



Allocating and insuring risk - key issues when drafting insurance and liability clauses

Where multiple businesses enter into arrangements to share responsibilities in relation to a particular project or asset, questions arise as to who should be liable for what risks (and to whom) and who should take the responsibility for obtaining insurance against those risks. This is often dealt with in an insurance and liability clause that specifies: (i) what risks each party is liable for; (ii) which risks are to be covered by insurance; and (iii) who is required to take out such insurance.

A number of recent cases have highlighted the importance of drafting such clauses, and insurance policies taken out pursuant to them, carefully. This will ensure that the agreed approach to allocating risk cannot be displaced in court action in the future.

Businesses operating in the construction sector will be familiar with these issues, which have been before the courts on numerous occasions. However, the principles can apply to any scenario where parties have chosen to allocate risks in a contract.

Examples

- Leasing of real property.
- Leasing or chartering of ships, planes, rolling stock etc.
- Construction contracts.
- Employment related contracts (*see Rathbone v Novae overleaf*).
- Service contracts.

The problem with subrogation

Insurance law provides an insurer with an automatic right of subrogation once it has indemnified its insured. This entitles the insurer to pursue, in the name of the insured, actions against third parties who are responsible for the loss which was the subject of the insurance.

This right has frequently caused problems where the parties to an agreement had not intended that they should be entitled to sue each other in respect of the given risk and have instead decided to seek indemnification from insurance.

For example, say a contractor and sub-contractor agree that the contractor will obtain insurance for the benefit of itself and the sub-contractor against damage by fire. The sub-contractor negligently causes a fire so the contractor claims on the insurance policy and is indemnified by the insurer – can the insurer subrogate to the contractor’s rights and sue the sub-contractor in negligence for the losses caused by the fire?

A matter of construction

There has historically been some ambiguity as to how this issue should be approached by the Court but in *Gard Marine v China National Chartering* (2015) the Court of Appeal confirmed that the answer lies in the proper construction of the underlying contract between the parties – not the terms of the insurance contract.

The Court held that if it is clear from the underlying contract that the parties’ intention was that they should look to insurance for indemnification in respect of a particular risk and not to each other, they will be precluded from suing one another in respect of that risk. In short, properly construed, the obligation to insure can amount to an exclusion of liability between the parties. Accordingly, the insurer’s right of subrogation cannot be meaningfully engaged because it does not have any greater rights under subrogation than the party whose shoes it is stepping into.

The Court’s approach to interpreting obligations to insure

- If the contract contains an obligation to insure a risk there will be a presumption that the parties intended not to be able to sue each other in respect of that risk.
- That presumption will be stronger if the provision requires the insurance to be taken out as co-insurance (see below) or there are other special circumstances which favour such an interpretation.
- As such an interpretation effectively amounts to an exclusion clause, the words in the underlying contract must be construed carefully.

Make it clear in the contract

Given the approach of the Court, if parties to an agreement want to exclude liability between each other in respect of a particular risk and instead look to an insurance policy, it should be expressly stated in the contract.

This can be done by way of express clauses that: (i) require one party to obtain insurance in respect of the relevant risk; and (ii) exclude liability between the parties in respect of the same risk.

If, on the other hand, the parties do want to retain the right to sue each other, and the obligation to insure is there to give comfort that there is financial substance behind the parties' promises, then this should also be stated expressly to avoid an inadvertent exclusion of liability where it was not intended.

Drafting the insurance to match the contract

In order to remove the risk that the insurer seeks to enforce subrogation rights, the parties should seek an express provision in the policy denying the insurer's rights of subrogation.

A no-subrogation clause in the policy coupled with an exclusion of liability in the underlying contract should ensure that the liability for the risk in question stays with the insurer.

Co-insurance or single name insurance

While a contract may provide that one party procure the insurance, an important issue to consider is whether the insurance should be in the name of that party or both parties to the contract.

As was highlighted in *Gard Marine*, naming both parties as insured on the policy (i.e. co-insurance) strengthens the presumption that the parties did not intend to be able to sue each other and so no effective right of subrogation can be taken by the insurers.

Rathbone v Novae (2014)

Rathbone is a case where the issues caused by subrogation and obligations to insure in an employment context were raised.

Rathbone, whose business included the management of trusts, had engaged an individual, V, under a consultancy agreement to provide professional trustee services to *Rathbone's* customers. The consultancy agreement contained: (i) an indemnity from R in respect of third party liabilities V incurred in the performance of his duties; and (ii) an obligation on *Rathbone* to procure insurance in respect of the same liabilities.

V was sued in his capacity as a trustee and, along with *Rathbone*, claimed on *Rathbone's* professional indemnity insurance. The insurance provided that it would afford cover to *Rathbone* and its

employees. The insurers contended that V was not an employee (and instead a consultant) and therefore not covered. The insurers also argued that if V was an employee and could claim on the policy, the insurers would be subrogated to V's right to claim indemnity for the same loss under the indemnity in V's consultancy agreement.

The Court of Appeal held that V was an employee and was covered under the policy and that the insurers had no right to subrogate a claim under the indemnity in the consultancy agreement. It was clear to the Court that the intention of *Rathbone* and V was to look first to insurance for the risks covered by the indemnity and so no right of subrogation could apply.

Key points

- Agree with counterparty which risks will be insured and which will fall to the parties.
- Expressly exclude the parties' liability to each other for the insured risks if the intention is to have sole recourse to policy.
- Include an express obligation to insure, and provide the key terms that the insurance must contain.
- Engage with insurance brokers and lawyers to ensure that the insurance is back to back with the contractual provisions on risk sharing.

Contact



Kari McCormick
Partner

+44 (0) 117 902 6620
kari.mccormick@burges-salmon.com



Matthew Walker
Associate

+44 (0) 117 307 6002
matthew.walker@burges-salmon.com



Canelle Goldstein
Solicitor

+44 (0) 117 307 6070
canelle.goldstein@burges-salmon.com

Burges Salmon LLP, One Glass Wharf, Bristol BS2 0ZX Tel: +44 (0) 117 939 2000 Fax: +44 (0) 117 902 4400
6 New Street Square, London EC4A 3BF Tel: +44 (0) 20 7685 1200 Fax: +44 (0) 20 7980 4966

www.burges-salmon.com

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