

“SUB-CONTRACTORS OF ANY TIER”

WHAT’S WRONG WITH IT?

**Geoff Lord
Kennedys
July 2010**

“SUB-CONTRACTORS OF ANY TIER” WHAT’S WRONG WITH IT?

1 INTRODUCTION

- 1.1 These were the words used by a questioner at the CILA Question Time earlier this year. He was referring to CAR and EAR Single Project Policies and to a part of the definition of “Insured” within such policies. Why, went on the question, despite the use of those words, are sub-contractors often not insured and should some other form of words be used.

- 1.2 My answer today is the same as I gave at the time: there is nothing wrong with the words used. What is wrong is a combination of the failure of those preparing sub-contract documentation to reflect the apparent intention of those arranging the project policy in their documentation and the adherence by the judiciary to a somewhat artificial analysis to determine whether or not a sub-contractor is or is not insured.

- 1.3 The position I attempt to analyse here is a narrow one of:
 - 1.3.1 A single project policy insuring various parties including “Sub-contractors of any Tier”.
 - 1.3.2 In which the property Insured is, broadly speaking, all of the works comprising the project.
 - 1.3.3 In which the premium has been paid on Estimated Contract Value (“ECV”) and will eventually be paid on Final Contract Value (“FCV”) as and when declared; and
 - 1.3.4 Where ECV and FCV will include all of the value of sub-contract works.

- 1.4 In these circumstances I begin from the premise that it is the intention of those arranging the project policy, that sub-contractors should be insured by the policy. The identity of those who arrange the policy doesn’t seem to me to be of importance but they will most likely be one of the employer or main contractor.

1.5 For those who want to look at the wider relationship between the parties to construction contracts and sub-contracts in terms of liability for loss and damage and the involvement of insurance, there is a detailed analysis by Roger ter Haar QC at Chapter 13 of Construction Insurance and UK Construction Contracts, Second Edition by Levine and ter Haar where all of the authorities are reviewed and a brave attempt made to reconcile the different decisions and produce a set of guiding principles.

1.6 My object here is rather different: I begin from the premise that there is a failure to achieve what the parties intend, to identify the reason for the failure and suggest a means by which it might be put right.

2 THE PROBLEM

2.1 The manifestation of the difficulties may be in one of two ways: either a sub-contractor wishes to claim for loss or damage to the works or wishes to defend a claim by the project insurers by way of subrogation. Either way the problem is whether or not the sub-contractor is an insured under the project policy.

2.2 The first hurdle to overcome is the method by which a sub-contractor may become an insured. The sub-contractor is unlikely to either have been identified before policy inception or to be a named insured at any stage of the project. Of course, naming a sub-contractor as an insured is a simple way to ensure that they have the benefit of the policy albeit that it is not a comprehensive solution to the problem.

2.3 The way the judiciary have explained it is that the employer or main contractor needs to be authorised, expressly or by implication, by or on behalf of the sub-contractor, to effect insurance on its behalf as a member of a class. In terms, therefore, a sub-contract needs to provide that the main contractor will procure the insurance of the sub-contractor on the terms of the project policy or as the case may be. The main contractor thus becomes the agent of the sub-contractor by operation of law and is obliged to act within the terms of its agency appointment. Thus any restriction or limitation in the construction contract of the insurance to be provided will restrict the cover the main contractor is authorised to procure.

2.4 Let us look at how this has worked in practice and with particular reference to the “Joint Names Policy” enshrined in the JCT forms of contract. That which is so described in the text of the contract forms is a composite policy and not a joint policy; it is not in joint names but in several names and covers a miscellany of different interests. It is a composite policy.

2.5 It seems clear from the authorities that there is no “rule of law” to the effect that rights of subrogation cannot be exercised against a co-Insured under a composite policy. The position is not wholly clear because the proposition seems to have been assumed as well established law although its origins and basis are less than clear. In Commonwealth Construction Co Ltd -v- Imperial Oil [1977] 69 DLR (3d) 558 the Supreme Court of Canada dealt with the submission that a party fully insured under a policy would not be pursued in a claim by the Insurer by way of subrogation as follows:

“The starting point of that submission is the basic principle that subrogation cannot be obtained against the Insured himself. The classic example is, of course, to be found in Simpson -v- Thomson [1877] 3 App Cas 279. In the case of true joint insurance, there is, of course, no problem; the interests of the joint insured are so inseparably connected that the several insureds are to be considered as one with the obvious result that subrogation is impossible. In the case of several insurance, if the different interests are pervasive and if each relates to the entire property, albeit from different angles, again there is no question that the several insureds must be regarded as one and that no subrogation is possible”.

2.6 In The Yasin [1979] 2 Lloyd’s Rep 45 Lloyd J. expressed the view that the rule in his view rested on the ordinary principles of circuitry. He half repeated that view in Petrofina -v- Magnaload [1984] OB 127 but seemingly with less confidence. Circuitry arises when, in this context, Insurers pursue an Insured which can seek indemnity under the policy from the Insurers - in simple terms the action can achieve nothing. The Courts will, of course, look at the “real” position in the action notwithstanding that the Claimant named in the action is the Insured which suffered the loss.

2.7 In the first instance decision in Stone Vickers (supra) Anthony Colman QC found an implied term to the effect that there could be no subrogation against a co-Insured. Whatever the origin of the common law rule of

subrogation, the important feature is that it is a matter of implication which can be displaced by an express agreement between the parties. If the parties choose to do something beyond the scope of the common law effect will nonetheless be given to the express agreement.

2.8 Once one has decided that there are co-Insured the next consideration is the extent to which, if at all, the intended recipient of the claim is insured. If there is a problem it is unlikely to be in the context of insurable interest, at least in the case of a sub-contractor, since a sub-contractor has an insurable interest in the entire contract works and not just those comprised in the sub-contract. This follows the decision of Lloyd J. in Petrofina. The case concerned a project policy to insure the construction of Lindsey Oil Refinery in South Humberside. Lloyd J. had to consider a preliminary issue as to whether or not the Insurers had a right of subrogation against Magnaload during whose sub-contract works significant damage had been caused when a lifting gantry under dismantling fell to the ground. Lloyd J. held that Magnaload were an Insured under the policy and that the insurance extended to the whole of the contract works. The “real” Plaintiff, having paid for the repairs, was New Hampshire Insurance Company, which was held not to have a right of subrogation against Magnaload because Magnaload was an Insured under the policy. The “legal principle” underlying the decision is one considered below.

2.9 A point which did not arise in Petrofina is the question of the extent to which a sub-contractor is insured where the sub-contractor is a member of a class described in the policy but not identified as an Insured at the time the policy incepts. In these circumstances the party which takes out the insurance policy is considered to be acting as an agent for the members of the class of insureds. The authority for the agent so to do is found in the sub-contract. The mere fact there exists a project policy which covers “sub-contractors” does not, without more, mean that a sub-contractor is insured under that policy or that, if it is, the sub-contractor is entitled to the benefit of the entire cover provided by the policy. That proposition is authorised by two decisions the first of which is Boston Fruit Company -v- British and Foreign Marine Insurance Co [1906] AC 336. There Boston Fruit had chartered a vessel from owners who had insured it “... as well as in their own name as for and in the names of all and every other person or persons to whom the subject matter of this policy shall appertain in part or at all”. The vessel

was involved in a collision such that the charterer had to pay damages to the owners of the other vessel. The charterer sought indemnity from British and Foreign Marine. The decision of the House of Lords is apparent from the following extract from Lord Macnaghten's speech :

“There is not the slightest evidence of intention on the part of the owners to protect the charterers by insurance unless such intention can be inferred from the mere fact of the existence of the policy taken in connection with the language of the charter ... it seems to me that the conclusion must be that when the owners proposed to insure, acting as they did without any communication with the charterers, the charterers cannot be regarded as persons within the contemplation of the proposal”.

2.10 The second authority is the decision of the Court of Appeal in Stone Vickers Ltd -v- Appledore Ferguson Shipbuilders Ltd [1992] 2 Lloyd's Rep 578. Appledore contracted with the National Environment Research Council to build the vessel “Charles Darwin”. The vessel was to have a Stone Vickers nickel aluminium bronze controllable pitch propeller. Whilst on sea trials it became apparent that the propeller was defective (it was suspected of being a “singing propeller” which is a characteristic unacceptable in shipbuilding) such that modifications were required. Stone Vickers claimed amounts due under the contract for the supply of the propeller; Appledore counterclaimed the cost of modifications to the propeller and the cost of extending the vessel's sea trials. Those items had in fact been paid by Appledore's insurers. Appledore was a subsidiary of British shipbuilders who had the benefit of a policy which included “Sub-contractors as additional insured for their own rights and interests. Without recourse against any Co-assured”. The sub-contract between Appledore and Stone Vickers was silent as to insurance but did impose liability for defects on Stone Vickers. The Court of Appeal held that there was no evidence of intention that Stone Vickers should have the benefit of the Appledore policy and Appledore's insurers were entitled to pursue Stone Vickers in respect of the counterclaim.

- (i) To sum up : if a party is a co-Insured, has an insurable interest in the insured property, and is insured under the policy for the particular loss then that party is immune from a subrogation action.

- (ii) A co-Insured may render itself vulnerable to a subrogation action if it is in breach of duty i.e., if the Insurer can avoid the policy in so far as it covers the co-Insured, or if the co-Insured is guilty of wilful misconduct in bringing about the loss.

2.11 One therefore looks for evidence of intention that the subcontractor is to be protected by the project insurance. One may find a provision to that effect in the main contract but, in general terms, that would be the exception rather than the rule and may give rise to a rather complex argument. What one all too often does find is that the main contract is silent on insurance of the subcontractor and that the subcontract then provides that the subcontractor shall insure at least the subcontract works and, probably, his own liability for the main contract works, in the joint names of the main contractor and the subcontractor. In terms: the exact opposite of an intention that the main contractor insure for the benefit of the subcontractor.

2.12 Quite what process of thought goes into the preparation of the subcontract is unclear. The premium for insurance of the subcontract works has already been paid; the premium cost to the subcontractor of insuring them again will be passed on to the main contractor through the subcontract price (such that the Employer will pay, and the insurance market will receive, two premiums for the subcontract works). If one wants the subcontractor to remain liable to third parties to the construction contract then the answer is surely to structure the project insurance to cap the subcontractors cover thereunder rather than to have the same liability insured twice.

2.13 What it comes down to is that by an apparent disregard for the terms and broad intention of a project policy the subcontract draftsman achieves a situation where the subcontractor is not insured by the project policy because, in practical terms, neither the main contractor nor anyone else, has authority to insure on the subcontractor's behalf. I suggest that that is not the intention of the project insurers or those involved in the arrangement of the project insurance.

3 SUBROGATION WAIVER AGREEMENTS

3.1 Another aspect of the problem is an express subrogation waiver agreement. Two examples appear in cross liabilities or multiple insured clauses currently in use in the London Market:

(i) *“Where more than one party comprises “The Insured” each of the parties shall, for the purpose of this insurance, be considered as a separate and distinct unit and the words “The Insured shall be considered as applying to each party in the same manner as if a separate policy had been issued to each of the said parties and the Insurers hereby agree to waive all rights of subrogation or action which the Insurers may have or acquire against any of the said parties arising out of any accident in respect of which a claim is made under this insurance”.*

(ii) *“It is noted and agreed that the Insured hereunder comprises more than one party, each operating as separate and distinct entities and that cover hereunder shall apply in the same manner and to the same extent as if individual insurances had been issued to each such party.*

The rights and indemnity of any of the parties who are not guilty of any fraud, misrepresentation, non-disclosure or breach of condition shall not be prejudiced or affected by any fraud, misrepresentation, non-disclosure or breach of condition by any of the other parties comprising the Insured.

Insurers hereby agree to waive all rights of subrogation which they may have or acquire against any of the parties comprising the Insured except where such rights of subrogation are acquired in consequence of any fraud, misrepresentation, non-disclosure or breach of condition by that Insured.

In respect of design consultants and consulting engineers such waiver of subrogation will only be in excess of any Professional Indemnity Insurance in force at the time of the loss subject to a minimum sum of HK\$15,000,000.

For the purpose of the indemnity granted by this Policy claims made by any of the parties defined as the Insured against any other party so described shall be treated as though the party claiming was not named as the Insured under this Policy. Provided always that nothing herein shall increase the sum insured under this Policy.”

3.2 Much turns on the decision of Colman J. In National Oilwell (UK) Ltd -v- Davy Offshore Ltd [1993] 2 Lloyd’s Rep 582. NOW had contracted to supply to DOL a sub sea wellhead completion system to be used as part of a floating oil production facility which DOL were building for use on the Emerald Field in the North Sea. NOW issued proceedings for invoices for unpaid work; DOL counterclaimed for defective items, delay and disruption alleged to cause loss in excess of £13m. NOW defended the counterclaim on grounds including an assertion that the losses claimed by DOL had in fact been paid by the Insurers of a project policy, that NOW were entitled to indemnity thereunder and that the Insurer could not subrogate against NOW as a co-Insured. The agreement between NOW and DOL included provision for insurance by which DOL were to insure “... the work and materials in the course of manufacture until the time of delivery ...” Colman J. had to deal with several preliminary issues. The headnote which precedes a very lengthy judgment contains 21 separate findings of which the following, in summary, are relevant :

- (i) NOW was an insured under the project policy taken out by DOL but there was no reason as a matter of law why the Insurers might not become bound to NOW as a co-Insured on terms which differed from and gave less extensive cover than, those on which Insurers became bound to DOL under the same policy.
- (ii) The obligation of DOL was to procure insurance only up to the time of delivery of each item comprised in the Works and not beyond that time or in relation to other property.
- (iii) There was nothing in the agreement between NOW and DOL which gave any wider authority to DOL to bind NOW to the policy to the extent contended for by NOW. There was nothing in the pre-contractual negotiations which could amount to the

giving of authority to DOL to effect cover of the width NOW contended for.

- (iv) The waiver of subrogation clause confined its effect to claims under the policy which were insured for the benefit of the party claimed against. In so far as there was a claim for post-delivery loss the waiver of subrogation had no application to that claim.

3.3 The upshot of the various findings was that DOL's Insurers were able to pursue their claim against NOW. That decision in NOW -v- DOL was, however, based upon the terms of the waiver of subrogation in the policy. The waiver of subrogation clause in that case was separated from the cross liabilities clause and provided :

“Underwriters agree to waive rights of subrogation against any Assured and any person, company or corporation whose interests are covered by this policy and against any employee, agent or contractor of the Principal Assureds or any individual, agent, firm, affiliate, or corporation for whom the Principal Assureds may be acting or with whom the Principal Assureds may have agreed prior to any loss to waive subrogation, including but not limited to helicopters, supply boats etc., existing installation(s) and tugs and/or Insurers. The foregoing shall not apply in respect of operations not connected with the project”.

The underlining is mine: Colman J. found that those words confined the effect of waiver to claims under the policy for losses which were insured for the benefit of the defendant party. It ruled out subrogated claims for pre-delivery losses but did not affect claims for post-delivery losses.

3.4 What if the policy had not contained the underlined words? The two examples given above do not : a literal application of those clauses suggests that the defendant party would not have to be insured by the policy in respect of the claim : quite simply the clauses do not say so. If that is the intention of those who drafted them, all well and good but, if not, then the intended result has not been achieved.

- 3.5 There is then the question of a subrogation waiver in favour of a person who is not a party to the contract of insurance at the time of the loss. There is one English case on the point : *The Surf City* [1995] 2 Lloyd's Rep 242. A cargo of naphtha was insured by Kuwait Petroleum Corporation, the policy providing that no right of subrogation was to be exercised by the Insurers against any vessel on which the naphtha was being carried, provided that the carrier was a subsidiary or affiliated company. The cargo was sold to Enimont Supply S.A. on cif terms which meant that Enimont also became the assignee of the policy. The cargo was lost due to the alleged negligence of Chesapeake Shipping Inc, which was in the same group of companies as Kuwait Petroleum. The issue in this case was whether the subrogation waiver applied only to persons actually indemnified by the policy and their affiliates of Kuwait Petroleum argued by Chesapeake. Clark J. held, as a matter of construction, that the waiver applied to Chesapeake. The parties had agreed that in that event it would not be equitable to proceed and Chesapeake was thus protected from suit.

4. **CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

The Act applies to contracts of insurance. In so far as material here it provides:

1. Right of third party to enforce contractual term

(1) ... a person who is not a party to a contract (a "third party") may in his own right enforce a term, of the contract if -

(a) the contract expressly provides that he may, or

(b) Subject to subsection (2), the term purports to confer a benefit on him

(2) Subsection 1 (b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by a third party.

(3) The third party must be expressly identified in the contract by name, as a member of a class or as answering

a particular description but need not be in existence when the contract is entered into.”

The Act came into force on 11 November 1999. Since then it has not played a part, as far as I know, in a case involving a subcontractor under a project policy. Whether, therefore, it might make a difference is a moot point. The likelihood is that a court would adopt an exercise similar to that in the authorities in section 3 above and find that, by virtue of subsection (2), there was no intention that the term should be enforceable by a subcontractor. Whatever the case, the position lacks certainty.

5. A SOLUTION?

It seems to me that, if my analysis of contractual intention is correct, then there is a remedy by reference to section 1 (1) (a) of the Act and by having the policy include an express provision such as:

“Notwithstanding anything to the contrary contained in any contract or subcontract between any of the parties hereto it is agreed and declared that subcontractors in any tier shall have the benefit of the insurance by this policy and shall for all purposes be treated as an Insured hereunder to the extent of their rights and liabilities in respect of and their interest in the Insured Property”.

I have no doubt that many of my colleagues will find ways of challenging such a provision on behalf on a project insurer who did not have the intention of including a subcontractor as an insured although quite why one should identify a class of persons, firms or companies and call them “Insured” or similar is, and always has been, somewhat unclear if one did not wish them to be exactly that.

Geoff Lord

Kennedys

London

July 15 2010