When “Skin in the Game” Meets Uninsurable Risk: Rethinking “Knock-for-Knock” Carve Outs

By Glenn Kangisser, Teena Grewal | February 5, 2026

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In the offshore oil and gas sector, procurement contracts have long served as sophisticated risk management tools designed to promote commercial certainty by clearly defining parties’ obligations and allocating risks in a predictable and insurable manner.

Central to this framework is the knock-for-knock indemnity regime, under which each party assumes responsibility for its own and its group’s personnel, property, consequential losses and pollution from its property, regardless of fault. Operators also typically indemnify contractors for catastrophic events such as blowouts, well control incidents and major spills. This structure has long promoted efficient project delivery by reducing disputes and simplifying insurance arrangements.

However, since the Deepwater Horizon oil spill in 2010 and the oil price collapse in 2014, operators have increasingly introduced carve outs and exceptions to these well-established regimes where a loss is said to arise from the contractor’s “gross negligence” or “wilful misconduct”.

A Shift in Risk and Responsibility

Although presented as measures to enhance accountability, these carve-outs can expose contractors to substantial, uninsurable liabilities that far exceed the value of their contracts. Under English civil law, “gross negligence” has no fixed legal meaning distinct from negligence. However, when the term “gross negligence” is used in an English law contract without being defined, English courts will interpret its meaning in the context of the contract. If the term is defined in an English law contract, English courts will normally look to that definition. Definitions of “gross negligence” and “wilful misconduct” vary widely between contracts and jurisdictions. Courts must therefore interpret these concepts on a case-by-case basis, particularly in complex, high value scenarios. This uncertainty increases the likelihood of disputes following major incidents.

Gross Negligence/Wilful Misconduct (GM/WM) carve outs undermine the traditional knock-for-knock model by introducing unpredictability into a regime designed to provide stability and insurability for both parties and the wider supply chain.

Insurance Gaps and Commercial Impact

Contractors generally do not insure against losses relating to the operator group’s personnel, property or catastrophic events, as these risks are traditionally assumed by operators. Contractors may not be able to procure adequate insurance for such losses in the case of their “gross negligence” or “wilful misconduct.” Standard liability policies typically exclude cover for wilful misconduct and may exclude gross negligence, leaving contractors without adequate protection. Contractors often cannot fully pass carve outs down to their supply chain, widening the insurance and liability gap.

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Contracting Complexity and Cultural Risks

GN/WM carve outs complicate negotiations and turn standard indemnity terms into extended debates over definitions, liability caps and exclusions. This increases transaction costs, prolongs dealmaking and strains commercial relationships. GN/WM carve outs also increase the likelihood, cost and duration of disputes by shifting resolution from insurers to litigation focused on intentions and degrees of fault.

There are cultural implications as well. In a safety-critical industry, transparency and timely incident reporting are essential. Fear of liability can encourage defensive behaviour or under-reporting, undermining the collaborative safety culture essential to offshore operations.

Balancing Accountability and Practicality

While some argue that GN/WM carve outs promote accountability, they often do so at the expense of commercial clarity and insurability. Effective accountability is better achieved through strong prevention systems, early reporting and shared responsibility. A focus in contracts on managing risk effectively rather than assigning blame supports transparency, trust and collaboration.

Toward a More Balanced Approach

Rather than defaulting to GN/WM carve outs, industry participants should reevaluate the principles underlying offshore risk allocation. Potential improvements include:

- Using clear, objective definitions of “gross negligence” and “wilful misconduct,” limited to senior personnel.
- Applying reasonable monetary caps for liability arising from “gross negligence” and “wilful misconduct” findings.
- Consulting insurers at the drafting stage to explore possible tailored coverage solutions, understanding that full coverage may not be possible.
- Investing jointly in training, safety systems, incident reviews and transparent reporting frameworks to reduce the likelihood of catastrophic events and the disputes that inevitably follow.

Conclusion

Offshore oil and gas operations inherently involve significant risk, which the knock-for-knock indemnity regime has long managed in a stable and insurable way. Broad GN/WM carve outs threaten this stability by creating uninsurable liabilities and uncertainty across the supply chain. A more balanced and commercially realistic approach that supports accountability, without undermining collaboration, is essential for the long-term sustainability of offshore oil and gas projects.

For a more detailed discussion, please click here.

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