court observed that the principle was not appropriate where there was no ambiguity, where the clause in question favoured both parties, and where the parties had equal bargaining power. Further, the Court noted that the presumption that parties to a contract do not intend to give up their right to claim damages for breach of contract must give way to the language of the contract. The Court's task (at para 23) "is not to re-shape the contract but to ascertain the parties' intention, giving the words they have used their ordinary and natural meaning". The Court summarized (at para 34):

> I can see no reason in principle why commercial parties should not be free to embark on a venture of this kind on the basis of an agreement that losses arising in the course of the work will be borne in a certain way and that neither should be liable to the other for consequential losses, however they chose to define them.

Therefore, in the result, the Court reversed the decision at trial on this point and denied recovery of the spread costs.

In sum, the Court had little time for old presumptions and "helpful" rules of interpretation. Instead, the Court endorsed the more important principle that (at para 14) "the court should give

the language used by the parties the meaning which it would be given by a reasonable person in their position furnished with the knowledge of the background to the transaction common to them both." This principle has been endorsed by a series of decisions of both the House of Lords and the UKSC (see *Chartbrook Ltd v Persimmon Homes Ltd*, [2009] UKHL 38, [2009] 1 AC 1101 and *Arnold v Britton*, [2015] UKSC 6, [2015] AC 1619) and is fully consistent with the approach of the Supreme Court of Canada in *Sattva Capital Corp v Creston Moly Corp*, [2014] 2 SCR 633, 2014 SCC 53 where the Court summarized the current state of contractual interpretation in Canada as follows:

> 47 ... the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" ... To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning:
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> ...
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> 48 The meaning of words is often derived from a number of contextual factors, including the purpose of the agreement and the nature of the relationship created by the agreement ... [References omitted].

The English Court of Appeal's approach in *Transocean* to the construction of knock for knock obligations is also fully consistent with that of the Alberta courts in similar cases: see *Precision Drilling Canada Limited Partnership v Yangarra Resources Ltd*, 2016 ABQB 365 (CanLII) commented on here.

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