# "CONSTRUCTION (INTERPRETATION) OF CONTRACT, EXEMPTION CLAUSES, AND THE INSURANCE ISSUE"

Jan M. van Dunné
Erasmus University Rotterdam

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**DISCUSSION OF LEGAL ISSUES UNDER CIVIL AND COMMON LAW**

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## A. CIVIL LAW ISSUES

### 1. Construction (interpretation) of contract under Dutch law.

1.1 General observations

Under Dutch law, the doctrine of interpretation of contract (or any legal act) definitely is placed under the governance of the principle of good faith, lately also known as the principle of reasonableness and fairness. This is in accordance with all civil code jurisdictions in Europe. Contrary to the old Civil Code of The Netherlands, the New Civil Code (1992) contains no articles on interpretation of contract. The former Articles 1378-1387 Old CC, with its distinct Roman law origin (in fact, a literal translation from the French CC), however, are still living law through a number of leading cases of the Dutch Supreme Court of the last decades. For this subject, reference is made to Asser-Hartkamp II, *Verbintenissenrecht,* 11th ed., 2001, No.279-288; Van Dunné, *Verbintenissenrecht, Vol.1*, 4th ed., Deventer: Kluwer, 2001, p.137-235; rules of construction discussed at pp.184 and 188/189 {[N.B.: 5th ed. 2004, p. 133-227, and p. 173 and 176-177].

The *Haviltex* case (1981) is a landmark decision on the normative interpretation of contracts; it however was preceded by a number of cases of comparable importance, illustrating the same view on construction of contracts, although neglected by some authors.

Of the rules on construction of contract, as developed by the courts over the years, the following seem of special relevance for an international dispute.

1.2 The role of the nature of the contract; reading the contract as a whole

The decision in *Kluft v. B en W Supermarkets*, Hoge Raad 18 November 1983, *NJ* 1984, 272, note Scholten (Van Dunné *o.c.*, p.186), social-economic circumstances and the reasonable meaning of a contract clause were considered to be relevant, and the clause must be read in the context of the whole contract (in this sense also Article 1384 Old CC). Here a time restriction was added to an open-ended non-competition clause in the sale of a supermarket, relied upon by the vendor after 15 years.

The nature of the contract is also stressed by the court in the case of *Frenkel v. KRO*, Hoge Raad 1 July 1985, *NJ* 1986, 692 (Van Dunné *o.c.*, p.186); compare also Article 1381 Old CC. A contractual obligation must be construed in consideration of the reasonable interests and moral rights of the other party, who had the copyrights of a movie made under the contract, which the employer was no longer prepared to broadcast.

Another exemplary case is *Amro v. Ned. Credietverzekerings Mij.*, Hoge Raad 11 November 1988, *NJ* 1990, 440 (Van Dunné, *o.c.*, p.187 ff.), where the reasonable meaning of the clause, according to the kind contract involved, was decisive. Here Cogasco, a Dutch consortium financed by Amro and 12 other banks, had undertaken a huge construction project in Argentina, which was insured by the Ned. Credietverzekerings Mij. The clause in dispute held that insurance coverage was under the condition of Cogasco 'having concluded' a property insurance policy with a certain Argentinean insurance company, for the period of construction and exploitation of the project (a gas pipe networks). Parties were divided on the issue whether the clause should be read as 'having concluded *and sustained*' an insurance policy; the insurance contract namely was terminated by the Argentinean insurer, on the grounds of default of payment, due to Cogasco's lack of funds (which, actually, the banks had stopped providing). The Court of Appeal, followed by the Supreme Court, held, in a reasonable interpretation of the clause, that the clause only made sense if it included the continuation of the insurance contract, which meant providing of local insurance coverage during the whole life of the project. All in all, this case is a clear example how far Dutch courts are prepared to go to take the reasonable meaning of a contract clause as the core of contract interpretation, thereby, if necessary, setting aside the literal meaning of that clause.

1.3 Standard clauses to be construed in accordance with their customary sense in business circles

In one of the early landmark decisions, *Koppe Shipowners*, Hoge Raad 20 May 1949, *NJ* 1950, 50, note Houwing (Van Dunné *o.c.*, p.157 ff.), the Supreme Court ruled that the customary sense attached to a standard clause in the branch of business concerned, must prevail above the literal text of that clause, if reasonable under the circumstances. Thus, in a reasonable construction of the clause ('*redelijke uitleg'*), a time condition ('payment within two weeks') was stricken, a condition which was established as a dead letter in (the insurance) practice. The Court of Appeal was of the opinion that reliance on the clause by the Insurance company (a Swiss insurer) under the circumstances was against good faith. The striking circumstances were, that the insured party, Koppe, was in default of payment of the premium, due to war conditions in The Netherlands in 1945; he did not receive his mail in his hiding place (to escape forced labour) and payment abroad would have been difficult anyway, at the time.

## 2. Exemption clauses under Dutch law

The position of Dutch contract law regarding the use of exemption clauses is a rather complicated matter. By tradition, public policy was the guiding legal principle, governing the question whether an exemption clause could be enforced; if against public policy, the clause would be null and void. This approach gradually was replaced by the reasoning that reliance on such clause could be contrary to the principle of good faith (also known as the principle of reasonableness and fairness). This approach was the general doctrine at the time of enactment of the New Civil Code, in 1992; the last mentioned principle is found in Article 6:2 (general principle of the law of obligations) and in Article 6:248 (in its role as the principle governing the law of contract).

Until the 1970's, the position of Dutch law was rather straightforward: reliance on exemption clauses is permitted in so far as no wilful misconduct of the contracting party (seeking reliance on the clause) is involved. Apart of the case of wilful misconduct of the contractor's employees, there is no objection to use of the clause. Leading cases are: *Surinam Post* (1920), *Bovag I* (1938) and *X rays* (1951). 'Gross negligence' is seen as akin to wilful misconduct, and therefore an obstacle to reliance on an exemption clause by a contractor. In a 1954 case, gross negligence was defined as: 'negligence which borders on wilful misconduct in terms of reprehensibleness' (*Codam v. Merwede*); in 1997, in *Municipality of Stein v. Driessen*, the Supreme Court brought it under the concept of '*bewuste roekeloosheid'*, intentional recklessness. It was defined as: 'an act or omission to act, that occurred recklessly and with the knowledge that damage would probably be caused'. This definition was taken from international conventions and Dutch transport law (compare Haak, note in *NJ* 2000, 429, *Solon case*, see *infra*).

Thus, 'ordinary' negligence of a contracting party could be exempted; the position on serious negligence, not leading to acceptance of gross negligence, for some time remained unclear. In the case *Saladin v. HBU* of 1967, it was held that the 'measure of fault' was relevant in examining reliance on exemption clauses, in its relation to the nature and importance of interests of parties involved, and the circumstances of the case. The latter being: the nature and contents of the contract, the societal position of the parties, the way in which the clause was agreed to by parties and the measure in which parties had realised the clause's tenor. As a consequence, much was left at the discretion of the courts, when application of an exemption clause was disputed.

A major development occurred in two decisions, where contrary to earlier cases, no consumer interests were involved, but the disputes concerned two commercial parties. In *pseudo-bird pest* (1976), it was held that in case the contractor is a company, management personnel ('*leidinggevende personeel'*) was to be taken at the same level as the contracting party itself (the legal entity). It was also ruled, that the issue whether liability for damages caused by gross negligence or wilful misconduct of a party's employees (being non-management personnel) could be exempted, will depend on a number of criteria in the light of the circumstances, and governed by good faith. This is also the rule in case of serious negligence ('*ernstig verwijtbaar handelen'*) of the contractor or its personnel.

Another leading case, of even greater importance, is *Matatag v. De Schelde*, of 1993, where the former decision is refined (the case will be discussed in more detail below). Here the Supreme Court found of importance that both parties were companies belonging to sectors of trade that were in a continuous course of dealing with each other and where standard clauses, including exemption clauses, were an everyday appearance (parties were a shipowner and a wharf). The addition made to the *pseudo-bird pest* rule, was directed at serious negligence ('*ernstige fouten'*) of personnel employed, that did not belong to the company's management ('*bedrijfsleiding'*). That personnel can be the company's own employees or, as was the situation in the case at hand, employees of a subcontractor hired to do work on the project (as pipefitters). Gross negligence, or wilful misconduct was not at issue, since the Court of Appeal, contrary to the District Court's decision, held that only serious negligence of personnel was involved (see *infra*).

## 3. The role of equity in regard to exemption clauses

In a long tradition, the insurance issue is deemed relevant in the construction and application of exemption clauses. The common context is, that the party relying on the exemption clause, did not have, or not sufficiently have, access to the insurance market to have its risks covered by insurance, whereas the opposing party is carrying adequate insurance for the risk in question. Thus, the insurance factor is taken into account by the courts in examining the use of exemption clauses. Leading cases are: *Bovag II* (*NJ* 1959,37) and *Bovag III* (*NJ* 1965, 37). Compare Van Dunné, *o.c.*, p.409 ff.

This line of thought was further developed, in a broader setting, in the seminal case on contract liability and force majeure, a case of failing equipment in the transport of valuable goods, the *airplane wings* case, *Fokker v. Zentveld* (*NJ* 1968, 102), which was codified in

Article 6:75 Civil Code. Reference is made to Van Dunné, *o.c.*, p.412 ff. According to the rule accepted, a contractor's liability for failing equipment is based on the law, the general opinion in society and reasonableness. When the party in question is not (sufficiently) insured for the damage that might be caused in the course of performance of contract, in a situation where the compensation for his work is not in balance with the value of goods dealt with, and the risks involved, according to the norms mentioned, that party will not be held liable for the damage caused. The Supreme Court furthermore held that the fact that a certain party is insured for the risks incurred, is an indication of the general view accepted in society, that the specific risk should lie with that party.

Fokker, the owner of the airplane wings transported, was adequately insured, and the (Italian) insurance company had redress on the contractor, Zentveld, a minor firm that was hired on a marginal hourly rate (NLG 17.50), to lift the wings from barges unto trucks by mobile crane, when they came in. A wing crashed when a bolt of the crane broke, due to an internal defect, invisible with the naked eye, causing NLG 80,000 damage to Fokker; Zentveld's insurance coverage (for the firm's two cranes) only was NLG 20,000. Incidentally, for a marginal increase of Fokker's insurance premium, its policy could have included Zentveld's risks (striking the insurer's right of redress by waiver of subrogation). Furthermore, Zentveld was told by a Fokker manager, that he should not worry about liability, since Fokker was insured for the risks involved. Unfortunately, Zentveld was unable to prove that in court.

In the decision of 12 May 2000, in *Mushroom farm* case (*JOL* 2000, 281), the insurance aspect was considered to be one of the relevant factors to be taken into consideration in the assessment of reliance on exemption clauses by a contract party. Since the Court of Appeal did not explicitly deal with the relevant circumstances, its decision was quashed.

An important extension to the present rule was given in the case of *Heeren v. Mertens Bouwmaterialen*, Hoge Raad 15 December 1995, *NJ* 1996, 319; see also: Court of Appeal Arnhem 27 May 1997, *NJ* 1999, 292; compare Van Dunné, *o.c.*, p.437 ff. In a sale of building materials, an exemption clause was applied by the vendor when the materials proved defective and damage was caused to the purchaser, who claimed compensation. The Supreme Court held that, as alternative to insurance, redress upon third parties, based on warranties, may be taken into account in the assessment of reliance on an exemption clause. In the present case, the vendor could have fallen back upon the producer of the materials, on the basis of warranties of merchantable quality and fitness for purpose, thus shifting liability to that third party. In a final decision of the Court of Appeal, it was held, on the grounds set out by the Supreme Court, that the vendor's reliance on the exemption clause, should be rejected, as clearly unreasonable against the purchaser of the materials.

## B. THE COMMON LAW APPROACH TO EXCLUSION CLAUSES AND INSURANCE

Leading cases

*Photo Production Ltd v. Securicor Transport*, of 1980, en *Ailsa Craig Fishing Co Ltd v. Malvern Fishing Co Ltd*, of 1981.[1]

[1] Resp.: (1980) *All ER* 556; (1983) *All ER* 101; cf. also my *Verbintenissenrecht 1*, p.417 v.

1. Lord Diplock's opinion, in support of Lord Wilberforce:

'For the reasons given by Lord Wilberforce it seems to me that this apportionment of the risk of the factory being damaged or destroyed by the injurious act of an employee of Securicor while carrying out a visit to the factory is one which reasonable businessmen in the position of Securicor and Photo Production might well think was the most economical. An analogous apportionment of risk is provided for by the Hague Rules in the case of goods carried by sea under bills of lading (…).

Either party can insure against it. It is generally more economical for the person by whom the loss will be directly sustained to do so rather than that it should be covered by the other party by liability insurance.'

2. Lord Wilberforce:

'they must be related to other contractual terms, in particular to the risks to which the defending party may be exposed, the remuneration which he receives and possibly also the opportunity of the other party to insure' (per Lord Wilberforce).

3. Lord Wilberforce, *Photo Production,*:

[in the light of the 1977 Act] 'in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case of judicial intervention undemonstrated, but there is everything to be said … for leaving the parties free to apportion the risks as they think fit and for respecting their decisions'.

Recent cases[2]

*Edmund Marray* ('rig')

Court of Appeal, *Watford Electronics*.[3] (Watford is buyer, Sanderson vendor):

(i) 'there was a 'significant risk' that a non-standard software product, "customised" to meet the particular marketing, accounting or record-keeping needs of a substantial and relatively complex business, such as that carried on by Watford, might not perform to the customer's satisfaction;
(ii) if the products do not perform, there would be a further "significant risk" that the customer might not achieve the profits or savings it hoped to make, and may also incur consequential losses from the failure to perform;
(iii) such risks were, or at any rate should have been, known to both parties when the contract was made;
(iv) Sanderson was in the better position to assess the risk that the product would fail to perform;
(v) Watford was in the better position to assess the amount of the potential loss if the product did fail to perform;
(vi) the risk of loss was likely to be such as could be covered by insurance, at a cost;

both the parties would have known, or ought reasonably to have known, at the time the contract was made, that the identity of the party who was to bear the risk of loss, or the cost of insurance, was a factor which would be taken into account when working out the price at which the customer was willing to purchase.'

[2] See also: Cheshire, Fifoot and Furmston, *Law of Contract*, 14th ed., London, p.197 ff.; Lawson, o.c., p.167 ff. (business contracts).

[3] *Watford Electronics Ltd v. Sanderson CFL Ltd*, (2001) *EWCA* Civ. 317; Lawson, p.173.

‘Where experienced businessmen, representing substantial companies of equal bargaining power negotiate an agreement, they may be taken to have had regard to the matters known to them. They should … be taken to be the best judge of the commercial fairness of the agreement which they have made, including the fairness of each of the terms in that agreement. They should be taken to be the best judge of the question whether the terms of the agreement are reasonable.’

*Salvage Association* case, ‘official referee’ (High Court, the Technology and Construction Court).

## C. EXCLUSION IN GERMAN LAW, AND THE INSURANCE ISSUE

The *Werftwerkvertrag* case of 1988

Exemption clause, Conditions for Docking and Repairs:

> ‘(3) The shipyard accepts no responsibility for any damage which may be caused to or by the ship and its cargo by the intended docking neither when entering nor leaving dock, nor during the time of vessel’s stay in dry-dock nor at the shipyard nor any damage caused by reason of the work carried out. Such liability is also not accepted by the shipyard if such damage is revealed later or by the occurrence of other events. The ship is responsible for guarding and all insurances. The shipyard has no custody or other secondary obligations which would create liability in the case of non-observation.
> (4) The shipyard, however, accepts responsibility for any damage which can be attributed to severe faults on the part of its executives. In this connection executives are members of the board of directors and the yard’s executive managers only.’

The German Supreme Court came to the following decision:

‘(b) Dem BerGer. is auch darin beizupflichten, daß der allgemeiner Branchenübung, entsprechende, praktisch lückenlose und auch im vorliegenden Fall bestehende Kaskoversicherungsschutz des Schiffseigners ein entscheidender weiterer Gesichtspunkt für die Beurteilung ist, ob durch eine Freizeichnung wesentliche Rechte des Vertragspartners in einer die Erreichung des Vertragszwecks gefährdenden Weise eingeschränkt werden. Im Streitfall geht es nicht um die – im allgemeinen kritischer zu bewertende – bloße Versicherbarkeit des dem Schiff durch gefahrgeneigte Arbeiten drohenden Schadenrisikos, sondern um einen entsprechend allgemeiner Branchenübung tatsächlich bestehenden Versicherungsschutz, der das Risiko eines Sachschadens am Schiff abdeckt. Auf die – ihm bekannte – Üblichkeit eines solchen Versicherungsschutzes kann und darf der Werftunternehemer sich billigerweise einstellen. Und für den Schiffseigner macht es keinen ins Gewicht fallenden Unterschied, ob im Falle einer Beschädigung seines Schiffes sein Kaskoversicherer oder etwa ein Haftpflichtversicherer der Werft den Schaden deckt. Wär die Werft gezwungen, trotz des auf Seiten des Schiffseigners bestehenden Kaskoversicherungsschutzes ihrerseits eine Haftpflichtversicherung für das volle Sachschadenrisiko abzuschließen, müßte der Schiffseigner, nicht nur seine Prämie für die eigene Kaskoversicherung aufbringen, sondern im Hinblick auf die von der Werft zusätzlich abzuschließende umfassende Haftplichtversicherung auch eine entsprechende Erhöhung des von ihm zu entrichtenden Werklohns in Kauf nehmen 9vgl. Hierzu BGHZ 33, 216, (220) = *NJW* 1961, 212 = *LM* § 67 VVG Nr. 16). Angesichts de außerordentlich hohen Versicherungswerte vond Seeschiffen kommt diesem Gesichtspunkt im Rahmen eines angemessenen Interessenausgleichs zwischen Schiffseigner und Werft eine nicht unerhebliche wirtschaftliche Bedeutung zu. Daß etwa der Kl. wegen des hier eingetretenen Schadenfalls eine unverhältnismäßige Erhöhung ihrer Kaskoversicherungsprämie droht, wie die Revision in der mündlichen Verhandlung geltend gemacht hat, is in den Tatsacheninstanzen nicht vorgetragen worden.

Als weiteren Gesichtspunkt für seine Auffassung führt das BerGer. unter Hinweis auf BGHZ 77, 126 (133) = *NJW* 1980, 1953 = *LM* § 635 BGB Nr. 55 mit Recht an, daß der Werft durch den Anschluß einer umfassenden Haftpflichtversicherung entstehende zusätzliche Prämienaufwand die Eigner unterschiedlich risikogefährdeter Schiffe gleichermaßen treffen würde. Dadurch würden nicht nur solche Kunden zusätzlich belastet, deren Interessen bereits ausreichend gewahrt seien, diese Kunden müßten vielmehr einen Teil der Reparaturkosten für besonders risikogeneigte Schiffe mittragen, während die Eigner dieser Schiffe dadurch einen sachlich nicht gerechtfertigten Vorteil hätten.'
[Abridgements: 'BerGer.' = Berufungsgericht, here: Court of Appeal; 'Kl. = 'Kläger', Claimant]

'Die Werftkunden (Reder und Schiffseigner) sind ihrerseits darauf eingerichtet, daß der bestehende Kaskoversicherungsschutz, die Risiken von Sachschäden an ihren Schiffen auch insoweit abdeckt, als solche Schäden anläßlich von Schiffsreparaturen auf der Werft entstehen. Ihnen ist bekannt, daß die Schiffswerften nicht zuletzt aus diesem Grune ihre Haftung für derartige Schäden, soweit sie auf einer Verletzung von Obhuts- und Schutzpflichten der Werft beruhen, weitgehend auszuschließen pflegen. Dabei macht es für sie – wie bereits erwähnt – keinen gravierenden Unterschied, ob solche Schäden nun von ihrem Kaskoversichterer oder von den Haftspflichtversicherern der Werften reguliert werden. Die Werftkunden haben es schließlich mit in der Hand, der Verwirklichung von Risiken, wie sie ihren Schiffen durch gefahrgenegte Schweiß- und Brennarbeiten der Werft drohen, durch die Bereitstellung ihrer Schiffsmannschaften und der bordeigenen Löscheinrichtungen weitgehend entgegenzuwirken und dadurch das Entstehen von Brandschäden an ihren Schiffen zu verhindern. Wenn unter diesen Umständen die Werften sich von ihrer Haftung für die Verletzung von Obhuts- und Schutzpflichten durch einfache Erfüllungsgehilfen, die nicht leitende Angestellte sind, auch in Fällen schwerwiegenden Verschuldens freizeichnen, ohne daß den Werftkunden dadurch im Ergebnis nennenswerte Nachteile entstehen, dann läßt sich nicht feststellen, daß die Freizeichnung einer mißbräuchlichen, alleein den Geschäftsinteressen der Werften nützlichen Zielrichtung dient und die schutzwürdigen Belange der Werftkunden außer acht läßt. Es stelt demzufolge keine unvertretbare, mit den Geboten von Treu und Glauben nicht zu verienbarende Regelung i.S. des § 9 AGB-Gesetz dar, daß die bekl. Werft das Risiko für Schäden, die dem Schiff der Kl. auch durch schwerwiegende Nachlässigkeiten und Verschen der mit den Arbeiten am Schiff befaßten Hilfspersonen der Werft drohten, auf die Kl. abgewälzt hat.'[4]

Rotterdam, 4 August 2005

[4] *NJW* 1988, 1785. For a discussion of this case and German law on the subject, see: Van Dunné, *o.c.*, 5th ed. 2004, p. 455-459.