

The application of the ‘knock-for-knock’ clause under Chinese law

Introduction

Knock-for-knock clauses, widely used in contracts related to towage and offshore work, generally maintain the principle that damage and loss to property or personnel suffered by a party’s “group” (as defined in the relevant contract) is borne by that party regardless of fault. It is popular due to the certainty achieved in the allocation of liability and is widely recognised in common law jurisdictions. However, the legal effect of knock-for-knock indemnity under certain civil law jurisdictions is not so straightforward. Chinese lawyer Jasmine Liu of Wintell & Co shares a recent judgment in China where the knock-for-knock indemnity principle was upheld.

Ping An Property Insurance Company of China, Ltd. Shanghai Branch vs Nanhai Rescue Bureau of the Ministry of Transport of PRC^[1]

The background

In October 2016, an agreement (the “Agreement”) was signed for the barge *Tai Xin 1* (the “Barge”) to be towed by tug *Nan Hai Jiu 115* (the “Tug”) to a nearby typhoon shelter, due to an imminent typhoon. The Agreement was a bespoke contract but adopted knock-for-knock terms by reference to BIMCO TOWHIRE (as Appendix 1), providing that each party would be responsible for their own property and personnel; and that each party would indemnify the other in respect of such liabilities (the “K4K Clause”).

During the towage, the main towing cable (owned by the Tug) broke due to severe weather, the Barge drifted and finally grounded on a reef. The Barge remained grounded on the site for more than two months, incurring significant salvage and repair costs. No personal injury or pollution resulted from the incident.

The local Maritime Safety Administration (the “MSA”) investigated the casualty, as is customary, and attributed the incident to a combination of bad weather and negligence on the part of the Tug and the Barge. The MSA then issued their investigation report, and provided that the Tug’s negligence included (i) a failure to comply with the towage plan, which requires the tug to maintain a substitute tow line onboard; and (ii) a failure to sufficiently estimate the difficulties and dangers of towing the Barge with anchor in strong winds. The report also cited that the Barge’s negligence included (i) a failure to properly prepare a typhoon prevention plan; and (ii) a failure to communicate and coordinate effectively with the Tug.

The claim

The Barge's H&M insurer commenced a subrogated claim against the Tug owner before the Guangzhou Maritime Court, claiming that the Tug was grossly negligent, causing the material incident, and that the K4K Clause shall not apply in such circumstances of gross negligence. The Tug interests defended the matter, alleging that the K4K Clause was valid.

The decisions

The Guangzhou Maritime Court held that the K4K Clause in the Agreement was valid, and therefore it was decided that the Barge interests were responsible for their losses as agreed under the Agreement. The judgment was upheld on appeal by the High People's Court of Guangdong Province.

Observations

This is a positive case for the application of the K4K Clause under Chinese Law, and considering the judgments, we make the following observations:

The K4K Clause is not a 'standard clause'

Unfair standard clauses are generally restricted as a matter of Chinese Law.

In this case the Court held that the Agreement was a bespoke contract, which had been negotiated and agreed by the parties. As a result, the K4K Clause was not deemed to be a set of 'standard clauses', imposed by one party on another.

Accordingly, it was found not to be unfair to allow either party to limit their liability in negligence to the other, in accordance with the K4K clause terms.

The K4K Clause shall not be invalid due to the breach of statutory obligations.

The Guangzhou Maritime Court held that the Tug interests failed to exercise due diligence in equipping the Tug with gear, including a substitute tow line, prior to and on commencement of the towage. Therefore, the Tug was neither seaworthy nor fit for the towage, and breached the statutory obligations as stipulated in Article 157 of The Maritime Law of the People's Republic of China (the "Maritime Law", terms in Appendix 2). However, such a breach would not render a K4K Clause as invalid. The main reasons were as follows:

(i) Article 162 of the Maritime Law clearly confirms that, in the course of sea towage, the contractual terms on allocation of liability among parties shall prevail over the fault-based liability regime.

(ii) Chapter 7 of the Maritime Law, Contract of Sea Towage does not expressly prohibit an exemption of liability arising from unseaworthiness. Within the same Chapter, as parties' seaworthiness obligations under Article 157 are not mandatory, an exclusion of liability

concerning these obligations is also not prohibited.

(iii) It is noted that Article 506 of the Civil Code of the People's Republic of China (the "Civil Code") states that any exemption clause in a contract cannot cover property damage to the other party because of deliberate intent or gross negligence. Here, the Courts found that the Tug's negligence cannot be deemed as intentional misconduct or gross negligence, as there was no evidence that the incident would have been avoided if the substitute tow line was available on the Tug.

Will the K4K Clause be upheld in respect of personal injury or death?

There were no personal injuries or deaths in this case, and we have not seen any other Chinese cases in respect of the K4K Clause involving personal injury or death.

There is uncertainty on how a Chinese court may consider a K4K Clause concerning personal injury or death. However, the Courts may be inclined to respect the parties' agreement in incorporating a K4K Clause, and the Clause may be upheld even in respect of personal injury or death of personnel belonging to each party's group. This is distinct from the personal injury or death of a third party.

However, the litigation risk remains due to the possibility of a wide interpretation of Article 506 of the Civil Code, which renders void exemption clauses that relate to personal injury of another party.

Note: The case was decided by the Guangzhou Maritime Court and the High People's Court of Guangdong Province. As China is a civil law country, there is uncertainty as to whether this rule applies to all jurisdictions in China.

Appendix 1

Clause 4 Liability and Indemnity (the "KFK Clause")

(1) The Towing Party is liable for injury or death of the Master and crew of the Tug and any other staff and agents of the Towing Party. The Towing Party will indemnify the Towed Party in respect of any liability adjudged due to a third party or any claim by a third party reasonably compromised arising out of injury or death of the Master or crew of the Tug or any other staff or agents of the Towing Party.

(2) The Towed Party is liable for injury or death of the Master and crew of the Vessel and any other staff and agents of the Towed Party. The Towed Party shall indemnify the Towing Party in

respect of any liability adjudged due to a third party or any claim by a third party reasonably compromised arising out of injury or death of the Master or crew of the Vessel or any other staff or agents of the Towed Party.

(3) The following shall be for the sole account of the Towing Party without any recourse to the Towed Party, its staff or agents, the Master, or crew, whether or not the same is due to any negligence or any fault of the Towed Party, its staff or agents, the Master, or crew?

(a) Loss or damage of whatsoever nature, howsoever caused to or suffered by the Tug or any property on the Tug;

(b) Loss or damage of whatsoever nature caused to or suffered by third parties or their property by reason of contact with the Tug or obstruction created by the presence of the Tug.

(c) Any liability in respect of wreck removal or in respect of the expense of salvaging, moving or lighting or buoying the Tug or in respect of preventing or abating pollution originating from the Tug.

The Towing Party will indemnify the Towed Party in respect of any liability adjudged due to a third party or any claim by a third party reasonably compromised arising out of any such loss or damage.

(4) The following shall be for the sole account of the Towed Party without any recourse to the Towing Party, its staff or agents, the Master, or crew, whether or not the same is due to any negligence or any fault of the Towing Party, its staff or agents, the Master, or crew:

(a) Loss or damage of whatsoever nature, howsoever caused to or suffered by the Vessel or any property on the Vessel.

(b) Loss or damage of whatsoever nature caused to or suffered by third parties or their property by reason of contact with the Vessel or obstruction created by the presence of the Vessel.

(c) Any liability in respect of wreck removal or in respect of the expense of salvaging, moving or lighting or buoying the Vessel or in respect of preventing or abating pollution originating from the Vessel.

The Towed Party will indemnify the Towing Party in respect of any liability adjudged due to a third party or any claim by a third party reasonably compromised arising out of any such loss or damage.

Appendix 2

The Maritime Law of the People's Republic of China

Article 157

The tugowner shall, before and at the beginning of the towage, exercise due diligence to make the tug seaworthy and tow-worthy and to properly man the tug and equip it with gears and tow lines and to provide all other necessary supplies and appliances for the intended voyage.

The tow party shall, before and at the beginning of the towage, make all necessary preparations therefore and shall exercise due diligence to make the object to be towed tow-worthy and shall give a true account of the object to be towed and provide the certificate of tow-worthiness and other documents issued by the relevant survey and inspection organizations.

Article 162

In the course of the sea towage, if the damage suffered by the tugowner or the tow party was caused by the fault of one of the parties, the party in fault shall be liable for compensation. If the damage was caused by the faults of both parties, both parties shall be liable for compensation in proportion to the extent of their respective faults.

Notwithstanding the provisions of the preceding paragraph, the tugowner shall not be liable if he proves that the damage suffered by the tow party is due to one of the following causes:

1. Fault of the Master or other crew members of the tug or the pilot or other servants or agents of the tugowner in the navigation and management of the tug;
2. Fault of the tug in saving or attempting to save life or property at sea.

The provisions of this Article shall only apply if and when there are no provisions or no different provisions in this regard in the sea towage contract.

The Civil Code of the People's Republic of China

Article 506

The following exception clauses in a contract shall be null and void:

1. those that cause personal injury to the other party;
2. those involving property damage to the other party as a result of deliberate intent or gross negligence.

[\[1\]](#) 2017年7月27日最高人民法院公告; (2017) Yue 72 Min Chu No. 1027

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