Indemnity, contribution and the meaning of ‘subsidiary’

There have been two very interesting appeal court decisions recently arising out of the same incident of an engine room fire on board the vessel ‘MV Far Service’ (the vessel) in July 2002. The first stems from the Scots court proceedings raised by Farstad Supply AS (Farstad), the owners of the vessel against contractors Enviroco Ltd (Enviroco), whose employees were carrying out tank cleaning services on the vessel at the time of the engine room fire. The Supreme Court overturned the decision of the Inner House in Scotland and approved the opinion of the judge of first instance, Lord Hodge (Farstad Supply AS v Enviroco Ltd & anor [2008] – ‘The Scottish Proceedings’). The second decision relates to proceedings issued in the Chancery Division of the High Court in London by Enviroco against Farstad, which were subject to an appeal to the Court of Appeal (Enviroco Ltd v Farstad Supply AS [2009] – ‘The English Proceedings’).

The facts relating to the contractual (and other) relationships between the parties involved are not unusual in the contractual sphere of oil support services in the North Sea, and the contractual indemnities ordinarily agreed by parties to allocate responsibilities and risk. The indemnities include references to each party’s associated companies. However, the implications for group companies working in the industry may be far reaching.

Scottish Proceedings

The vessel owned by Farstad was chartered to Asco UK Ltd (Asco), pursuant to a charterparty dated 4 February 1994. Asco was a third party in the Scottish proceedings, although Farstad did not adopt Enviroco’s
position in relation to Asco and Asco did not appear. There was also a contract between Asco and Enviroco, the terms of which were not in issue in the Scottish proceedings. Although not highlighted in the Supreme Court judgements, Enviroco claimed to be an associated company within the Asco Group (discussed on p58 under ‘English proceedings’).

Farstad claimed against Enviroco in negligence for damages. Enviroco claimed a contribution from Asco under the Scottish Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 (the 1940 Act). Enviroco’s claim was based on contribution and, according to Lord Clarke, ‘Enviroco has not alleged any breach of that contract [the contract between Asco and Enviroco] against Asco’. Farstad accepted that if Enviroco was entitled to a contribution from Asco, then Asco would be entitled to an indemnity from Farstad pursuant to the indemnity clauses in the charterparty between Farstad and Asco. It should be noted that a claim for contribution in England and Wales is under the Civil Liability (Contribution) Act 1978, which is worded differently to that of the 1940 Act.

1940 Act

Section 3(1) provides:

‘Where in any action for damages in respect of loss or damage arising from any... negligent acts... two or more persons are, in pursuance of... the judgment of a court found jointly or severally liable in damages or expenses, they shall be liable inter se to contribute to such damages or expenses in such proportions as... the court... may deem just.’

Section 3(2) provides:

‘Where any person has paid any damages or expenses in which he has been found liable... he shall be entitled to recover from any other person who, if sued, might also have been held liable in respect of the loss or damage.’ [Emphasis added.]

Section 3(3) provides:

‘Nothing in this section shall:

b) affect any contractual or other right of relief or indemnity or render enforceable any agreement or indemnity which could not have been enforced if this section had not been enacted.’

Lord Clarke’s position is that s3(1) could only apply where Asco was sued directly by Farstad and Asco was
found liable to Farstad. For the court to decide whether Asco was liable, the court would have to consider any defences that Asco may have under the charterparty. In discussing s3(2), Lord Clarke accepted that it is not suggested that two separate actions are required, but that the section could apply in third party proceedings. It is not necessary for Enviroco to be found liable and then to pay Farstad before making a claim in contribution. Enviroco is entitled to claim a contribution from Asco if Enviroco can show that Asco, ‘if sued, might also have been held liable’.

Lord Clarke reviewed the case law in respect of the interpretation of the phrase ‘if sued’, and referred to Lord Hodge’s ‘clear and concise analysis’ in the Outer House. ‘Asco, if sued’ refers to circumstances in which Asco may have been, ‘relevantly, competently and timeously sued; in other words, that all essential preliminaries to a determination of the other party’s [Asco’s] liability on the merits have been satisfied’ (Lord Keith in Central CMT Co Ltd v Lanarkshire CC [1949] at 461). Lord Hope agreed with Lord Hodge’s summary of the case law that ‘if sued’ means ‘if sued to judgment’ and that the time for the test is the date the pursuer sues the defender. It is enough that the pursuer could have sued the third party at that date. So whether or not Enviroco is successful in claiming a contribution under s3(1) or 3(2) depends on whether or not Asco has a defence, which in turn depends on the true construction of the charterparty.

**Charterparty**

Clause 33.5 provides:

‘The owner shall defend, indemnify and hold harmless the charterer, its affiliates and customers from and against any and all claims, demands, liabilities, proceedings and causes of action resulting from loss or damage in relation to the vessel... irrespective of the cause of loss or damage, including where such loss or damage is caused by, or contributed to, by the negligence of the charterer, its affiliates or customers.’

Crucially, Lord Clarke found that clause 33 as a whole contains a ‘division of responsibility between the owner and the charterer of a type which has become familiar’. He again agreed with Lord Hodge that ‘the obligation to hold harmless goes further than the obligation to reimburse because they are words of exception’, and that:

‘The expression “defend, indemnify and hold harmless”... is wide enough to include the exclusion of liability for loss incurred by the owner...[and] is wide enough both to provide a defence by one party to claims made by the other party and to provide an indemnity in respect of the claims of third parties.’

Lord Clarke concludes that clause 33.5 excludes Asco’s liability to Farstad in respect of any damage caused by Asco’s own negligence. It therefore follows that Enviroco is not entitled to a contribution on the basis that Asco would have a defence, as any claim by Farstad against Asco is excluded by clause 33.5 of the charterparty.

Lord Clarke went on to discuss the circumstances where clause 33.5 was found to be an indemnity clause.
and not an exclusion clause. If Asco was found liable to Farstad and Farstad had to indemnify Asco for such liability, the claim would be subject to the English law defence of circuity of action (the charterparty being subject to English law). If it were a matter for Scots law, the outcome would be the same by application of the principle of frustra petis quod mox es restiturus.

Lord Hope specifically disagreed with Lord Carloway’s approach in the Inner House that:

‘A victim ought not... to be able to extinguish the [right of contribution] by a private arrangement with other potential wrongdoers, whether that arrangement is made before or after the accident.’

The reasoning is that if Farstad had sued Asco as a second defender and Enviroco’s claim was under s3(1) of the 1940 Act, then Asco would have a defence relying on the exclusion clause and Enviroco would have no claim for contribution. Lord Mance also disagreed with Lord Carloway’s position, on the basis that the argument was not relevant in circumstances where Asco could never be successfully sued by Farstad for this damage. He also stated that this was not a whim on the part of Asco, but rather the result of ‘deliberate contractual arrangements apportioning risk between Farstad and Asco’. As Lord Mance stated, if it were otherwise, it:

‘Would be to ignore the actual legal position between [Farstad] and [Asco] and to introduce by the back door a liability which was barred at the front door.’

English Proceedings

The English proceedings were issued after the Scottish proceedings and concentrated on the meaning of ‘affiliate’ in the charterparty indemnity clauses. The series of indemnities by Farstad to Asco also covered Asco’s ‘affiliates’, including the indemnity in respect of all claims and liabilities resulting from loss or damage to the vessel. ‘Affiliate’ is defined in clause 1(a) of part B of the charterparty as:

‘Any subsidiary of the charterer or customer or a company of which the charterer or customer is a subsidiary. For the purposes of this definition “subsidiary” shall have the meaning assigned to it in s736 of the Companies Act 1985.’

The parties agreed that following re-enactment, the relevant sections were s736 and s736A, which provide that:

1. A company is a ‘subsidiary’ of another company, its ‘holding company’, if that other company:

2. a) holds a majority of the voting rights in it;
3. b) is a member of it and has the right to appoint or remove a majority of its board of directors; or

4. c) is a member of it and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in it, or if it is a subsidiary of a company, which is itself a subsidiary of that other company.

These provisions have been reproduced in s1159 and schedule 6 of the Companies Act 2006.

Enviroco claimed to be an affiliate of Asco and was therefore entitled to take the benefit of the indemnity clause in the charterparty between Farstad and Asco in any claim by Farstad against Enviroco. Enviroco contended that both it and Asco were subsidiaries of a third company, Asco plc, and Enviroco was a subsidiary within the meaning of s736(1)(c). They did not rely on (a) or (b). Prior to November 1999 Enviroco’s share capital was registered to Asco plc. In November 1999 the share capital was split into A and B shares, and Asco plc was shown on the register of members as holding 333,751 A shares. Stoneyhill Waste Management Ltd was the registered holder of 333,751 B shares.

On 11 May 2000 Asco plc charged its shares in Enviroco to the Bank of Scotland under a deed of pledge that required the shares to be registered in the name of the bank or its nominee. At first instance Gabriel Moss QC, sitting as a deputy judge, found for Enviroco and held that, construed in the context of the charterparty, Asco plc was a member of Enviroco. Farstad appealed. The Court of Appeal allowed the appeal holding that Asco plc was not a member of Enviroco and it follows that Enviroco could not then take the benefit of the contractual indemnity in the charterparty.

Although there was much discussion on the possible interpretation of s736, the impact of the decision may be far reaching. In groups of companies, one company may wish to include its ‘affiliate’ companies or subsidiary companies in contractual indemnities, in the full knowledge that certain ‘subsidiaries’ are more than likely to be sub-contracted to carry out works. The contracting party relies on the fact that certain companies are known to be ‘subsidiaries’ and as is the practice, reference is made to the Companies Act definitions. Practically, a ‘subsidiary’ company may not always remain a ‘subsidiary’, as defined by the Companies Act, in light of inter-group refinancing and restructuring. On entering into a long-term contract, such as the charterparty in this case, it may be that it was intended that Enviroco receive the benefit of the indemnity, but due to intergroup refinancing, Enviroco was no longer a ‘subsidiary’ of Asco. This may be appealed to the Supreme Court.