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Insurance issues for commercial development

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What this talk will cover

- Key insurance terminology
- Who takes out the insurances?
- What is the issue for drafting and agreeing construction contracts?
- JCT 2016
- What is the best solution for each (new build and fit-out)?
- Gard Marine
  - The facts
  - The main issues
  - The court decisions (Commercial Court, Court of Appeal and Supreme Court)
  - Implications

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Key insurance terminology (1)

- **Contractors All Risk (CAR) Insurance (construction insurance):** provides cover against the risk of accidental physical damage to the construction works, however caused (subject to exclusions). Construction works includes the 'permanent works' (the project's intended outcome) and the 'temporary works' (the structures and materials needed to achieve, but will not form part of, the outcome).

- **Existing Structures (property insurance):** when works are carried out on an existing building under a JCT contract, insurance "Option C" covers damage to existing parts of the building as a result of the renovation or refurbishment works. (joint employer and contractor)

- **Public Liability Insurance:** covers injuries to third parties or damage to third party property arising from or in the course of business (not including liability for products supplied).

Key insurance terminology (2)

- **Employer's Liability Insurance:** covers an employer for liability arising out of illness or injury to an employee sustained as a result of their work for the employer. It is a legal requirement upon all employers.
- **Professional Indemnity Liability Insurance:** covers professional service providers in the event of a claim by an individual (usually a client but could be a third party) who has suffered loss or harm as a result of breach of contract, non-performance or negligent performance of the service. It covers damages and legal costs associated with defending the claim.
- **Co-insurance:** where the insurer and the insured, or multiple insurers, share the risk.

Key insurance terminology (3)

- **Composite insured:** two or more persons with a separate interest in the subject matter of the insurance are parties to the same insurance contract. Each insured's right to claim insurance is independent of its co-insured so a party can claim even if another has breached any terms of the contract.
- **Waiver of subrogation:** subrogation is the right of an insurer to 'step into the shoes' of its insured and recover part of a payment it has made in respect of a claim from a third party that was partly at fault. Waiver of subrogation is where the insurer agrees not to exercise that right in the event of a pay out.
- **Joint Names Policy (JCT definition):** a policy of insurance which includes the Employer and the Contractor as composite insured and under which the insurers have no right of recourse against any person named as an insured, or, pursuant to clause 6.9 [(sub-contractors)], recognised as an insured thereunder.

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Who takes out the insurances?

- JCT Options A, B and C
  - Option A – New build - Contractor takes out Joint Names All Risks Insurance
  - Option B – New build - Employer takes out Joint Names All Risks Insurance
  - Option C – Employer takes out Joint Names All Risks Insurance and Joint Names Specified Perils insurance for existing structures (e.g. refurbishment)
- Property owned by a landlord
- Landlord's Insurance?
- New position under the JCT 2016 suite

What is the issue for drafting and agreeing construction contracts? (1)

- CAR insurance usually deals with damage by splitting it into 3 categories:
  1. Damage to insured property/works.*
  2. Consequential loss.
  3. Liability to third parties.
- In the case of a fit-out, a landlord is unlikely to accept adding a contractor to its building insurance for the duration of the works.
- This is problematic because it leaves the contractor without cover if its works cause damage to other existing parts of the property.
  - For example if a fit out works to one floor result in the flooding of another, this would not be covered by CAR insurance.

*CAR will only cover this category.

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What is the issue for drafting and agreeing construction contracts? (2)

- By way of compromise, a tenant may
  - seek a waiver of subrogation against itself and the contractor from the landlord's insurer; or
  - rely on the contractor's public liability insurance, CAR insurance on a limited reinstatement value.
- What is the effect on price?

JCT 2016 (1)

- Clause 6.1

  The Contractor shall be liable for, and shall indemnify the Employer against, any expense, liability, loss, claim or proceedings whatsoever in respect of personal injury to or the death of any person arising out of or in the course of or caused by the carrying out of the Works, except to the extent that the same is due or any act or neglect of the Employer, any Employer's Person or any Statutory Undertaker.

- Clause 6.2

  Subject to clause 6.3, the Contractor shall be liable for, and shall indemnify the Employer against, any expense, liability, loss, claim or proceedings in respect of any loss, injury or damage whatsoever to any property real or personal in so far as such loss, injury or damage arises out of or in the course of or by reason of the carrying out of the Works and to the extent that the same is due to any negligence, breach of statutory duty, omission or default of the Contractor or any Contractor's Person

JCT 2016 (2)

- Clause 6.3
  1. Where paragraph C.1 of Insurance Option C applies, the Contractor's liability and indemnity under clause 6.2 excludes any loss or damage to Existing Structures or to any of their contents required to be insured under that options that is caused by any of the risks or perils required or agreed to be insured against under that option.

  2. The exclusion in clause 6.3.1 shall apply notwithstanding that the loss or damage is or may be due in whole or in part to the negligence, breach of statutory duty, omission or default of the Contractor or any Contractor's Person.

JCT 2016 (3)

- Schedule 3 Insurance Option C

C.1 The Employer shall unless otherwise stated by the Contract Particulars for clause 6.7 and this Schedule effect and for the period specified in clause 6.7.2 maintain a Joint Names Policy in respect of the Existing Structures together with the contents of them owned by him or for which he is responsible, for the full cost of reinstatement, repair or replacement or loss or damage due to any of the Specified Perils.

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What is the best solution for each (new build and fit-out)?

- **New build:**
  - Project insurance by Employer
  - CAR insurance by Contractor
- **Fit-out:** Landlord includes the Contractor as a joint name on Existing Structures insurance or has its insurer waive subrogation against the Contractor.

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Insurance Issues for commercial development (Part 2 – *Gard Marine* (Supreme Court, 10 May 2017))

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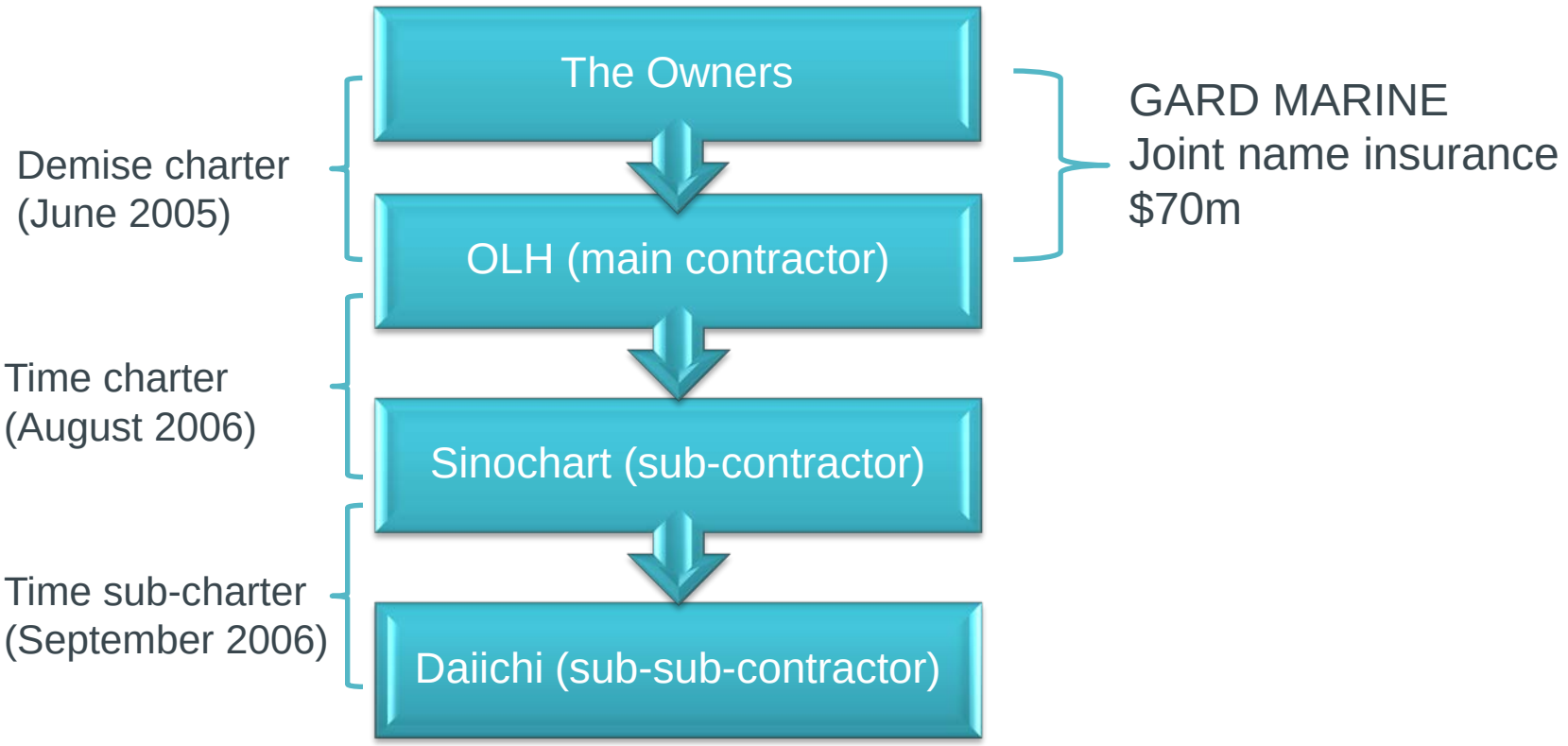
- The facts and the decisions
- Implications

The facts (1)

The Parties



The facts (2)

- Daiichi (the sub-sub-contractor) sub-chartered “OCEAN VICTORY” in mid September 2006
- Sailed from South Africa (Saldanha Bay) to Japan (port of Kashima)
- Arrived in Kashima a month later and discharged her cargo
- On leaving port she sank
- Insurers (including Gard Marine) paid out €70m under hull insurance (she was worth €88 million)
- Insurers took assignment of owner’s/main contractor’s rights, and sued the sub-contractor (Sinochart)
- Sub-contractor sought to pass on any liability to Daiichi (sub-sub-contractor)

The Main Issues

- Was there a breach of the safe port warranty?
- Could the Owner/main contractor (or Gard Marine as their assignee) bring a claim against the sub-contractor (Sinochart) in respect of insured loss, even though Owner and main contractor had bought joint name insurance?
- If the answer was “yes”, then the sub-contractor (Sinochart) could pass liability down the contractual chain to sub-sub-contractor (Daiichi).

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The Commercial Court decision (30 July 2013)

- A triumph for insurers
- Sub-contractor (Daiichi) had breached the safe port warranty
- Insurers (as assignee of Owner's/main contractor's claim) could sue sub-contractor (Sinochart) (who could then sue the sub-sub-contractor (Daiichi) for the entire value of the ship (($88million), plus uninsured losses (wreck removal costs and loss of hire)

Court of Appeal decision (22 January 2015) (1)

- Unanimous decision (Longmore, Gloster and Underhill LLJ)
- A triumph for the sub-contractors
- No breach of safe port warranty – trial judge reversed on factual issues
- Trial judge also reversed (obiter) on the recoverability/co-insurance issues
- Court of Appeal said that Owner could **not** claim against main contractor (who, in turn, could not sue sub-contractor (Sinochart)), due to terms of contract/co-insurance arrangements

  "… *even if the* [main contractor] *had been in breach of* [contract], [the main contractor was] *under no liability to the owners for that breach because the owners had agreed to look to the insurance proceeds rather than to* [the main contractors] *for compensation. The* [main contractor] *cannot therefore show that they have suffered any loss as a result of the* [sub-contractor's] *breach of* [contract] *and the* [sub-contractor has] *no liability to the* [main contractor] *which* [the sub-contractor] *can pass on* [to] *the* [sub-sub-contractor (Daiichi)]" (Longmore LJ, paragraph 92) (emphasis added)

- Didn't matter if insurers didn't pay, or went insolvent

Court of Appeal decision (22 January 2015) (2)

- Construction cases applied (CAR policies; joint names)

  "*….it would be nonsensical if those parties who were jointly insured under the CAR policy could make claims against one another in respect of damage to the contract works. Such a result could not possibly have been intended by those parties…..*" (Mr Recorder Jackson QC in Hopewell v Ewbank (1998)).

  "[The Court of Appeal] *would,* [as] *in GD Construction v Scottish & Newcastle (2003) … say that the prima facie position where a contract requires a party to that contract to insure should be that the parties have agreed to look to their insurers for indemnification rather than to each other. That will be all the more so if it is agreed that the insurance is to be in joint names for the parties' joint interest …*" (Longmore LJ, paragraph 83, *Gard Marine*)

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The Supreme Court decision (10 May 2017) (1)

- Confirmed no breach of the safe port warranty
- 2 different approaches on the recoverability/co-insurance issue (the majority approach and the minority approach)

The Supreme Court decision (10 May 2017) (2)

The Majority Approach (Lords Toulson, Hodge and Mance)

- Upheld the Court of Appeal
- Owner could not sue the main contractor for losses covered by joint insurance, so there was no liability to pass down contractual chain
- Joint names/co-insurance provision was part of a comprehensive scheme to cover losses
- Risk was allocated to the insurers. Policy decision to avoid litigation between the parties to establish liability

> "*The critical question is whether the contractual scheme between the owners and the* [main contractor] *precluded any claim by the former against the latter for the issued loss…This is a matter of construction. It has become a common practice in various industries for the parties to provide for specified loss or damage to be covered by insurance for their mutual benefit, whether caused by one party's fault or not, thus avoiding potential litigation between them. The question is each case is whether the parties are to be taken to have intended to create an insurance fund which would be the sole avenue for making good the relevant loss or damage, or whether the existence of the fund co exists with an independent right of action for breach of a term of the contract which has caused that loss. Like all questions of construction, it depends on the provisions of the particular contract*". (Lord Toulson, paragraph 139, *Gard Marine*)

The Supreme Court decision (10 May 2017) (3)

The Minority approach (Lords Sumption and Clarke)

- Because of the particular terms of the contract, the minority considered that the main contractor **would have been** liable to owner for losses covered by joint names insurance

- Liability was not expressly or impliedly **excluded** by the terms of this contract. Joint insurance was the means to **satisfy** the main contractor's liability to the Owner. It did not **exclude** the liability. Liability **could** therefore be passed on down the contractual chain

Reasons for the minority approach

- A different approach – based on strict interpretation of the contract (a "Commercial Court approach", not a "TCC approach"?)

- Liability of main contractor not expressly excluded. The relevant term of the particular contract, did not oust insurers' right of subrogation (unlike another alternative clause in the same contract)
  - *"The* [contract] *contains a clear and express safe port warranty. If clause 12 were to be construed as an exhaustive code, that clause would be rendered nugatory with regard to insured risks. It would in effect exempt the* [main contractor] *from liability for breach of the safe port warranty in exchange for paying for the full insurance. For that to be the intention of the parties there would have to be* [spelled out in] *clear words".* (Lord Clarke, paragraph 52, quoting from/agreeing with the Commercial Court)

- Lord Sumption stressed that the *Gard Marine* case was unique, because it raised for the first time:
  - *"…the question of how the principle about co-insurance* [i.e. co-insureds cannot sue each other for insured loss] *affects claim against a third party wrongdoer who is not himself a co-insured and is not party to the arrangements between them. There is no necessity to exclude a claim against him and indeed no reason why either of the co-insureds or their insurer should wish to do so. It is impossible to identify any contract whose business efficiency depends upon that result being achieved…"* (Lord Sumption, paragraph 99)

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Implications?

General co-insurance rule confirmed by the minority

"*It is well established, and common ground between the present parties, that where it is agreed that the insurance shall inure to the benefit of both parties to the contract, they cannot claim against each other in respect of an insured loss. Coinsurance is the paradigm case.* …[As confirmed] *by the House of Lords in Co-operative Retail Services Ltd v Taylor Young Partnership Ltd [2002] 1 WLR 1419… it is an implied term of the contract of insurance and/or of the underlying contract between the co-insureds pursuant to which their interests were insured. The implication is necessary because if the co- insureds are both insured against the relevant loss, the possibility of claims between them is financially irrelevant. It would be absurd for the insurer to bring a subrogated claim against a co-insured whom he would be liable to indemnify against having to meet it*" (Lord Sumption, paragraph 99) (the minority)

General co-insurance rule confirmed by the majority

It is well established, as [the minority judges in *Gard Marine*] *acknowledge, that, where it is agreed that insurance shall inure to the benefit of both parties to a venture, the parties cannot claim against each other in respect of an insured loss. This principle is now best viewed as resting on the natural interpretation of or implication from the contractual arrangements giving rise to such co-insurance: Co-operative Retail Services Ltd v Taylor Young Partnership Ltd* (2001)*…*". (Lord Mance, paragraph 114 (the majority)).

General implications – where is joint names / co-insurance used? (1)

- Affirmation of general rule (co-insured cannot sue each other for insured loss)
- Policy decision to avoid litigation – welcome in spheres where co-insurance / joint names insurance is used
  - Construction (JCT standard forms)
  - Commercial property (*Rowlands v Berni Inns* (1986))
  - Shipping (BIMCO standard form agreements)

Implications in Construction (1)

- Joint names Contractors' All-Risk ("CAR") cover is common. Main contractor and specified sub-contractors named on policy

  "*In the case of a building or engineering contract, where numerous different sub-contractors may be engaged, there can be no doubt about the convenience from everybody's point of view, including, I would think, the insurers, of allowing the head contractor to take out a single policy covering the whole risk, that is to say covering all contractors and sub-contractors in respect of loss of or damage to the entire contract works. Otherwise each sub-contractor would be compelled to take out his own separate policy. This would mean, at the very least, extra paperwork; at worst it could lead to overlapping claims and cross-claims in the event of an accident. Furthermore, …the cost of insuring his liability might, in the case of a small sub-contractor, be uneconomic. The premium might be out of all proportion to the value of the sub-contract. If the sub-contractor had to insure his liability in respect of the entire works, he might well have to decline the contract*" (Lloyd J in *Petrofina v Magnaload* (1984))

  "[The] *clear intention of the JCT forms as a whole was that the risk of damage due to a specified peril should fall upon the insurers, rather than the parties to the relevant contracts*" (HHJ Peter Coulson QC, *Hunt v ASME*, 27 June 2007 (paragraph 32)).

- JCT definition of "joint names policy" (mirrors the general rule, affirmed in *Gard Marine)*.

  "[A] *policy of insurance which includes the Employer and the Contractor as composite insured and under which the insurers have no right of recourse against any person named as insured*…" (Keating on Construction Contracts, 10th edition, paragraph 20-394)

Implications in Construction (2)

- What about a sub-contractor who is not party to co-insurance? Does he 'get away with it'?
- Possibly, subject to:
  - losses that fall outside insurance cover (e.g. wreck removal costs in *Gard Marine*, and possibly loss of profit claims / increased cost of working claims in construction)
  - availability of other claims against sub-contractor?
  - *Gard Marine* hinted at tort claims being available, in addition to contract claims (to circumvent apparent unfairness?)

Implications in Construction (3)

- Relying on tort claims against sub-contractors who are not co-insureds. Not necessarily straightforward.
  - Norwich City Council –v- Harvey (1989)
    Employer failed to show that sub-contractor owed employer a duty of care, because they had each contracted with the main contractor on the basis that the Employer had assumed the risk of damage by fire.

    "…*Where the parties have come together against a contractual structure which provides for compensation in the event of a failure of one of the parties involved the court will be slow to superimpose an added duty of care beyond that which was in the contemplation of the parties at the time that they came together*" (Purchas LJ in Pacific *Assocates v Baxter* (1990)).

    "…*In comparable situations the Courts have set their face against imposing obligations in tort where the parties have chosen to regulate their relationships by contract*" (Tuckey J in *Saipem v Dredging* (1993)).

    "[There] *is generally no assumption of responsibility by the sub-contractor or supplier direct to the building owner, the parties having so structured their relationship that it is inconsistent with any such assumption of responsibility*" (Lord Goff in *Henderson v Merrett* (1995))

Implications in Construction (4)

"*The general reason for rejecting* [the imposition of a duty of care by the sub-contractor to the employer] *is based on a consideration of the JCT contractual provisions as a whole, both main contract and sub-contract….* [The main contract]…*provided an extensive indemnity to the employer… in respect of negligence on the part of* [the main contractor] *and any sub-contractor…or sub-subcontractor…who happened to be on site. But that wide indemnity* [excluded] *…loss and damage to the existing structures caused by fire. In other words, the parties to the main contract and any sub-contract would have known that, if there was fire which caused damage…, that damage would be insured under the Joint Names Policy, and that*…[the] *employer, would look to the insurers to pay for the cost of reinstatement…. It would be inconsistent with that overall regime for any party to seek to sidestep the allocation of risk and responsibility set out in these lengthy forms of contract, by trying to investigate possible causes of action against the subcontractor in negligence*" (HHJ Peter Coulson QC at paragraph 38 of *Hunt v ASME* (2007))

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Conclusions

- Co-insurance rule confirmed
- Terms of contract paramount
- Unintended consequence? – sub-contractors who are not a party to co-insurance arrangements potentially ‘get away with it’?
- Use of specialist sub-contractor collateral warranties - are they still useful in the light of the Gard Marine case?

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Questions?

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