

Insurance brokers and contract reviews requested by clients - a danger area for brokers

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1 Introduction

- 1.1 Most brokers have had this experience. A client provides them with a contract (often referred to as a "retainer") they have recently entered into. The broker is asked to review the contract and ascertain what insurance cover the client reasonably requires by reason of the contractual relationship it has entered into.
- 1.2 This may sound like a simple request, but it can give rise to some of the most complex problems known to liability and insurance law.
- 1.3 For example, what appeared to be a relatively straightforward insurance and indemnity clause occupied over 365 hearing days and 10 years of litigation following an explosion at the Piper Alpha oil rig in the North Sea in 1988. Famously, after some 360 days of hearing, the trial judge decided that the plaintiffs had sued the wrong party. If the cream of the UK Bar can be under such confusion, what hope have you got?
- 1.4 This paper will hopefully set out some guidance to brokers on how to manage requests for contract reviews from clients. The key is to follow some basic steps, but more importantly, to recognise when you're out of your depth. Some contract issues are easy, but others require the client, broker and a specialised insurance lawyer to sit down and work it out.

2 The general duty of insurance brokers – how much law are you expected to know?

- 2.1 The short answer is quite a lot, particularly when you are organising policies of liability insurance. Your clients are entitled to rely on your experience to ascertain their needs, advise on what cover is available and how negotiations should be conducted with an insurer.
- 2.2 A useful summary is provided by Justice Von Doussa in *SWF Hoists & Industrial Equipments Pty Limited v State Government Insurance Commission* (1990) 6 ANZ Insurance Cases 61–002; [1990] ATPR41–045:

"Insurance brokers are required in the ordinary course of their business to have knowledge of aspects of the law which regulate insurable risks, the liabilities which can arise from the eventuation of those risks, and the types of insurance cover which can be issued to protect against them."
- 2.3 This duty is a significant one. As brokers, you are regularly involved in negotiating a product which covers legal liability. Your job requires extensive knowledge of liability law, as well as the fundamentals of insurance law.

- 2.4 Most importantly though, in difficult cases, this duty is discharged by advising the client to obtain legal advice¹. So when should you do that? I will deal with a relatively easy example, then move onto some really difficult ones.

3 Indemnity clauses and contractual liability exclusions

- 3.1 This is an issue that comes up frequently in contracts for professional services.
- 3.2 The problem is that professional service providers are usually small to medium enterprises (**SMEs**) that are frequently doing business with massive organisations - eg consulting engineers on construction projects; valuers providing mortgage valuation services to banks.
- 3.3 The behemoth client, as part of its precedent documents, usually asks for an indemnity from the service provider. For example, clauses such as:

The [service provider] will indemnify [client] against any loss and damage however caused by any breach or failure by [service provider] to perform its obligations under this agreement.

- 3.4 Or to use a more recent example:

The [service provider] and the firm or business of which they are an officer or employee indemnify and continues to indemnify [client] and its officers, employees and agents, against any claim or proceeding, and against any liability, damage, loss, cost or expense (including legal costs on a full indemnity basis) arising directly or indirectly out of:

- *Any breach of this agreement (including this brief and any letter of appointment);*
- *Any damage to real or personal property;*
- *Negligence by [service provider] or anyone for whom it is responsible in connection with providing the services detailed in this brief and any letter of appointment.*

- 3.5 So what's the problem? Any broker dealing with professional indemnity insurance, should know that an indemnity clause is likely to infringe a contractual liability or assumed liability exclusion in the policy.
- 3.6 A standard contractual liability exclusion reads as follows:

[Insurer] will not pay for any amounts insured under the policy for or arising out of ... a liability which the insured has assumed under a contract unless such liability would have attached in the absence of such contract.

- 3.7 In other words, put the contract to one side, would your insured still be liable for the same amount? That question requires a quite complicated analysis as to whether or not the insured's liability under the contractual indemnity, will be the same as liability for common law negligence or under the *Trade Practices Act* (now known as the Australian Consumer Law).

¹ See *Sarginson Brothers v Keith Moulton & Co Limited* (1942) 73 Lloyds Legal Report at 104.

- 3.8 As a general rule, liability under a contractual indemnity will be for more and be easier to prove against your insured. Causation defences which often reduce an insured's liability (and greatly improve its negotiating position) are more difficult to make out in relation to a claim for contractual indemnity. The basis for calculating damages is also different and, in relation to costs, the difference between 'full indemnity costs' and costs awarded on the usual party/party basis, can easily amount to hundreds of thousands if not millions of dollars.
- 3.9 So what should you tell your insured? These are some key pointers:
- Indemnity clauses like this are included to make it easier for the client to sue your insured successfully
 - The indemnity clause could void all or part of the liability insurance, because assumed liabilities are specifically excluded.
 - Your client can request that an underwriter provide an endorsement to cover this assumed liability, but that will often be more expensive and there is no guarantee that such an endorsement will be provided.
 - Alternatively, you can ask your client to remove the indemnity clause even though you are not covered for liabilities that arise under this indemnity clause.
- 3.10 My simple rule is that the 'I' word (I mean indemnity) has no place in a contract for professional services. It only greatly complicates the position between the insured and the insurer and is counterproductive, given that usually the main concern the client has, is that its professional service providers are adequately insured.
- 3.11 Indeed, signing an indemnity clause will often infringe other provisions of the retainer, which oblige the insured not to do anything to void their professional indemnity insurance.
- 3.12 And finally, it would be wise to advise your insured that they should seek legal advice as to whether or not this assumed liability could create a liability that would not attach in the absence of the contract. Sometimes insureds are prepared to take that risk after receiving legal advice, but that is their call – your obligation is to identify the issue and bring it to the attention of your insured.²

² Note that write backs to contractual liability exclusions can be negotiated as endorsements to the policy. Recently I saw such an endorsement in respect of a contractual liability exclusion which said the exclusion 'will not apply to a liability under this extension which the insured has assumed under a contract by reason of having contracted out of the operation of proportionate liability legislation'. Again, I personally would not advise an insured to agree to contract out of proportionate liability legislation, but it's their call to do so if they can and wish to.

4 The tough stuff – where a contract obliges an insured to organise insurance for another party

- 4.1 Frequently retainers require insureds to organise insurance for themselves and for others. This sort of clause is commonly what brokers are asked to review.
- 4.2 The simplest form of review is where an insured is asked to organise cover to a certain limit and provide evidence of adequate professional indemnity insurance cover. This is extremely simple. There is not a broker in this room, who would not have provided a certificate of currency on behalf of a client.
- 4.3 However, where the contract requires the insured to organise cover for specific risks and for other parties, the issues can become extremely complex.
- 4.4 A common but frequently misunderstood issue is organising cover for subcontractors. Many professional services businesses, rely on subcontractors to do a lot of their work. Sometimes the subcontractor only works for the insured, but perhaps more commonly, subcontractors will have a handful of businesses that they do work for. This relatively simple position, often leads to great confusion as to who is liable to whom and who should organise their own insurance.
- 4.5 A few key concepts need to be understood by brokers. They are:
- As a general rule liability follows the letterhead. If your insured has used a subcontractor to prepare work for a client, but that work has been sent out on its letterhead, then your insured is liable for that work even though the work was done by a subcontractor and not by an employee.³
 - Most professional liability policies provide 'vicarious' cover to your insured for work done by subcontractors. This means that your insured is covered but the subcontractor is not.
 - What then ensues in the event of a claim, is a subrogation action by the insurer in the name of your insured against the subcontractor. Often the subcontractor is surprised by this, as they have been told by your insured that they have organised insurance cover for them.
- 4.6 The reality is that unless a subcontractor is a named insured and entitled to the benefit of the waiver of subrogation clause in the policy, they do not have cover. Once again, it is up to brokers to identify this issue and bring it to the attention of their client. Often it would also be prudent to recommend that they obtain legal advice in relation to the contractual arrangements between the insured and the subcontractor. This is a very common problem.
- 4.7 The next layer of complexity, mainly relates to "contractors all risk" type policies. This is a highly specialised area both in practice and insurance law.

³ There are some theoretical exceptions to this rule, but I have not encountered any in practice.

- 4.8 Commonly on major construction projects, a great deal of attention is paid to the issue of who organises what insurance. 'Alliance' contracting has given rise to very specific policies where the exposures are large. Brokers involved in those types of projects, are used to working with the client and a team of lawyers, to identify the right insurance solutions.
- 4.9 The key for any broker is to identify when they are out of their depth. A contractual provision to look for, is one which obliges an insured to take out and pay for a policy that provides cover for incidents arising out of the work under the contract.
- 4.10 Such a seemingly innocent clause, can lead to horribly complex issues. I will deal with some examples in a moment, but the key point for brokers is that if a client wants you to organise the cover they are obliged to organise under a contract, the alarm bells should start ringing. As a minimum you need to go through the following checklist:
- 1 What primary liability will arise? In other words, what is the subject matter of the contract? Is it liability arising out of the construction works? Is it specific advice? Is it just a part of the works?
 - 2 Exactly which party is the insured obliged to organise insurance for?
 - 3 Is the cover vicarious or actual? In other words, does your insured wish to preserve an insurer's right of subrogation against negligent subcontractors?
- 4.11 What is commonly confused is insurance cover for loss/damage to property, against cover for negligence. Commonly a head contractor, will organise property damage cover for plant and equipment lost or damaged whilst on site. However, liability insurance is a very different thing. Usually the cover only relates to the property damage, not liability for the negligent act that may have caused it.
- 4.12 Put another way, an earthquake on a construction site which damages equipment will be a relatively straightforward insurance scenario. However, an explosion on site which 3 or 4 subcontractors may have negligently caused, will often lead to very complicated litigation involving a number of parties and their insurers.
- 4.13 Turning now to my example, I attach a paper which summarises what is commonly known as the 'ELF litigation'.
- 4.14 Briefly, the Piper Alpha oil rig exploded in 1988. Negligent work by some of the contractors was the cause of the explosion. There was much loss of life and liability.
- 4.15 The owners of the platform sued the contractors under indemnity clauses in the contract. Note that this was not just the contractors responsible for the loss and damage, but all contractors that did work on the platform who had agreed to indemnify the owners against any and all liabilities directly or indirectly caused, occasioned or contributed to by any omission or negligence of the contractors. Each contractor also organised a public insurance policy that provided cover for incidents arising out of work under the contract.
- 4.16 Even though the subcontractors were required to take insurance in the name of the owners, the owners as a precaution took out their own insurance policy. Those

insurers then issued subrogation actions in the name of the owner against each of the subcontractors.

4.17 After over 300 days of litigation, one silk had the bright idea that as the owners had already been indemnified, they had not suffered any loss and therefore had no standing to bring the claim against the contractors. That strikeout application was successful. The owners (insurer) appealed to the House of Lords. The House of Lords overturned the decision.

4.18 Key findings in the House of Lords decision are that:

- A contract of liability insurance is a contract to indemnify against loss (ie contract of indemnity).
- A party is not entitled to receive more than one indemnity in respect of one loss. It follows that, if one insurer pays the whole of this loss, the insured cannot claim any part of that loss from another insurer.
- However, where there is a primary obligation owed by a third party to an insured in respect of the loss, and the insured pays the loss, the insurer may be subrogated to the rights of the insured and sue the third party in the name of the insured.
- A liability of the third party to indemnify the insured will be a primary obligation that is not discharged by payment of an insurer (and can therefore, be the subject of a subrogated claim) where the indemnity clause is framed in a way as to make it a primary obligation.

4.19 Confused? I have tried for years to try and explain these concepts simply, but it simply takes time and patience. The simple message is that any contract needs to deal firstly with the primary liabilities, then deal quite separately with the issue of the insurance cover to be organised.

4.20 Some brokers are expert in relation to these issues, but they really are few and far between. Know your limitations and do not hesitate to recommend to the insured that they obtain legal advice as to exactly what their obligations are under the contract you have been asked to review.

5 Summary

5.1 Key points are:

- 1 As a broker you have a duty to understand key concepts of liability in insurance law. However, you can discharge this duty to your client by recommending that they seek legal advice in appropriate circumstances.
- 2 When being asked to conduct a contract review, key items to look for are:
 - Indemnity clauses given to clients as the assumed liability exclusion will be relevant.

- Whether or not the insured uses subcontractors to do the work (and if so what is the insurance arrangement with the subcontractor).
 - Any clause that obliges your insured to take out insurance for another party.
- 3 Don't be worried if you feel out of your depth very quickly – contract reviews dealing with insurance issues, is a highly specialised area which often requires specialist input. Do not hesitate to recommend that your client seek legal advice if there is any doubt. Your friendly lawyers at DLA are obviously here to help!

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