Indemnity- and Hold Harmless Clauses

1 Introduction and Definition

1.1 Legal regimes and limitations

This abstract will focus on some aspects of how indemnity and hold harmless clauses are treated in the English and Norwegian legal regimes. It should be noted that this abstract will only treat commercial contracts negotiated by businessmen. Accordingly, special problems connected to the use of indemnity clauses between a commercial party and a consumer will not be treated.

It should be pointed out that this abstract only contains a short summary of a few selected problems from the main thesis “Indemnity- og hold harmless-klausuler i norsk rett.” For a more complete overview and detailed discussions, please refer to the main thesis.

1.2 Definitions and presentation of legal term

*Indemnity clause*

“Indemnity” is a widespread expression used not only in a contractual context. It can 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 in very dissimilar and vast numbers of commercial contracts. As the following will show, it is not possible to define, in general, the exact content of indemnity clauses, as this will depend upon the wording of each individual contract. It is important to keep in mind that the effects of such

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1 Black’s Law Dictionary
clauses are not decided by the label “indemnity clause,” but on the basis of the contractual wording itself.

A study of theory and contract practice shows that indemnity clauses can be sorted into three main categories, based on the liability covered by the clause. It should be pointed out that an indemnity clause might cover one, or even all, of these categories, depending upon the exact wording of the clause. The purpose of this division is to give an overview of how indemnity clauses can distribute liability. However, this division has not been used by English or Norwegian courts, and therefore does not have any legal consequences.

Liability in tort

The first category of indemnity clauses consists of clauses in which one party to the contract agrees to indemnify the other party against liability in tort. A good example of this is a contract using the “knock for knock” principle, where the parties agree to reciprocal indemnities covering such liability. There are several different forms of liability that can occur under this category. The first is liability that one party may incur towards third parties. For example, in a construction contract, let’s say a subcontractor A agrees to indemnify the general contractor B. The subcontractor is hired to do tile work on a commercial building, and as the tile work turns out to be defective, the general contractor incurs liability towards the owner. Another example is where contractor A and contractor B agree to an indemnity clause where A is to indemnify B against any loss or liability with respect to personal injury, in relation to the execution of the contract. If in this case B was to injure one of A’s employees, B has the right under the agreement to be indemnified by A, effectively making A bear the liability towards the employee.

The second form of liability is where one party agrees to indemnify another party against liability which third parties may incur towards that other party. This category has many

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2 A common question in this relation is whether negligence is covered by the indemnity clause or not. For more about this, see section 2.2.3.

3 This was the case in Smith v South Wales Switchgear Ltd, [1978] 1 WLR 165.
resemblances with guarantees, but an obligation to indemnify must be distinguished from an obligation to guarantee. An example of this is the case of *Yeoman Credit Ltd. v Latter*, where a company let a car on hire-purchase to the first defendant, who was an infant. The second defendant signed a form headed “Hire-purchase indemnity and undertaking,” and the question was whether this document was an indemnity or a guarantee. Since the hire-purchase agreement would be void because of statutory provisions, a guarantee would also be void because it guarantees a void contract. An indemnity, on the other hand, would be enforceable, as the fact that the debtor was a minor would not provide a defence against the primary liability to indemnify the creditor. The court held that “[a]n indemnity is a contract by one party to keep the other harmless against loss, but a contract of guarantee is a contract to answer for the debt, default or miscarriage of another who is to be primary liable to the promise.”

Although the significance of this distinction has now been removed by s.2 of the Minors’ Contract Act 1987, it can be concluded that while a guarantor’s liability is considered collateral or secondary, the indemnifier’s liability is considered primary. A guarantee is a promise to discharge the debtor’s liability only if the debtor should fail to do so himself, while a contract of indemnity is a promise to discharge the debtor’s liability in any event, whether the principal debtor defaults or not.

Another consequence of this difference was pointed out in *Goulston Discount Co. Ltd v Clark*. Here, the hirer in a hire-purchase agreement defaulted after paying only the first two or three instalments. The agreement was terminated, the car was reposessed and resold, but the plaintiffs could only sue the hirer for arrears of the instalments. A third party had

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4 [1961] 1 W.L.R 828
5 Namely the Infants Relief Act, 1874
6 [1961] 1 W.L.R 828 p 831
7 Chitty, Volume II Specific Contracts, para 44-036
8 Anson’s Law of Contract 28.ed, p. 79
9 [1967] 1 Q.B 493
signed a specific recourse agreement, and the question was whether this was an agreement of guarantee or of indemnity. If the agreement was found to be a guarantee, the third party would be under no more liability than the hirer. However, the agreement was found clearly to be an indemnity, based on an interpretation of the contract. The consequence was that the third party was found to be liable for the entire balance of the hire-purchase price which the plaintiffs had been unable to recover against the hirer, and not to be liable for only the unpaid instalments prior to the termination. Based on this, it can be concluded that the indemnifier’s liability is stricter than that of the hirer (and, thereby, that of a guarantor), as the purpose of an indemnity is to put the hire-purchase company in the same situation as if the hire-purchase agreement was carried out and completed.

The distinction between the two provisions seems to be less significant under Norwegian law than under English law. They are often used alternately, and with the same purpose. However, there are a few basic differences worth pointing out. First of all, the promise of an indemnity has a different aim than a guarantee. While the promise of a guarantee relates to the object itself, the purpose of an indemnity is to secure that the indemnitee does not suffer economic loss. In other words, the object itself is not the essential thing, but rather to prevent loss for the indemnitee.

Often this will not be of importance, as the legal consequences regularly will be the same. But the difference reflects the available remedies: While guarantees can have several remedies connected to them, such as rectification or delivery of substitute goods, the only available remedy with an indemnity clause is a claim for damages. In some situation this distinction may have an impact. For example, if someone orders a black car, but instead receives a yellow one, this will usually constitute a breach of contract. If the car was guaranteed to be yellow, the buyer might have the right to claim rectification or delivery of a substitute. However, an indemnitee could very well end up without a satisfying remedy. It is not certain that delivery of a car with the wrong colour represents a loss for the indemnitee. As the indemnity clause requires a loss, the indemnitee might not have a claim
against the seller. This shows that it is important to consider whether a guarantee or an indemnity clause best will safeguard the buyer’s interests.

A third form of liability consists of clauses where one party agrees to indemnify the other against liability that other may have against him. In the building enterprise and the oil and gas industry, agreements containing reciprocal indemnity clauses between the operating parties are common. This way, each party bears the risk of loss or damage to property, injuries or death to his own side. For example, contractor A and contractor B may agree to reciprocal indemnity clauses. When A damages B’s equipment, A has the right under the agreement to be indemnified by B, effectively making B bear the loss.

A fourth and last form of liability is where one party A agrees to indemnify the other party B against the loss or liability B suffers that does not involve third parties. An example of this can be an acquisition agreement. In such agreements it is common for the seller to indemnify the purchaser against any breach of any representations or warranties of the seller. If the purchaser suffers a loss or liability because of such breach, he can rely on the seller to indemnify her. Another example would be where, for instance, the parties agree upon an arrangement where the purchaser is free to withdraw from the deal, given that he indemnifies the seller from any loss arising from such event.

In The Eurus, such a clause was considered. Here, the ship The Eurus was chartered, and the owners had agreed to “be responsible” for any time, costs or delays or loss suffered by the charterers due to failure to comply with voyage instructions given by the charterers. Precise orders were given in relation to loading, and the master of the charterparty complied with the orders in a literal sense. But because of a special rule in Lagos, relating to the dating of the bill of lading, the charterers were obliged to pay an additional sum of almost $ 700,000. This loss was claimed by the charterers as money payable under the

10 The word indemnify was not used, as the contract used the term “be responsible for” instead. The clause was, however, treated as an indemnity clause.
contractual indemnity given by the owners,\textsuperscript{11} and the court found that the loss was caused by the master’s failure to comply with the instructions given by the charterers, but was found too remote\textsuperscript{12} to be covered.

\textit{Breach of contract}

The second main category of indemnity clauses is made up by clauses covering breach of contract. For example, in an acquisition agreement, the indemnity might be part of the overall remedies provision, triggered by a breach of any representation, warranty or covenant.\textsuperscript{13} If the indemnitee suffers a loss caused by such breach of contract, he has the right to be indemnified. Often, this category will, more or less, be another name for damages, as the applicable rules of law will provide many of the same rules. However, the parties are free to make certain adjustments, as for example inserting caps and baskets which would otherwise not follow from the applicable rules of law.

\textit{Specific circumstances}

The third and last main category of indemnity clauses consists of clauses where the event triggering the liability is a loss arising from specific circumstances which is agreed upon in the contract.\textsuperscript{14} This is practical, for example, where the vendor has disclosed matters to the purchaser. In such case the warranties are “robbed” of their force, but the purchaser might still want contractual protection against the consequences of the matter in question. An example of this can be the purchase of a business with an ongoing litigation. The purchaser wants to buy, but because of the risks connected with the litigation he is only willing to offer half of what the vendor is demanding. Here, the parties can agree to an indemnity for this specific circumstance, which might lead to a successful transaction.

\textsuperscript{11} Total Transport Corporation v Arcadia Petroleum Ltd. [1998] 1 Lloyd's Rep. 351
\textsuperscript{12} For more on the relation between remoteness and indemnity clauses, see section 2.2.2.
\textsuperscript{13} Parker, P.L., Slavic J, p.1365
\textsuperscript{14} William J L Knight: The Acquisition of Private Companies and Business Assets, p. 180
There is no legal impediment in English law to the inclusion in a contract of an indemnity clause of any of these categories. It is, however, important that clear and unambiguous language is be used to secure the effectiveness of the clause.\textsuperscript{15} At least some states in the US\textsuperscript{16} define indemnity as to only include the categories involving third parties, needing clear and unambiguous contractual provision to enforce indemnification between the parties.

\textit{Hold harmless}

Contracts often employ a provision called a “hold harmless clause,” or the term “hold harmless” is used independently. In English law, the two terms have long been held to be synonyms. Etymologically the word “indemnity” derives from the Latin word \textit{indemnis}, meaning “harmless”, combined with \textit{facere}, meaning “to make”.\textsuperscript{17} Blacks Law Dictionary define hold harmless as “[t]o absolve (another party) from any responsibility for damages or other liability arising from the transaction; INDEMNITY.” This, of course, is a very similar definition to the term indemnify, and indicates that the two terms are synonyms.

American law seems to have a slightly different approach towards the two terms. In the case of \textit{Brentnal v Holmes},\textsuperscript{18} when discussing what is meant by indemnifying and “saving harmless,”\textsuperscript{19} it was held that “the terms are synonymous, and mean the same thing.” Mellinkoff’s Dictionary of American Legal Usage points out that “indemnify” is often used as a synonym of “hold harmless.” However, when distinguished from “hold harmless,” indemnify is defined as to “reimburse for any damage.” This can be interpreted to be

\begin{itemize}
  \item \textsuperscript{15} Lewison: The Interpretation of Contracts p. 335
  \item \textsuperscript{16} One example is South Carolina, see \textit{Smoak v. Carpenter Enterprises, Inc}. 319 S.C. 222, 460 S.E.2d 381 S.C.,1995, where it was held that a standard indemnification provision is “limited to the reimbursement for damages, costs, expenses, etc. incurred in third party actions, not actions between the contracting parties themselves.” Another example is California, see the judgement \textit{Queen Villas Homeowners Association v. TCB Property Management 2007 Cal. App. Lexis 470 (Cal. Ct. App. Feb. 28, 2007)}.\textsuperscript{17}
  \item \textsuperscript{17} Garner: A Dictionary of Modern Legal Usage 2. ed.
  \item \textsuperscript{18} 1 Root (Conn.) 291. 1 Am. Dec. 44 (1791)
  \item \textsuperscript{19} As the following will show, “save harmless” is synonymous with “hold harmless”.
\end{itemize}
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. In theory, this is a distinction which could have a practical impact. On the other hand, the difference can easily be modified by including the phrase “loss or liability” in the indemnity clause, which gives the clause the same practical effect and impact. As many indemnity clauses are drafted very broadly, this is often the case.

Based on this, it must be concluded that, in every practical sense, a hold harmless clause will have the same effect and impact as an indemnity clause.

2 Indemnity clauses under English law

2.1 English Legal Regime

2.1.1 Damages under Common Law

If a contracting party does not comply with the standard set forth in the contract, or within the timeframe decided upon, the party will be in breach of contract. It is a fundamental tenet in common law that, unless explicitly excluded by agreement between the parties, an action for damages is available as a remedy to the claimant in the case of a breach of a contract. Damages for breach of contract are designed to compensate for the damage, loss or injury the claimant has suffered through that breach. The general rules about the assessment of damages will not be treated here. There are, however, a number of rules which can limit damages for breach for contract, which are of interest concerning indemnity clauses.

Causation

In order to establish a right to damages, causation must first be proved. The demand for causation simply means that there must be a causal connection between the defendant’s
breach of contract, and the claimant’s loss.\textsuperscript{20} Damages for a loss may be recovered by the claimant only where the breach of contract was the effective or dominant cause for that loss, but the breach of contract need not to be the sole cause.\textsuperscript{21}

\textit{Remoteness of damage}

Recoverable damages in the case of breach of contract are limited by the principle of remoteness. This means that a claimant cannot recover damages for a loss which is a too remote consequence of the breach. The general rules on the topic of remoteness were formulated in \textit{Hadley v Baxendale}.\textsuperscript{22} In this case, the court founded a basic two-branch rule as to when the innocent party can recover damages. The damages recoverable in respect of such breach of contract are “such as may fairly and reasonably be considered arising naturally, i.e. according to the usual course of things” from such breach itself, or when they are “such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach of it.” The principles laid down in the judgement above were further considered in \textit{Victoria Laundry (Windsor) Ltd v Newman Industries Ltd.}, \textsuperscript{23} where it was held that the test of remoteness is whether the loss was “reasonably foreseeable as liable to result” from the breach.\textsuperscript{24}

\textit{Mitigation}

In the case of breach of contract, the duty to mitigate the other party’s loss is another factor which can limit the amount of damages recoverable by the innocent party. The person who has suffered a loss must take any reasonable steps available to mitigate the extent of the

\textsuperscript{20} Malik v Bank of Credit and Commerce International SA [1998] 1 A.C 20

\textsuperscript{21} Galoo v Bright Grahame Murray [1994] 1 W.L.R 1360

\textsuperscript{22} (1854) 9 Exch 341

\textsuperscript{23} [1949] 2 K.B 528

\textsuperscript{24} This remoteness test was further interpreted and qualified in \textit{Koufos v C. Czarnikow Ltd (The Herron II)} [1969] 1 A.C. 350.
damage caused by the breach.\textsuperscript{25} The basic reasoning behind the rule is that a claimant should not be compensated by the other party for a loss that is not really caused by the breach itself, but is in fact caused by the claimant’s own failure to act in a reasonable way after the breach.

“Mitigation of damage” is comprised of three different, although closely interrelated, rules.\textsuperscript{26} The first rule is that the claimant cannot recover damages for any part of his loss due to the defendant’s breach which the claimant should have avoided by taking reasonable steps. This means that the claimant cannot recover for avoidable loss. The second rule is a consequence of the first rule, saying that where the claimant does take reasonable steps to mitigate his loss and incurs losses or expenses when doing so, these losses or expenses are recoverable to the claimant. This applies even when the mitigation steps were unsuccessful, as long as the attempt was reasonable. The third rule says that where the claimant does take steps towards mitigating the loss, and is successful in doing so, he cannot recover for such avoided loss. The underlying principle is that the claimant is entitled to damages only for his actual loss.

2.1.2 Interpretation

Indemnity clauses will be interpreted by the courts using the same rules of contract interpretation applicable to contracts in general. The general rules of interpretation will not be treated here.\textsuperscript{27} As to the interpretation of indemnity clauses in particular, the similar effects of an exemption clause and an indemnity provision has led the courts to subject these clauses to the rules which apply to the interpretation of exemption clauses.\textsuperscript{28}

\textsuperscript{25} Anson’s Law of Contract 28.ed, p. 614
\textsuperscript{26} McGregor on Damages 17.ed, p. 216-217
\textsuperscript{27} For more about this, see for example Peel, Interpretation
\textsuperscript{28} Smith v South Wales Switchgear Ltd, [1978] 1 WLR 165
Traditionally the general approach of the courts towards exemption clauses has been a hostile one, and the courts tend to look more critically at these clauses than other types of contract clauses. However, in modern times this approach has been somewhat abandoned by the courts. This development is closely connected to the enactment of the Unfair Contract Terms, and in *Photo Production Ltd v Securicor Ltd* 29 it was stated that “[i]n commercial contracts negotiated between businessmen capable of looking after their own interest and of deciding how risk inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction on words in an exclusion clause which are clear…” The new balance may have been expressed in the judgement of the High Court of Australia in *Darlington Futures Ltd. v Delco Australia Pty Ltd.* 30 where it was said that “…the interpretation of an exclusion clause is to be determined by construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole […]”.

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.” 31 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.

There are some limitations as to the use of *contra proferentem* when interpreting a contract. First of all, the rule does not apply where the wording of the contract is clear. *Contra proferentem* is a principle of construction, 32 which can be applied when two or more possible interpretations exists. This will not be the case when the wording of the contract is sufficiently clear and unambiguous, thus allowing no room for construing *contra proferentem*.

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30 (1986) 61 A.L.J.R 76 (Australia)
31 Peel, Interpretation p. 9
32 Lewison p. 172
proferentem. Second, the principle does not apply where the wording of the contract does not clearly benefit one party, or where the parties both are benefited equally.33

2.2 Legal Effects of Indemnity Clauses

Indemnity clauses can have several intended legal effects which the contracting parties seek to achieve. In many ways it can be correct to say that the purpose of contractual indemnity is to amend the legal regime within which the contract operates.34 The reason for the parties to include such provisions should be that a solution different, or more certain, than the one offered by the legal regime, is sought.

2.2.1 Risk allocation

One function of contracts is that it enables risk to be allocated between the parties in advance.35 It has been held by the courts that commercial parties must be left free to decide how to allocate commercial risks.36 This is essential in many commercial dealings, and especially in large and complex transactions. It is perhaps most important when dealing with potentially enormous liability, such as in oil and gas contracts.

The use of indemnity clauses as a contractual provision is an attempt to distribute such risks arising from the transaction. Indemnification is the right of one party who is legally responsible for a loss to shift that loss to another party.37 In addition to representing an actual transfer of liability that would otherwise be the responsibility of one of the parties at

33 Anderson: Drafting and Negotiating Commercial Contracts p. 102
34 This is for example the case with indemnity provisions in the oil and gas industry, see Genieve Macattram p.5
35 Anson’s Law of Contract p. 3
36 Homburg Houtimport BV and Others v. Agrosin Private Ltd and Another [2003] UKHL 12; [2003] 2 W.L.R. 711 at [57]
37 Stark p. 248
law, indemnity clauses may represent a confirmation of pre-existing liability that, for various reasons, needs to be more precisely or additionally addressed.\(^\text{38}\)

### 2.2.2 Remoteness and mitigation

Remoteness and mitigation are rules relating to damages under common law. The question is whether or not these rules also apply to indemnities, thereby affecting what the indemnified party is entitled to. Should the indemnitee be entitled to all losses flowing from the breach, or will this be affected by the rules of remoteness and/or mitigation?

There is not a lot of authority on this particular issue, but in the event of a breach of contract triggering the indemnity, there are two decisions from the Court of Appeal which are of interest. In *Royscot Commercial Leasing Ltd v Ismail*\(^\text{39}\) a director had provided an indemnity in support of an equipment lease granted to his company. It was argued by the director that the lessor should have mitigated its loss following a default by the lessee. The argument was rejected on the basis that “a claim under a contract of indemnity is not a claim in damages at all, but it is a claim in debt for a specified sum due on the happening of an event which has occurred.”

Many have claimed that there is no duty to mitigate and no remoteness limit to the sums recoverable under an indemnity, and *Royscot Commercial Leasing Ltd v Ismail* has been taken as the authority for this general proposition. However, in “The Eurus”\(^\text{40}\) the Court of Appeal made statements to the contrary. The Court of Appeal stated that “as to the purpose of the clause, I cannot see why the parties would have wished to provide that, for some breaches of contract by the owners, the charterer’s loss would be recoverable whether or

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\(^{38}\) Parker, P.L., Slavic J p 1351

\(^{39}\) 29. April 1993. This decision was brought to my attention by Ed Peel’s paper “Recent Developments & Current Issues in Contract & Tort”. As this decision is not available through Westlaw, my presentation of this decision is based on Peel’s paper.

\(^{40}\) *Total Transport Corporation v Arcadia Petroleum Ltd.* [1998] 1 Lloyd’s Rep. 351. The issue was also considered at first instance, see [1996] 2 Lloyd’s Rep. 408.
not it was within the reasonable contemplation of the parties, while for all other breaches
the ordinary rule as to damages in a contract case would apply." 41 It was concluded by the
court in the first instance, and upheld by the Court of Appeal, that where the indemnity is
triggered by a breach of contract, the indemnity as a matter of construction only covers
foreseeable consequences caused by that trigger. The parties are free to enter an agreement
containing a provision to the contrary, however “express language” will be needed to
persuade the courts that the contractual indemnity in question was intended to cover more
than the normal indemnity in damages.

The two decisions might seem contradictory, but it has been suggested that they are
reconcilable.42 It was pointed out in The Eurus that there is no inherent indication of what
is meant to be covered by an indemnity, as this will depend on what the contract says. In
The Eurus there was nothing to indicate that the parties intended the indemnity to be wider
than the normal indemnity in damages. In Royscot, however, the indemnity was found to
refer to a particular sum which amounted to a debt. There is no duty to mitigate in debt, as
opposed to the duty to mitigate in damages,43 and because of this, the results were
different.

Based on the fact that there is so little authority, the conclusion is uncertain. It appears that
the rules of mitigation and remoteness will apply to indemnities triggered by a breach of
contract. The parties can, however, exclude limitations like mitigation and remoteness in
the agreement, but in order to do so successfully, the parties must use some form of
“express language.” It appears to be a case of contra proferentem, which means that the
parties’ intention of letting the indemnitee be covered for the full extent of his loss must be
indicated sufficiently clear by the contract.

41 Publication page references were not available in the document on Westlaw
42 Ed Peel: Recent Developments & Current Issues in Contract & Tort p. 22
43 Ibid
In some situations liability arises not because of breach, but because the parties have agreed that one party is to indemnify the other for loss in specific circumstances. An example is where a party provides an indemnity in support for the buyer’s debt in a hire-purchase agreement, such as in the case of *Goulston Discount Co. Ltd v Clark*. Another example would be where a lessor is relieved from a contractual duty to move into new offices, while in return agreeing to indemnify the lessee. It is not obvious that the rules of remoteness and mitigation should apply to these situations, and there is no authority on the issue. In *The Eurus* it was stated very clearly in the first instance that the decision did not address whether these rules also apply to indemnity clauses where the indemnity’s trigger is not a breach of contract.

Many have claimed that claims in these situations are not subject to the rules of mitigation and remoteness. The common reasoning is that remoteness and mitigation are rules relating to damages, and that they therefore cannot, and should not, affect claims under an indemnity not triggered by a breach of contract. 44 As there is no authority on this issue, the conclusion remains uncertain.

### 2.2.3 Negligence

When dealing with provisions attempting to exclude a party’s liability for its own negligence, the courts have developed some specific rules of construction. In the judgement of *Walters v Whessoe Ltd and Shell Refining Co. Ltd.*, 45 when commenting on the construction of indemnity clauses, it was stated that it is “well established that if a person obtains an indemnity against the consequences of certain acts, the indemnity is not to be construed so as to include the consequences of his own negligence unless those consequences are covered either expressly or by necessary implication.”

44 In the US, however, some have suggested that equitable considerations might lead a court to impose some form of duty to mitigate or reasonableness standard on a party seeking relief under an indemnity, see Parker, P.L., Slavic J, p. 1356.

45 [1960] CA (Civil Division) 6 Build LR 23
A three-tier test for the construction of such clauses was formulated in the case of *Canada Steamship Lines Ltd. v the King.*46 First, the court is to examine whether the clause contains express reference to negligence. This can mean either the use of the word “negligence” itself, or the use of a word which is synonymous. If this is the case, the clause successfully covers negligence. Second, if the clause fails the first stage, the courts examine whether or not the wording of the clause in its ordinary sense is wide enough to cover negligence. If not, the clause fails at stage two of the test. Third, if the clause was found to be wide enough to cover negligence, the courts proceed to examine whether the loss or damage contemplated in the clause may be based on some legal liability other than negligence.47 If such other legal ground is found to exist, the clause will fail the test, provided that this other liability is not so remote or fanciful that the parties could not have intended that the indemnity clause cover it.

An example of the three-tier test being applied to an indemnity provision is found in the case of *E.E Caledonia Limited v Orbit Valve Co.*48 A disastrous fire occurred on a drilling platform, caused by the negligence and breach of statutory duty of the operators’ employees, resulting in the death of the contractors’ engineer. The operators sought an indemnity from the contractors, but the court found that the indemnity clause did not cover the operators’ negligence. After concluding that the clause did not contain an express reference to negligence, the clause was found to contain wording wide enough to cover negligence. However, the liability the claimants sought to be indemnified against could be based on other grounds than negligence, and such grounds were not too remote or fanciful. The indemnity clause was, therefore, found not to cover negligence.

46 [1952] 1. Lloyd’s Rep. 1
47 For example, this can be breach of statutory duty.
48 [1994] 2 Lloyd’s Rep. 239
In the case of *HIH Casualty & General Insurance Ltd. v Chase Manhattan Bank*\(^{49}\) the wording of the clause in question, although some other liability was possible, was found to be wide enough to cover negligence, and that the clause did in fact cover negligence. It was pointed out by the House of Lords that the rules set forward in *Canada Steamship* are only guidelines, and that the aim is to construe the clause to find the meaning intended by the parties.

A particular observation is the common practice of carving out liability for “gross negligence” in indemnity provisions.\(^{50}\) As a matter of principle, English courts have not recognized the distinction between “simple” and “gross” negligence.\(^{51}\) In *Armitage v Nurse and Others*\(^{52}\) the question was whether a trustee exemption clause validly could exclude liability for gross negligence. The court proposed that “[i]t would be very surprising if our law drew the line between liability for ordinary negligence and liability for gross negligence,” and continued stating that “we regard the difference between negligence and gross negligence as merely one of degree.”\(^{53}\) It was then stated that the submission that it is contrary to public policy to exclude the liability of a trustee for gross negligence does not have support in any English or Scottish authority.

### 3 Short comparative overview

In certain areas, Norwegian law has legal solutions which deviate from the ones which are found under English law. Because of this, it will generally be of interest to explore these

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\(^{49}\) [2003] UKHL 6, [2003] 2 Lloyd’s Rep 61

\(^{50}\) Key Contractual Issues, [http://www.cdg.co.uk/files/news/KeyContractualIssues.pdf](http://www.cdg.co.uk/files/news/KeyContractualIssues.pdf)

\(^{51}\) Pentecost v London District Auditor [1951] 2 KB 759

\(^{52}\) [1997] 3 W.L.R 1046

\(^{53}\) Ibid p 254
aspects and differences before considering the legal effects of an indemnity clause under Norwegian law.

This article will not go into details with regard to the problems arising in this respect, as these problems have already been the subject of thorough discussions under the project of which this article is part.\textsuperscript{54} However, a few differences of importance will pointed out.

First, it can be pointed out that freedom of contract is a consideration which traditionally has been especially emphasized under English contract law. The main purpose of an indemnity clause is to allocate risks between the parties, predictability being an important outcome of this. Freedom of contract is an essential factor in this respect.

However, emphasizing freedom of contract and predictability can easily come into conflict with what is considered a reasonable result in each individual case. Sometimes a contract can lead to results which might be considered unreasonable for one of the parties. In such cases, these considerations are not always reconcilable. It can be claimed that case law shows that English courts have taken the stand that predictability is a more important consideration than achieving entirely reasonable results in each individual case.

Under Norwegian law, it must be claimed that the courts tend to emphasize considerations of reasonableness more than predictability and freedom of contract. Naturally, foreseeability in commercial contracts is also something which is sought after. However, the impression is that Norwegian courts, more often than English courts, will place a deciding emphasis on the consideration of achieving fair and reasonable results. This can have consequences for the legal effects that are possible to achieve with an indemnity clause under Norwegian law, compared to the legal effects such clause can achieve under English law.

\textsuperscript{54} Reference is made to the results published under the project, and which can be found at the website of the project: \url{http://www.jus.uio.no/ifp/anglo_project/index.html}
Second, an important difference between Norwegian law and English law is the significance of the principle of good faith. While the principle must be held to be of modest importance under English law, it plays a more prominent part under Norwegian law.

Under English law, a duty of good faith exists in several and concrete circumstances. However, the courts have been sceptical to introduce a general duty of good faith between parties to a contract. As a consequence, English law has “developed piecemeal solutions in response to demonstrated problems of unfairness,” rather than accepting a general duty of good faith. Under Norwegian law however, a general and mandatory duty to act in accordance with good faith is imposed upon the contracting parties. This superior principle constitutes a supplementary duty in the contractual relationship between the parties, and means that the parties will have a duty to take reasonable consideration and protect the other party’s interests. It is certain that the duty of good faith will be relevant when interpreting or supplementing contracts under Norwegian law and the parties cannot contract contrary to it. As a consequence, the principle can be relevant when determining the legal effects of an indemnity clause under Norwegian law.

4 Indemnity clauses under Norwegian law

4.1 Conditions for indemnification

As under English law, the legal effects of an indemnity clause under Norwegian law will mainly depend upon an interpretation of the clause itself. This means that, as a starting point, the parties are free to contract as they desire. To a large extent, this means that the parties are also free to determine the conditions for indemnification.


56 Nazarian, Lojalitetsplikt i kontraktsforhold, p. 50.
However, after the applicable rules of law, a number of rules can limit the amount which can be recovered when making a claim for damages. Often the contract will not explicitly regulate the question of whether or not these conditions also apply for the indemnity clause. When interpreting a contract under Norwegian law, the contract will normally be supplemented by the applicable rules of law, if the provisions of the contract are found not to regulate the matter in question. But as contractual indemnities and claims for damages is not the same thing, it is not given that the rules will apply. And, even if the wording of the contract does contain an explicit regulation, certain limitations on the freedom of contract might still apply, thereby having consequences for the legal effects of the clause.

4.1.1 Economic loss

As indemnification is the central function of an indemnity clause, the demand for a loss is essential. A claim for indemnification will only succeed if the indemnitee can prove an economic loss. The starting point must be a concrete determination of the losses suffered. However, sometimes the indemnitee can only prove that he has suffered loss, but cannot establish the size of the loss. After the applicable rules of law, the loss will be approximately determined by the courts.57 The same may probably apply when the claim is based on an indemnity clause.

4.1.2 Remoteness

After the applicable rules of law, the amount recoverable when claiming damages is limited by the principle of remoteness. This principle means that a claimant cannot recover damages for a loss which is a too remote consequence of the breach or tort in question. The primary function of this limitation is to remove atypical losses from the liability for damages, thereby preventing unreasonable results.

57 Hagstrøm p. 538.
Norwegian courts have not considered the question of remoteness in relation to indemnity clauses, and the issue has not been subject to much theoretical discussion. As a consequence, it must be held as uncertain whether or not the rule of remoteness will apply to losses recovered under an indemnity clause. If the contract is silent, it might be natural to assume that the rule will apply when making such claim for indemnification. It could be argued that it makes little sense that any loss, no matter how remote, would be recoverable under the clause, merely because the parties have agreed to make use of an indemnity clause. Lacking other basis, it might therefore be natural to assume that the rule of remoteness will apply.

Whether or not a loss is too remote to be recovered is decided by an overall evaluation, where both size and character of the loss is relevant. The fact that a party has agreed to indemnify another for a specific loss or liability, will, of course, strongly influence the consideration as to whether or not a loss or liability is regarded as too remote. In some commercial contracts, for example oil and gas contracts, comprehensive losses must be held to be foreseeable. When considering a loss under an indemnity clause, the evaluation must be made from the indemnitor’s perspective, as he would be responsible for the loss. The subject of evaluation will be which losses must be considered as normal and foreseeable within the scope of the indemnity clause. This must be supplemented with any special knowledge possessed by the indemnitor. It should be pointed out that disproportion between the contractual compensation and the liability for breach of contract is not sufficient to establish that a loss is inadequate.

If the indemnity clause explicitly excludes the rule of remoteness, the question might be different than when the clause is silent. Because of the freedom of contract, the parties may probably be free to agree that no loss shall be considered too remote. However, as pointed out above, the purpose of the rule of remoteness is to prevent unreasonable results. An indemnity clause without such limitation could prove to be very burdensome for the

58 Hagstrøm p. 526.
59 Hagstrøm p. 530.
indemnitor. As the following will show, the clause could therefore possibly be subject to censorship by the courts. This represents a clear difference from English law: While a clear wording under English law would be sufficient to exclude the rule of remoteness, such clause could possibly be subject to censorship by Norwegian courts if found to produce an unreasonable result.

4.1.3 Mitigation

The applicable rules of law also impose a duty on the party claiming damages to take reasonable steps to mitigate any losses. The reasoning behind this rule is considerations of reasonableness and a desire to prevent the waste of resources. Although it can be problematic to determine exactly how far the duty to mitigate actually goes, the consequence of breaching this duty is clear: The damages awarded to the claimant will be reduced equivalent to the savings the claimant should have made had the claimant been more diligent.

As pointed out above, it is doubtful whether or not the rule of mitigation will apply to indemnity clauses under English law. The question has not been treated by Norwegian court, so the answer must be held as somewhat uncertain under Norwegian law as well. However, as opposed to English law, where mitigation can be said to be a rule related to assessment of damages, the rule of mitigation in Norwegian law originates from the general principle of good faith. This means that the rule of mitigation will apply to any contract under Norwegian law. The consequence is that the rule also applies to indemnity clauses, and effectively imposes a duty to mitigate losses on the indemnitee. It must be considered unlikely that Norwegian courts would allow the indemnitee to “lean back” and ruin the other party’s contractual interest by not mitigating the losses that should have been avoided.

60 Hagstrøm p. 561.
Under English law, the parties are also free to exclude this limitation, given that the wording of the clause is sufficiently clear. However, because the rule of mitigation is an outcome of the general duty of good faith, it is more deeply rooted than the similar rule in English law. Because the parties of an agreement must act according to good faith, it is probable that the parties cannot agree to exclude the duty to mitigate losses from an indemnity clause. As far as such arrangement would conflict with the duty of good faith, it is unlikely that the clause will have legal effects in accordance with its wording. This, therefore, represents a clear difference from English law. If the parties uncritically believe that the clause will achieve legal effects according to its wording, this difference could have consequences.

4.1.4 Negligence under Norwegian law

As pointed out in section 2.2.3, the parties can opt to exclude liability for negligence under English law, given that the wording of the contract is clear. This is an outcome of the general freedom of contract. Although freedom of contract is an important consideration under Norwegian law as well, other considerations could lead to a different result. This will be subject to further discussions in the following sections.

The parties to a contract governed by Norwegian law are subject to a general duty of good faith, meaning that the parties cannot contract against it. As a consequence, the parties are not necessarily allowed to exclude liability for negligence under Norwegian law, even if the wording of the contract seemingly is clear. Whether or not liability can be excluded by an indemnity clause under Norwegian law will depend upon several considerations. It should therefore be emphasized that the issue of negligence constitutes one of the most notable differences between English and Norwegian law with respect to indemnity clauses and legal effects.
4.2 Interpretation

Indemnity clauses can be an effective way to allocate contractual risks. Under Norwegian law it is not the label “indemnity clause” itself which determines the legal effects of the clause. The legal effects must be determined by an interpretation of the clause in question. This makes it interesting to have a look at some rules of interpretation and how indemnity clauses will be interpreted.

The general rules of interpretation will also apply to indemnity clauses. An example of this is the rule of contra proferentem. In Norwegian law, this rule has been formulated in several ways. One alternative is to say that if an agreement is found to be unclear, it is to be interpreted in disfavor of the party who has written it.61 Another alternative is to say that the contract is to be interpreted in the disfavor of the party who wanted the clause to be part of the contract.62 A third alternative is to say that the contract should be interpreted against the party of the contract who should have expressed itself more clearly.63 Both parties will, of course, have a responsibility for making the contract sufficiently clear. However, when dealing with indemnity clauses, the clause should probably be interpreted against the indemnitee in case of ambiguity. As the indemnitee will benefit from the clause, it is natural to impose on him the responsibility for a clear and unambiguous wording.

Although the starting point is freedom of contract, Norwegian case law shows that exclusion clauses will often be subject to restrictive interpretation, even in commercial contracts. As indemnity clauses in practice often will act as exclusion clauses, the rules related to such clauses will be relevant for indemnity clauses as well. Restrictive interpretation can sometimes be based on legal arguments, for example in cases of contra proferentem. However, the real reason for restrictive interpretation in Norwegian law will

61 Hov, Avtalerett p. 79.
63 Selvig p. 276.
often be considerations of reasonableness. In such cases, the courts will not necessarily feel bound by a seemingly clear wording. This is a clear difference from English law, where, in order to achieve a fair and reasonable result in each individual case, the courts will not use interpretation to adjust a contract when the wording is clear. This can be illustrated by indemnity clauses limiting liability for negligence. Under English law, the use of the word “negligence” or a synonym will be sufficient to exclude such liability. However, under Norwegian law this will not necessarily be sufficient, as the clause in certain situations could be interpreted restrictively, even if it does seem to contain clear wording.

Exclusion clauses are a typical example of contract clauses which can be limited by Norwegian courts by using this method of interpretation. There are several examples of this in Norwegian case law. The tendency seems to be that Norwegian courts will not allow a clause to have legal effects according to its wording in cases of fundamental breach of contract. This is somewhat similar to what is known as “fundamental breach” under English law, which has been rejected by English courts. A difference is that this evaluation in English law would start with the breach of contract, and then consider whether the breach was too fundamental to be excluded. In Norwegian law the starting point is the clause itself: If the clause causes a fundamental breach of contract to be without effect, the courts will not necessarily uphold it.

This means that indemnity clauses, like exclusion clauses, may be interpreted restrictively under Norwegian law if found to be unreasonable.

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64 Selvig p. 279.
66 See for example Rt-1911-1037, Rt-1982-1357 and Rt-1953-35.
67 Hagstrom, Tidsskrift for Rettsvitenskap 1996 s. 421, on p. 453.
68 Although the starting points are different, the result will probably be same however.
4.3 Mandatory restrictions and censorship

As already pointed out, the legal effects of an indemnity clause will mainly be a question of interpretation in Norwegian law. However, if the parties deviate from the solutions provided by non-mandatory rules, the contract could suffer from disproportionality.\(^{69}\) As a consequence, Norwegian law has certain mandatory restrictions on the freedom of contract, even in commercial agreements. Thus, the legal effects of an indemnity clause will not solely depend on an interpretation of the clause.

Due to the similarities between indemnity clauses and exclusion clauses, many of the same scruples and considerations apply to both contract clauses. This means that, in Norwegian law, indemnity clauses are likely to be treated the same way as exclusion clauses in relation to the mandatory rules.\(^{70}\) Traditionally, the starting point has been that the parties are free to make use of exclusion clauses to regulate liability in the contract between them. This follows from the freedom of contract. However, it was generally thought that a party could not exclude liability for loss or damage caused by the party’s own intentional or grossly negligent (“grovt uaktsomme” in Norwegian) acts.

The subsequent development in case law and theory has shown that this general point of view cannot be upheld. The introduction of section 36 in the Norwegian Contracts Act has given the courts the possibility to modify or disregard agreements which are found to be unreasonable or contrary to good business practice. Whether or not an exclusion of liability can be upheld will depend on an overall evaluation, based on the criteria of reasonableness found in section 36.\(^{71}\)

This being said, and although it is possible, section 36 will rarely apply to commercial contracts between professional parties. To the extent it will apply, the threshold must be

\(^{69}\) Hagstrøm p. 622.

\(^{70}\) For a thorough discussion of exclusion clauses in commercial contracts under Norwegian law, see Hagstrøm, Tidsskrift for Rettsvitenskap 1996 s. 421.

\(^{71}\) Hagstrøm p. 630.
high. Based on this, the courts are unlikely to openly disregard an indemnity clause in a commercial contract based on section 36. If the indemnity clause is found to be unreasonable, restrictive interpretation based on the criteria found section 36 might be more likely.

5 Conclusions

There is a clear difference between English and Norwegian law with regard to the legal effects of indemnity clauses seeking to exclude liability for “gross” negligence and intent. While the legal effects of an indemnity clause under English law mainly will depend upon an interpretation of the clause, an indemnity clause under Norwegian law will also be subject to several mandatory rules, such as the general duty of good faith and the standard of reasonableness found in section 36 of the Norwegian Contracts Act. Also, the court could use restrictive interpretation to adjust the balance of the contract, which is a clear difference from English law.

Further, the freedom of contract under English law also allows the parties to exclude the normal conditions related to damages, such as mitigation and remoteness, from applying to the indemnity clause. Under Norwegian law, such contract terms could easily be disregarded or censored by the courts.

It must therefore be concluded that several legal effects which could be achieved by an indemnity clause under English law are not necessarily permitted under Norwegian law. As

72 Exclusion of liability based on gross negligence or intent in knock for knock arrangements in offshore fabrication contracts has been subject to discussion in theory. This discussion will not be further considered in this abstract. For more on this subject, see Hagstrøm, Tidsskrift for Rettsvitenskap 1996 s. 421 and Kaasen, Petroleumskontrakter (2006).
a consequence, the expectations of the parties with regard to the legal effects of the clause could be frustrated if they rely solely on a literal understanding of the indemnity clause, or otherwise expect the legal effects achievable under English law to occur under Norwegian law as well, without first considering the differences between the two legal systems.