CONSTRUCTION INSURANCE INSURED STATUS INSIGHTS

March 2019

WHEN AM I INSURED OR, MORE IMPORTANTLY, AM I INSURED AT ALL?

When insurers and insureds enter into an insurance contract they must all be certain as to what degree of protection the policy affords. Otherwise, it could be argued, what really is the purpose of the policy? This principle is commonly applied in relation to the scope of coverage provided but not frequently enough in relation to the fundamental question of whether the parties themselves are actually insured by the policy at all.

This is of particular significance within the construction industry where it is quite common for the insurance of property, contract works, or the liability risk for bodily injury or property damage, to protect multiple parties involved in a project under a single insurance policy.

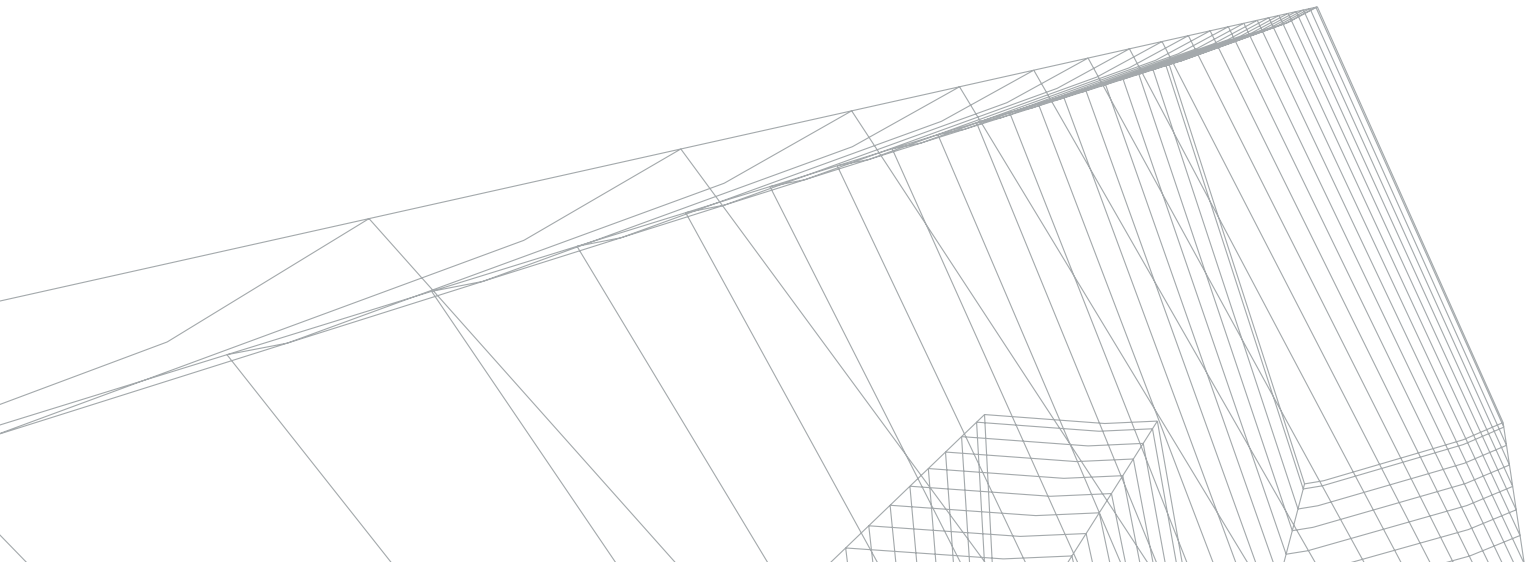
The normal practice of naming all insured parties on a policy can be problematic given the complexity of building and infrastructure projects. For example, there may be a very substantial list of subcontractors, very few of which are actually formally engaged at the time the project insurances are put in place.

It is for that reason that construction insurances incorporate provisions that extend coverage to other parties without the specific requirement for these to be either identified or a formal endorsement made to the policy.

For decades now the law has allowed challenges to what the parties set out to agree in their contract or in their insurance policy. Rather worryingly, a different interpretation is often delivered to that envisaged by one or more of the parties, potentially undermining faith in the insurance process.

The English courts will always construe the particular contract in dispute in its "factual matrix", considering the document as a whole to ascertain the intention of the parties. Therefore, while the below is a useful guide, with particular reference to English case law, every case needs to be carefully considered on its particular facts and the language of the whole contract.

This paper seeks to address some of the more common questions and issues that are presented to our specialist construction practice. To begin with, we will attempt to add clarity by defining some common terms that are used where multiple parties are insured under the same policy.



1. JOINT INSURED

Each insured shares the same policy and the rights of the insured parties stand or fall together. One insured party can be denied cover if another party breaches the terms of the policy.

Comment

This term should be reserved for cases where two or more parties have an identical interest in the subject matter of the insurance. It is not generally appropriate for parties to a construction contract to be included as joint insureds given their different interests in the project works.

2. CO-INSURED

Each insured party's insurable interests/ liabilities are individually insured so the actions or omissions of one party should have no effect on the rights of the other under the policy. Generally speaking a vitiating act by one insured will not prejudice the rights of the other. There may be language in the policy that deals expressly with this issue.

Comment

Where reference to joint insured status is made in commercial contracts, the reference should be changed to read 'co-insured' to indicate that the separate interests are to be insured.

However, also note that where two insured parties can demonstrate that they have separate interests in an insurance policy then the policy may be considered a composite policy and they are hence co-insureds (see **General Accident Fire and Life Assurance Corporation Ltd vs Midland Bank Ltd (1940)**).

For example, whilst JCT contracts continue to use the term "Joint Insured", the definition within that suite of contracts makes it clear that the policy must be placed on a composite basis so that it operates on a co-insured basis.

3. NAMED INSURED/ADDITIONAL INSURED

This terminology is more commonplace in the USA where policy development can be a little different to European formats.
A named insured should be defined in the policy (such as ABC plc plus associated/ subsidiary companies etc.) and will usually have the benefit of all coverage given under the policy. Where a named insured wants to include another party under the policy (who does not fall within the definition of named insured) then the policy needs to be specifically endorsed to include that party as an additional insured. When this has been endorsed the additional insured will usually enjoy the same benefits under the policy as the original named insured although the endorsed additional insured's status can be subject to coverage, territory or time restrictions if expressly stated in the endorsement.

Comment

When a client is required by contract to insure another commercial entity under their own insurances as an additional insured, or where a client is requiring another commercial entity by the terms of a contract to provide them with additional insured status, then it is important to ensure that full insured status has been achieved as would be the case as a joint insured or co-insured. In other words it is worth checking that the endorsement creating this additional insured status is complete. There should be no difference in the extent of cover provided to the additional insured compared with the joint insured or co-insured parties unless this was specifically agreed and therefore intended.

4. NOTING OF INTEREST

It is not uncommon for a party to ask for its interest to be noted on a policy. For nearly 20 years the Association of British Insurers (ABI) and the British Banking Association (BBA) had an agreement in place whereby insurers would give prior notice of any cancellation of cover alteration to those whose interest was noted on the policy. This agreement lapsed in 2012.

However, in the absence of more specific language, having an interest noted on an insurance policy does not necessarily mean that you will be entitled to compensation for a loss insured or be entitled to any other rights or notice under the terms of the insurance contract.

Comment

In order to properly protect an insurable interest, the party with the interest should either be included as an insured party under the insured contract, or seek specific provisions.

5. RESPECTIVE RIGHTS AND INTERESTS

The number of insured parties identified as 'the insured' under a policy and the scope of cover afforded to these parties may be wider than required by the relevant construction contracts.

For example, for the sake of expediency before a project commences, an owner's policy might be established to cover all subcontractors of any tier. Nevertheless, as part of the commercial negotiations during the letting of contracts or subcontracts, the principal may elect not to grant policy coverage to one of these parties. Alternatively, the cover could be restricted in some way for certain project parties.

How can the project policy be established so as not to over-ride the commercial considerations of the parties?

The phrase 'for their respective rights and interests' is sometimes inserted after the categories of insured parties. This has the effect of limiting the application of the insurance to no more than required by the (sub)contract(s) between the parties. It also adds an additional indication that the policy is composite and that all insured parties are to be treated separately.

The case of **National Oilwell (UK) Ltd v Davy Offshore Ltd (1993)** demonstrated that the courts are prepared to recognise the wording of construction contracts in deciding the extent of insurance available under insurance policies. In this case, a construction all risks (CAR) insurance policy included National Oilwell as an "other Assureds" and specified that "the interest of other Assureds shall be covered…unless specific contracts contain provisions to the contrary". The contract between Davy and National Oilwell stated that Davy would insure the materials of National Oilwell until the time of delivery.

A loss occurred after delivery and because of the terms of the contract, insurers were allowed to deny coverage to National Oilwell in this case.

This should not, however, be confused with an insured's pervasive interest which permits an insured party to be insured for more than their own interest in an insured asset. For example, under a composite CAR policy a subcontractor can be insured for its pervasive interest in the entire contract works, based on his potential liability for damage to those works, even though there is no proprietary or possessory right in such property. However, the exact boundaries of this concept are potentially somewhat fluid.

Comment

In order to protect the interest of other insureds, the insurance provisions of the contract should be carefully reviewed to ensure they accurately reflect the intention of the parties. Overall, the key to delivering a risk allocation in accordance with the project parties' wishes and understanding is to achieve accuracy and clarity in not only the policy document but also the contractual terms. To this end, close attention should be paid to the contract clauses relating to the risk of loss or damage to the works, liabilities for injury or damage and indemnities being given or being demanded.

6. NON-VITIATION

Vitiation in this sense means to make void or annul and hence a vitiating act is one where an insured party breaches the terms and conditions of the policy to the extent that the insurer can avoid its liability or obligations. A non-vitiation clause therefore expressly distinguishes the rights of each insured party and states that the insurer will only implement any rights that they may have against a vitiating insured.

From the above examination a non-vitiation clause may be considered unnecessary where the interests of the insured parties are insured via a composite policy.

However, it is possible that all such rights could be collectively affected, for example the broker acting on behalf of all insureds could fail to inform the insurer of a fact material to them all. Alternatively, the insured may collectively have ongoing obligations via a policy warranty for proper maintenance of the property in question.

Non-vitiation provisions can therefore be used to deal with circumstances that could otherwise affect all insured parties, irrespective of composite policy status. Such provisions may also include a non-invalidation clause to the effect that an individual insured's interest should not be prejudiced by any act or neglect of the insured in respect of any property insured, provided the insured, on becoming aware, immediately gives written notice to the insurers and pays an additional premium if required.

Comment

Lenders participating in limited recourse financing transactions generally require non-vitiation clauses as part of their specifically required lender endorsements. Non-vitiation conditions are also generally used on project construction policies perhaps using a variant on the LEG Multiple Insured Clause, which is replicated in the Appendix.

The use of these clauses can also introduce the concept of the insured's innocent non-disclosure not being deemed a vitiating act and therefore offers a benefit to all insured parties. Such conditions may have a cost implication.

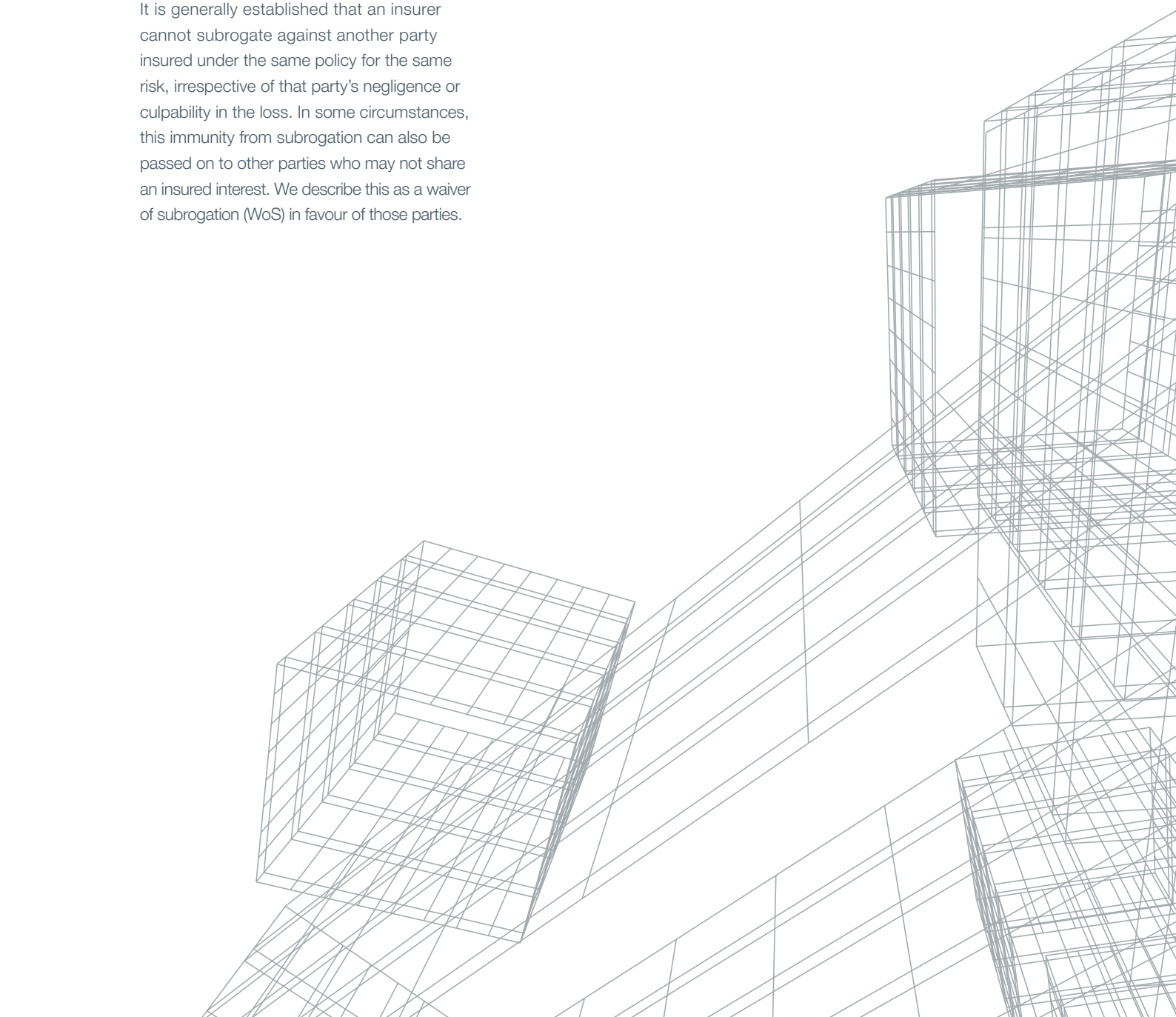
7. SUBROGATION/WAIVER OF SUBROGATION RIGHTS

Subrogation is a legal principle that permits the legal rights and remedies of one party to be transferred to another. For example, when an insured is indemnified by its insurer, any rights possessed by the insured, be they in tort or contract, are subrogated to the insurer, thus opening up the possibility of the insurer making a recovery of its outlay from a culpable party.

It is generally established that an insurer cannot subrogate against another party insured under the same policy for the same risk, irrespective of that party's negligence or culpability in the loss. In some circumstances, this immunity from subrogation can also be passed on to other parties who may not share an insured interest. We describe this as a waiver of subrogation (WoS) in favour of those parties.

8. COMPOSITE POLICY

A composite policy is one that recognises that the multiple insured parties have different interests in the subject matter of the policy. Those different interests are also protected separately, so that the failings of one insured will not affect the rights of the other(s).



WAIVER OF SUBROGATION CASE STUDIES

Having explored some of the common terms and concepts surrounding this important area, we will move on to some of the recent cases that address the question of who is insured and to what extent they are free from the threat of subrogation.

Following the cases of **Hopewell Project Management v Ewbank Preece (1998)** and **Co-operative Retail Services v Taylor Young Partnership (2002)**, it was generally accepted that an insurer cannot exercise a right of subrogation against a co-insured. The case of **Tyco Fire & Integrated Solutions Ltd v Rolls-Royce Motor Cars Ltd (2008)** threw some doubt on this assumption. The judgment in that case held that Tyco (the contractor) was liable to indemnify Rolls-Royce (the employer) for damage to Rolls-Royce's existing structures caused by Tyco's negligence, despite a contractual requirement for Rolls-Royce to maintain a joint names insurance for specified perils.

RATHBONE BROS V NOVAE CORPORATE UNDERWRITING [2014]

This case concerned alleged negligent investment decisions made by a trustee (PEV) and the insurance arranged by Rathbone plc whose subsidiary had employment/consultant agreements with the trustee.

The courts had to consider a number of issues including whether Rathbone plc's insurers could subrogate against Rathbones having agreed to indemnify the trustee (PEV).

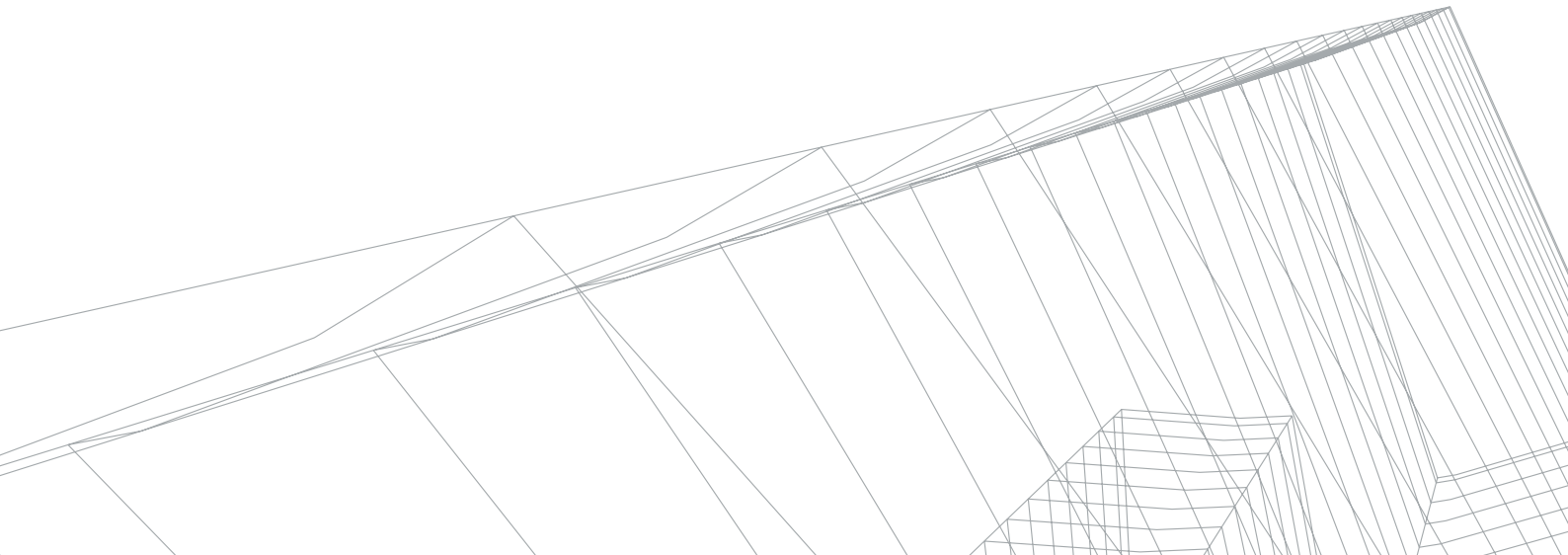
Different arguments were considered but importantly the majority judgement of the court of appeal was to reverse the lower court's finding that the insurers could subrogate. They did this by holding that it was an implied term that the insurers would not seek to be subrogated to the second claimant's rights under the indemnity.

The outcome supports the usual position that under English law, an insurer will typically be unable to exercise rights of subrogation in the name of one co-insured against another co-insured.

GARD MARINE V CHINA NATIONAL CHARTERING [2015]

This case concerned a ship that sank in the port of Kashima in Japan. The contract provided for the ship owner and the charterer to have joint names hull insurance. The issue was whether this co-insurance precluded the insurer from bringing subrogated/assigned claims in the name of one insured against the other insured.

The majority of the Supreme Court upheld the generally established rule that no such claims could be brought but at the same time emphasising that regard has to be given to the specific terms of the contract between the co-insureds.



HABERDASHERS' ASKE'S FEDERATION TRUST V LAKEHOUSE CONTRACTS & ORS [2018]

This case concerned fire damage at a total cost of £8,750,000 to a school undergoing refurbishment as a result of a negligent sub-contractor. The employer had arranged project insurance in the joint names of the employer/main contractor and all sub-contractors.

As a co-insured to the project insurance the sub-contractor would have expected to be protected against subrogation by the project insurance. However, notwithstanding the arrangements between the employer and main contractor, the contract between the main contractor and the sub-contractor imposed an obligation on the sub-contractor to carry its own insurance to £5,000,000.

The court held that the sub-contractor was not an insured to the project insurance as it had expressly agreed that it would carry its own insurance. This outcome emphasises the need to ensure that the insurance policy and the contract obligations are written to support each other at all levels of the project.

In this case the total amount claimed from the sub-contractor was quantified at £5,000,000 – being the value of the insurance they were required to hold under the sub-contract - as opposed to the total cost of the fire damage.

PREZZO LTD V HIGH POINT ESTATES LTD [2018]

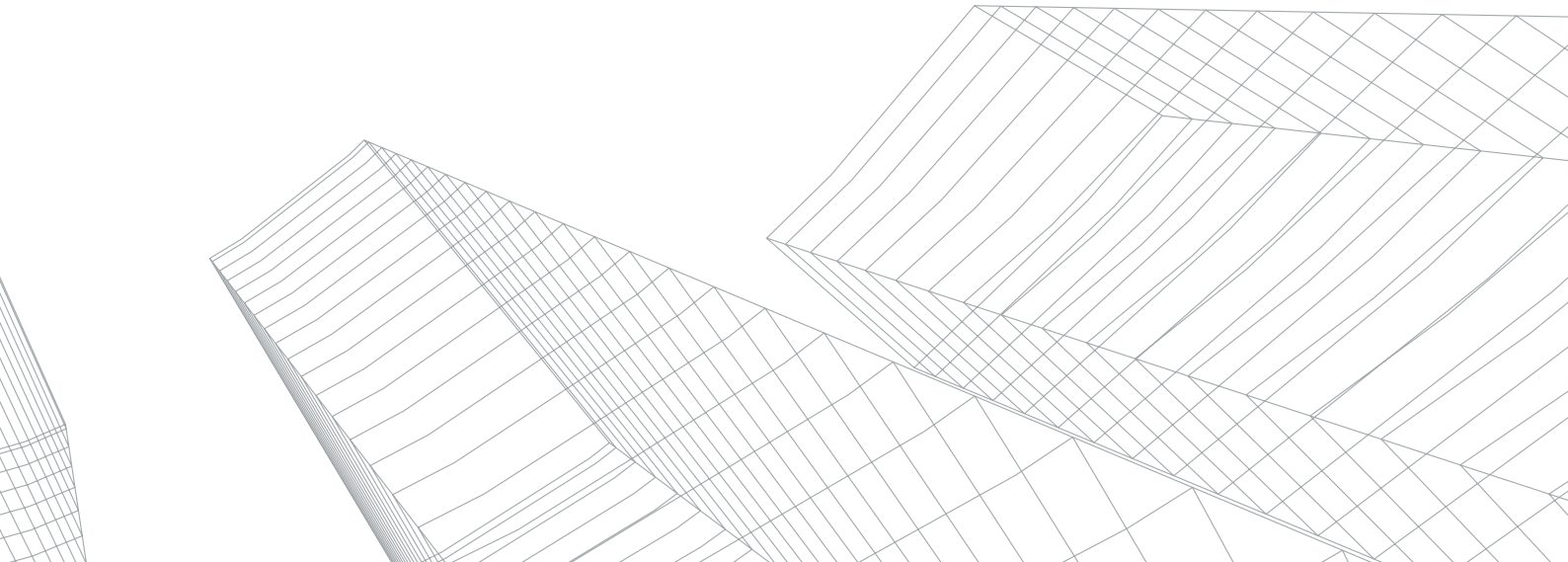
This case concerned a building partly occupied by a tenant where under the lease the landlord was obliged to "insure the premises in accordance" with the superior lease.

The court held that the landlord's obligation to insure for the tenant was limited to the premises leased by the tenant as opposed to the whole building, and the landlord's insurers were able to subrogate in respect of the remainder of the building.

LESSON

Where a tenant is only taking partial occupation of a larger building, it would be well advised to ensure that the protection afforded by the landlord's policy extends to the whole building and includes the tenant as a full named insured with a total waiver of subrogation. In the absence of this wider protection it would be prudent of the tenant to consider a high level of third party liability insurance.

This case also illustrates the issue regularly faced by fit-out contractors who seek to rely on the employer's (or tenant's) insurance of the existing structure.



CONCLUSIONS

What is certain is that to avoid the risk of excessive judicial challenge, the parties need to consider carefully the extent to which the terms of the insurance policy are aligned with the contractual provisions, and furthermore that the implications of those provisions are fully understood.

Drafters need to consider carefully what they are trying to achieve. Key questions to be addressed would include:

NEGLIGENT CO-INSURED

If a co-insured party acts negligently, should it still benefit from the policy without a threat of subrogation?

EXTENT OF COVER EXTENDED TO A CO-INSURED

If the employer's policy insures for all risks but his contractual obligation is only to provide insurance for specified perils, then negligent damage by a contractor by a non-specified peril would allow the employer's insurer(s) to subrogate against the culpable contractor.

In the absence of very specific language this would still be the case even where the policy contained a general waiver of subrogation provision against co-insureds as its rights under the policy are limited to specified perils.

Other points to take into account are:

- What is the effect of a primary insurance clause?

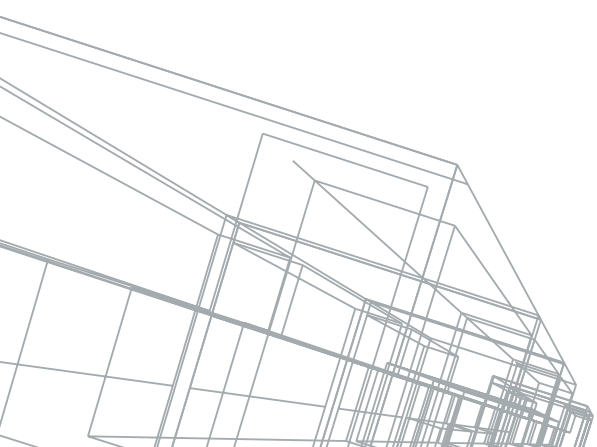
On its own it simply provides that the policy will pay first. If it is the intention not to seek contribution from other policies then more specific language is required.

- Does the **Contracts Rights against Third Parties Act 1999** apply?

In certain circumstances this Act enables a person who is not a party to the contract to have the benefit of the contract. However insurance policies more often than not have an express provision excluding the operation of the Act.

DURATION OF THE INSURANCE OBLIGATION

Does the insurance obligation extend to damage occurring beyond practical completion? This was considered in **GB Building Solutions Limited v SFS Fire Services Limited (2017)** where damage arose after practical completion of the sub-contract works and as a consequence it was held that the sub-contractor had no contractual entitlement to the policy, and therefore no defence to the subrogation.



APPENDIX

MULTIPLE INSUREDS' CLAUSE (LEG)

Subject otherwise to the terms, Conditions and Exclusions of the Policy.

i. It is noted and agreed that if the Insured described in the schedule comprises more than one insured party each operating as a separate and distinct entity then (save as provided in this Multiple Insured's Clause) cover hereunder shall apply in the same manner and to the same extent as if individual policies had been issued to each such insured party provided that the total liability of the Insurers to all of the insured parties collectively shall not exceed the sums insured and limits of indemnity including any inner limits set by memorandum or endorsement stated in the policy.

ii. It is understood and agreed that any payment or payments by Insurers to any one or more such insured parties shall reduce to the extent of that payment Insurers liability to all such parties arising from any one event giving rise to a claim under this policy.

iii. It is further understood that the insured parties will at all times preserve and enforce the various contractual rights and agreements entered into by the insured parties and the contractual remedies of such parties in the event of physical loss or damage.

iv. It is further understood and agreed that Insurers shall be entitled to avoid liability to or (as may be appropriate) claim damages from any of the insured parties in circumstances of fraud, misrepresentation, non-disclosure or breach of any warranty or condition of this policy committed by that insured party each referred to in this clause as a Vitiating Act.

v. It is however agreed that (save as provided in this Multiple Insured's Clause) a Vitiating Act committed by one insured party shall not prejudice the right to indemnity of any other insured party who has an insurable interest and who has not committed a Vitiating Act.

vi. Insurers hereby agree to waive all rights of subrogation which they may have or acquire against any insured party except where the rights of subrogation or recourse are acquired in consequence or otherwise following a Vitiating Act in which circumstances Insurers may enforce such rights notwithstanding the continuing or former status of the vitiating party as an Insured.

vii. The lenders to the project shall not be entitled to any indemnity under this policy for or arising from physical loss or damage in respect of which Insurers are by reason of a Vitiating Act no longer liable to indemnify any one or more other insured party.

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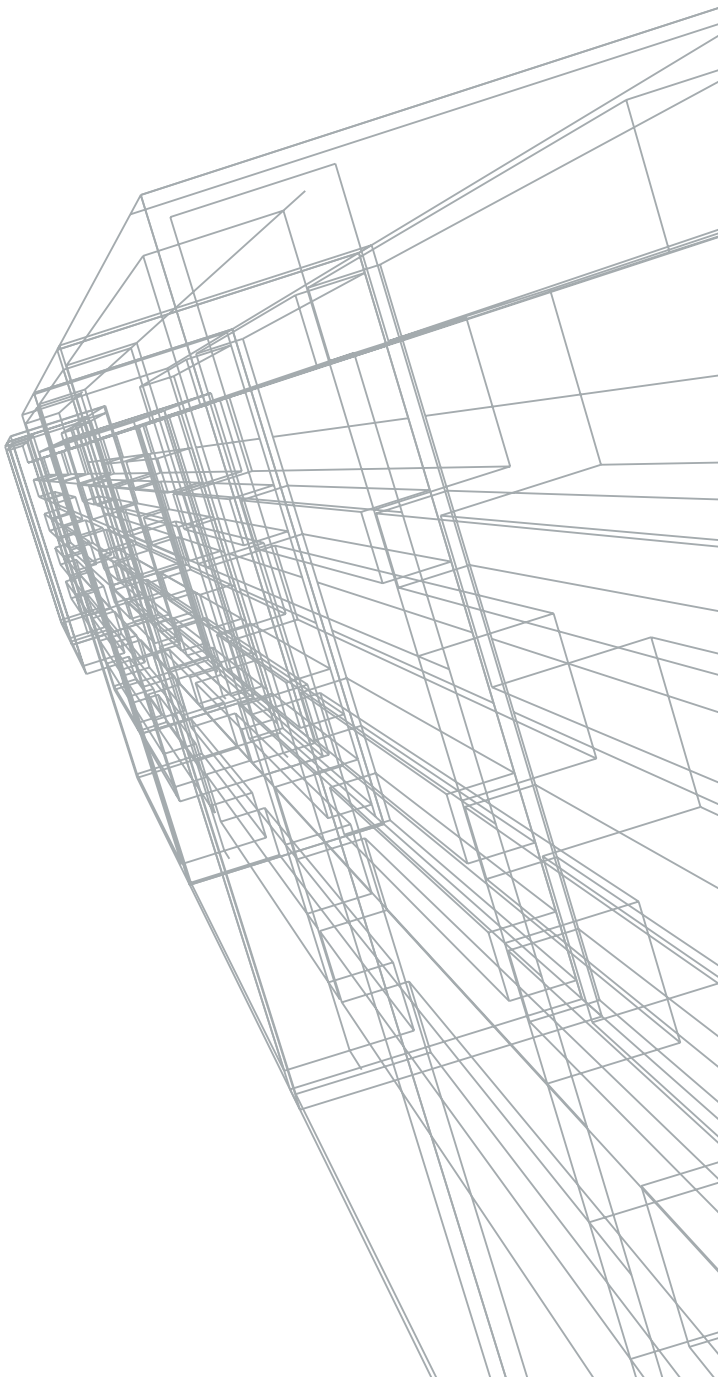

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