THE IMPACT OF CONSTRUCTION INSURANCE ON RISK ALLOCATION

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Introduction

It is a feature of the standard construction contract forms that they nearly all contain express, and often elaborate, provisions about what the parties must do by way of insurance. On the other hand, most of the standard forms do not contain any express provisions – of the kind which are widely to be found in other types of contract – seeking to exclude or limit the liability of one party to the other. An important exception to this principle is the family of contracts produced jointly by the Institution of Mechanical Engineers and the Institution of Electrical Engineers which do contain wide limitations on the liability of the contractor to the employer, and which have been held to be broadly effective.

What I want to consider here is a line of cases which have held that the express conditions about insurance have an effect on the liability of the parties to each other. There are in fact two distinct lines of reasoning, though (as will be seen) they can overlap.

One of the lines of reasoning is that as a matter of construction of the contract the express insurance provisions should be taken implicitly to effect limitations of liability. This principle has been applied both as between contractor and employer and also, perhaps more surprisingly, between subcontractor and employer as regards liability in tort. The second line of authority says that in certain circumstances the fact that A and B have taken out a joint names policy with the same insurer in respect of the same risk will mean that A and B cannot be liable to each other even if it is the conduct of A which has brought about the damage. I will consider the two groups of cases separately and then say something about the overlap between them.

Insurance provisions as implicit limitation or exemption clauses

Position as between employer and contractor

Let me start with some propositions which, in broad terms, I think are not controversial. First, building contract law is simply a part of general contract law, though of course there are problems which peculiarly arise in relation to building contracts. So there is at the very least a strong presumption that a solution to building contract problems is to be found in the doctrines of general contract law.

Although there have of course been thousands of reported cases of exemption and limitation clauses, and at the margin the application of the rules is still quite often difficult, the broad pattern of the rules about such clauses is not now in serious doubt. They are subject to controls developed at common law and to the statutory controls imposed by the Unfair Contract Terms Act 1977 and, in a consumer context, the Unfair Terms in Consumer Contracts Regulations 1999. As far as common law is concerned, it is now clear that someone who seeks to rely on an exemption or limitation clause must first of all show that it has been successfully incorporated into the contract, and then show that it is clearly and appropriately worded to produce the consequence for which it contends. In particular, it cannot be doubted that the general rule is that someone who claims that a contractual provision has excluded liability for negligence or for serious breach of contract has to show that clear words have been used to produce this result.

Probably the most commonly cited case for this proposition is the judgment of the Privy Council in *Canada Steamship Lines Ltd v The King*. Lord Morton said:

> (1) If the clause contains language which expressly exempts the person in whose favour it is made (hereafter called the 'proferens') from the consequences of the negligence of his own servants, effect must be given to that provision ...
>
> (2) If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens. If a doubt arises at this point, it must be resolved against the proferens ...
>
> (3) If the words used are wide enough for the above purpose, the court must then consider whether the 'head of damage may be based on some ground other than that of negligence' to quote again Lord Greene in the *Alderslade* case. The 'other ground' must not be so fanciful or remote that the proferens cannot be supposed to have desired protection against it; but subject to this qualification, which is no doubt to be implied from Lord Greene's words, the existence of a possible head of damage other than that of negligence is fatal to the proferens even if the words used are prima facie wide enough to cover negligence ...[1]

As Lord Justice Buckley said in *Gillespie Brothers & Company Ltd v Roy Bowles Transport Ltd*:

> … it is inherently improbable that one party to the contract should intend to absolve the other party from the consequences of the latter's own negligence.[2]

A separate point is that contracts often do not say anything about insurance even where everyone knows that it is extremely probable that one or other or both of the parties will be insured. So clients do not (I think) require their lawyers to be insured though there must be a not insignificant number of cases

1 *Canada Steamship Lines Ltd v The King* [1952] AC 192, PC, at page 208.

2 *Gillespie Brothers & Company Ltd v Roy Bowles Transport Ltd* [1973] 1 All ER 193, CA, at page 203f.

where the client could not reasonably expect his claims to be met if the lawyer were not insured (although more sophisticated clients will know that lawyers require to be insured, many will have no idea of the limits of the solicitor's insurance).

At one time it used to be fashionable to pretend that insurance was irrelevant but this is clearly now an out of date view. In *Photo Production Ltd v Securicor Transport Ltd* the House of Lords clearly regarded an exemption clause which put the whole risk of the burning down of the plaintiff's factory by the negligence of the defendant's servants on the plaintiff as entirely reasonable (provided that, as was the case, it was clearly expressed) because in all normal situations, the prudent owner of buildings carries fire insurance against such events.[3] Usually, it will be the normal pattern of insurance arrangements rather than the actual insurance arrangements of the parties which will be the key factor.[4]

The starting point for present purposes is *Wimpey Construction UK Ltd v Scottish Special Housing Association*.[5] In this case, the appellant contracted with the respondents to modernise 128 houses in Edinburgh on JCT 1963 terms (local authority with quantities), July 1977 revision.[6] In the course of carrying out the works, one of the houses was damaged by fire in circumstances where it was assumed for pleading purposes that the fire had been caused by the appellant's negligence. The House of Lords held that the combined effect of clauses 18(2) and 20[C] of the contract was that the risk of the fire, even if caused by the appellant's negligence, was on the respondents.

A single, short, reasoned speech was delivered by Lord Keith of Kinkel who said:

> The opening words of clause 18(2) make it clear that the liability of the contractor for damage to property caused by his negligence or that of a sub-contractor or of anyone for whom either of them is responsible is subject to an exception. The ambit of the exception is to be found in clause 20[C]. Clause 19(1)(a), dealing with the contractor's obligation to insure against, *inter alia*, damage to property, does not shed any light on that matter, since the insurance is to cover only the contractor's liability for such damage, whatever that liability may be. Clause 20[C] provides that the existing structures and contents owned by the employer are to be at his sole risk as regards damage by, *inter alia,* fire. No differentiation is made between fire due to the negligence of the contractor and that due to other causes. The remainder of the catalogue of perils includes some which could not possibly be caused by the negligence of the contractor, such as storm, tempest and earthquake, but others might be, such as explosion, flood and the bursting or

3 *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, HL.

4 *Flamar Interocean v Denmac* (*The Flamar Pride and The Flamar Progress)* [1990] 1 Lloyd's Rep 434, QBD(CommCt).

5 *Wimpey Construction UK Ltd v Scottish Special Housing Association* [1986] 9 Con LR 19, HL.

6 Standard Form of Building Contract (local authority with quantities), 1963 edition, July 1977 revision, Joint Contracts Tribunal.

> overflowing of water pipes. There is imposed on the employer an obligation to insure against loss or damage by all these perils, in quite general terms. I have found it impossible to resist the conclusion that it is intended that the employer shall bear the whole risk of damage by fire, including fire caused by the negligence of the contractor or that of sub-contractors. The exception introduced by the opening words of clause 18(2) must have the effect that certain damage caused by the negligence of the contractor or of sub-contractors, for which in the absence of these words the contractor would be liable, is not to result in liability on his part. The nature of such damage is to be found in clause 20[C], which refers in general terms to damage by fire to the existing structures. No sensible content can be found for the words of exception in clause 18(2) if they are not read as referring to damage of the nature described in clause 20[C]. Counsel for the respondents strove valiantly to indicate some such alternative content but was unable, in my view to do so convincingly.[7]

Lord Keith approved a similar decision of the Court of Appeal in *James Archdale & Company Ltd v Comservices Ltd* though the wording was not exactly the same.[8] It is important to note that in this case there was no evidence as to what actual insurance arrangements had been made by the employer, but it is clear that the contract did not contemplate a joint names policy on behalf of the employer and contractor but a policy taken out by the employer in its own name. It does not appear that the *Canada Steamship* case or similar cases were cited to the House of Lords in the *Wimpey* appeal.

There has been no direct challenge to the *Wimpey* case in any later case but it has not always been followed. In a case which turns on the construction of a contract, it can always be argued that the words are different. This is what happened in the Court of Appeal decision in *Dorset County Council v Southern Felt Roofing Ltd*.[9] The employer's premises were damaged by a fire which again was assumed to be due to the negligence of the defendant contractors. The contract was a Dorset County Council adaptation of the JCT 1963, 1977 revision and provided (in clause 2.1) that, 'The Council shall bear the risk of loss or damage in respect of the Works and (where appropriate) the existing structure and contents thereof (excepting temporary buildings, plant, tools and equipment owned or hired by the Contractor or any sub-contractor) by fire, lightning, explosion, aircraft and other aerial devices or articles dropped therefrom'. The Court of Appeal held that this clause imposed on the Council the risk of loss or damage by fire which was not caused by the negligence of the contractor, but that it should not be read as putting the risk on the employer of fire caused by the contractor's negligence. In this case, the Court of Appeal did prefer to apply Lord Morton's principles in the *Canada Steamship* case.[10]

The question was discussed in the context of the provisions of IFC 84[11] in

7 See note 5, at page 22.
8 *James Archdale & Company Ltd v Comservices Ltd* [1954] 1 WLR 459, CA.
9 *Dorset County Council v Southern Felt Roofing Ltd* [1989] 29 Con LR 61, CA.
10 See note 1.
11 Intermediate Form of Building Contract, 1984 edition, Joint Contracts Tribunal.

Scottish & Newcastle plc v G D Construction (St Albans) Ltd.[12] In this case, His Honour Judge Richard Seymour QC held that the wording of IFC 84 did not operate so as to provide an implied exception for fire caused by the negligence of the contractor. The question was also discussed by the Court of Appeal in relation to the JCT Minor Works[13] clause in the *London Borough of Barking and Dagenham v Stamford Asphalt Company Ltd*.[14] Again the court refused to construe the insurance provisions as limiting the contractor's liability.

Position between employer and subcontractor

In virtually all the cases above, the employer's premises were damaged by a fire caused or assumed to be caused by the negligence of the contractor. Suppose the fire is caused by a negligent subcontractor. In modern conditions, it is actually much more likely that such a fire will be started by a subcontractor, since the contractor will not have many men of his own actually working on the site. Of course, the contractor will normally be liable in such a situation, but if the effect of the contractual provisions is that the employer cannot sue the contractor, can he sue the subcontractor instead? The claim against the subcontractor will of course be in tort, and there will not normally be a contract between employer and subcontractor (unless the subcontractor is nominated).

This question was considered in the important judgment of the Court of Appeal in *Norwich City Council v Harvey*.[15] In this case, the contract between the employer and the contractor was on JCT 1963 terms, 1977 revision[16] so that clause 20[C] was again a key provision. In this case, the employer had not sued the contractor but maintained an action against a subcontractor and the individual workman who did the damage. The Court of Appeal held that it would not be just or reasonable to exclude the subcontractor from the protection which the contract had given to the contractor. In such circumstances there was not such a close and direct relationship between the building owner and the subcontractor for the subcontractor to owe a duty of care to the employer.

This decision was certainly not lacking in boldness, particularly since, as far as the law of tort was concerned, it came before the series of decisions in the House of Lords in the 1990s which expressly put the presence of a duty of care on an assessment of what is fair, just and reasonable. Most lawyers in 1988 would have thought that where the defendant carelessly caused property damage to the plaintiff, a duty of care was easily to be inferred. Criticism along these lines is perhaps therefore less easy to make today than it would have been in 1988.

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12 *Scottish & Newcastle plc v G D Construction (St Albans) Ltd* [2001] 80 Con LR 75, QBD(TCC).

13 Agreement for Minor Building Works, Joint Contracts Tribunal.

14 *London Borough of Barking and Dagenham v Stamford Asphalt Company Ltd* [1997] 54 Con LR 1, CA.

15 *Norwich City Council v Harvey* [1989] 1 All ER 1180, CA.

16 See note 6.

The Court of Appeal did choose more or less to ignore the formidable technical difficulties presented by the decision of the House of Lords in *Scruttons Ltd v Midland Silicones Ltd* which was cited but not mentioned in the judgments.[17] It will be remembered that in that case the majority of the House of Lords, Lord Denning dissenting, had taken the position that normally a non party could not rely on an exemption clause contained in a contract between other parties. This is undoubtedly an unsatisfactory rule which has been substantially eroded (certainly in the context of carriage of goods by sea) by changes in contract practice and by later decisions of the Privy Council. One may think that the Court of Appeal ought to have explained why it was not applicable on the facts of the present case. There is a problem here with the impact of the Contract (Rights of Third Parties) Act 1999, which I discuss below. (In *Welsh Health Technical Services Organisation v Haden Young Ltd*, the judge held that there was a direct contract between employer and subcontractor.[18] The insurance provisions in JCT Minor Works[19] as regards subcontractors were held to have a different effect by the Court of Appeal in *National Trust v Haden Young Ltd*.[20])

The leading case for present purposes is *British Telecommunications plc v James Thomson & Sons (Engineers) Ltd*.[21] BT invited tenders for works of refurbishment and repair to a telephone switching station in Glasgow and accepted a tender from MDW Ltd. The defendants were domestic subcontractors to MDW in respect of certain steel work. On 17th June 1990, during the course of the works, a fire broke out which it was alleged was due to the negligence of the defendants. The contract between BT and MDW was on JCT 1980 terms, including amendment 2.[22] The parties accepted that the combined effect of clauses 20.3 and 22C.1 was that the employer could not sue the contractor for loss or damage due to fire, even if the fire was caused by the negligence of the contractor or any subcontractor. BT therefore sued the subcontractor.

Lord Rodger, sitting at first instance, held that in considering whether it was fair, just and reasonable to impose a duty of care on the defendants, the court should have regard to the contractual setting, and that the defendants were entitled to contract on the basis that BT were undertaking to insure and to look to the insurance policy alone for a remedy. He accordingly held that the defendants were not under a duty of care.

The same view was taken by the Inner House of the Court of Session by a majority but it was unanimously rejected by the House of Lords. There was a single reasoned speech by Lord Mackay which did not disapprove of either the *Wimpey*[23] or *Norwich City Council*[24] cases. Instead he was careful to

17 *Scruttons Ltd v Midland Silicones Ltd* [1962] AC 446, HL.
18 *Welsh Health Technical Services Organisation v Haden Young Ltd* [1987] 37 BLR 135, QBD.
19 See note 13.
20 *National Trust v Haden Young Ltd* [1994] 41 Con LR 112, CA.
21 *British Telecommunications plc v James Thomson & Sons (Engineers) Ltd* [1998] 61 Con LR 1, HL.
22 Standard Form of Building Contract, 1980 edition, Joint Contracts Tribunal.
23 See note 5.

distinguish them. The House of Lords did not deny that in deciding whether there was a duty of care, it was proper to look to the contractual setting, but it insisted that one must look to the whole of the contractual setting and that the insurance provisions in JCT 80 made a clear distinction between the position of nominated and domestic subcontractors.[25] Lord Mackay said:

> … the terms of provision for insurance of existing structures in respect of specified perils, while they provide for the recognition of the nominated sub-contractor as an insured under the policy or that such nominated sub-contractor shall have the benefit of a waiver of any right of subrogation which the insurer may have against him, provide no such protection for any domestic sub-contractor.[26]

It is I think clear that this is a speech which requires careful reading between the lines. Lord Mackay did not criticise the earlier decisions, but he was careful not to endorse them. What he did was to steer carefully around them. Further, he endorsed the decision of His Honour Judge John Hicks QC in *Kruger Tissue (Industrial) Ltd v Frank Galliers Ltd*.[27] In this case, the plaintiffs Kruger manufactured paper products at a factory in Gwynedd. In 1992, the first defendants Galliers were engaged as main contractors for the erection of an extension and the carrying out of internal alterations to the warehouse and production area. The second defendants, DMC, were roofing subcontractors and the third defendants, H & H, their sub-subcontractors. The main contract was on JCT 1980 terms.[28] Part of the premises included a warehouse which had an elevated tower section of the roof (the tower). During the contract, the tower came to be dismantled by H & H. On 9th January 1992, a fire broke out due to the use of hot cutting equipment and set the tower alight. His Honour Judge Hicks QC held that clause 22C did not impose on Kruger a duty to insure in respect of consequential loss such as loss of profit or increased cost of working arising from destruction of the tower, and that accordingly they were not barred from claiming against Galliers for such loss. The obligation to insure was only 'for the full cost of reinstatement, repair or replacement of loss or damage'.

Impact of the Contracts (Rights of Third Parties) Act 1999

The purpose of the 1999 Act was to amend, or perhaps even to abolish, the well established doctrine of privity of contract. It is clear that the underlying principle is respect for the autonomy of the parties. The parties are free, if they wish, to confer by contract rights on third parties. If they say that is what they want to do then effect should be given to that, but if they say that they do not want to do this then equally effect should be given to that.

As all construction lawyers know, the most obvious result of the Act is the proliferation of clauses saying that 'this contract is not intended to confer any rights on third parties'. There must be a problem as to the effect of such

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24 See note 15.
25 See note 22, clause 22.3.
26 See note 21, at page 8.
27 *Kruger Tissue (Industrial) Ltd v Frank Galliers Ltd* [1998] 57 Con LR 1, QBD(OR).
28 See note 22.

exclusionary words on contractual provisions which, correctly construed, fall on the *Wimpey*[29] side of the line. It is clear that since the Act came into force it is open to the parties expressly to say that an exemption or limitation clause should have effect, not only as between the parties, but also to protect the position of a non party, but the construction provisions have never said this expressly. What they have done under the previous law is to produce this result indirectly. That one can still do but can one still do it and at the same time say that one is not doing it? There must be at least some doubts as to this. On the other hand, it is clear that the Act does envisage that all existing exceptions to privity of contract will continue in force. Perhaps this principle will save the *Wimpey* line of cases, where they are appropriate, but it would be much safer for the draftsmen of such provisions to direct their minds directly to them and say what they want to achieve.

Impact of joint names clauses

The starting point here must be the decision of Mr Justice Lloyd in *Petrofina (UK) Ltd v Magnaload Ltd*.[30] In this case, an accident occurred at an oil refinery at Killingholme, where a major extension was being built. The refinery was owned by Lindsey Oil, the third plaintiffs, who operated it for the benefit of the first and second plaintiffs. The works were financed by the fourth plaintiff, Omnium Leasing, a consortium of companies. The main contractors were Foster Wheeler, who had subcontracted heavy lifting operations to Greenham (Plant Hire). Certain specialist lifting equipment was provided by the first defendants, Magnaload, and the second defendants, Mammoet Stoof. The plaintiffs alleged that the accident was due to the negligence of the first and second defendants. The proceedings involved a preliminary issue as to the whether the first and second defendants were covered by a contractor's 'all risks' policy taken out by Foster Wheeler. The judge had no doubt that it was both legally possible and desirable to take out a single policy to cover all the many parties involved in a construction transaction. He said:

> 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, as [W] pointed out in the course of his evidence, 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

29 See note 5.

30 *Petrofina (UK) Ltd v Magnaload Ltd* [1983] 3 All ER 35, QBD(CommCt).

to decline the contract.[31]

The judge went on to hold that possible claimants and possible defendants were insured under the same policy. This has the effect of defeating the insurer's right of subrogation.

This decision is of enormous importance in the present context. The insurances required to be taken out under JCT 1963[32] were not joint names policies but those directed to be taken out by JCT 1980,[33] clause 22, are in general joint names policies. It follows that if the policies taken out are in fact joint names policies, then the joint names will not be able to sue each other because they have no liability to each other and this will defeat any subrogation rights which would otherwise exist. This provides a distinct line of reasoning quite separate from that in the previous section. The discussion of insurance provisions as limitation or exemption clauses depends on deductions from the agreement the parties have made about who is to insure; the present situation turns on what the parties have actually done about insurance. Of course, usually, the parties will have done what they agreed to do, though as we all know this will not be true in 100% of cases. This therefore opens up the possibility of different results, depending on whether we are following the reasoning of the previous section, or this one.

The most important case on this argument is *Co-operative Retail Services Ltd v Taylor Young Partnership*.[34] In this case, the claimant, the Co-op, engaged Wimpey to build a new office headquarters building in Rochdale. The contract was JCT 1980 (private with quantities).[35] Hall, the electrical subcontractors for the builder's generator system, were on DOM/1 1980 conditions.[36] Hall entered into a warranty with the Co-op and Wimpey dated 11th October 1993. The insurance requirements of clause 22A of the main contract were met by a joint names policy which insured Wimpey, the Co-op and Hall.

On 16th March 1995, before practical completion, a fire occurred at the site when the generator was being commissioned and the building was extensively damaged. The Co-op alleged that the fire was due to negligence or breach of contract on the part of the architects TYP and the mechanical and electrical engineers HLP. TYP and HLP alleged that the fire was a result of breaches of the main contract by Wimpey and breaches of warranty by Hall and sought contribution under the Civil Liability (Contribution) Act 1978 from Wimpey and Hall. The House of Lords held that the effect of the joint names policy was that Wimpey and Hall were never liable to the Co-op for any damage arising out of the fire and that it therefore followed that Wimpey and Hall

31 See note 30, at page 42a.
32 See note 6.
33 See note 22.
34 *Co-operative Retail Services Ltd v Taylor Young Partnership* [2002] 1 All ER (Comm) 918, [2002] 1 WLR 1419, [2002] BLR 272 and 82 Con LR 1, HL. See too (2000) 16 Const LJ 347 and 74 Con LR 29, CA; and (2000) 16 Const LJ 204 and 74 Con LR 12, QBD(TCC).
35 See note 22.
36 Domestic Sub-Contract (DOM/1), 1980 edition with amendments 1-3 and 5-9, Construction Confederation, 1990.

were not liable to contribute to HLP and TYP.

It follows from this that all those who are within the ambit of a joint names policy are free of liability to each other. I must say that if I were the defendants in this case, I am not sure I would think the result was demonstrably fair. However, since the result flows from the fact that the 1978 Act is about contribution between those who are liable, it must follow that contribution cannot be obtained against those who are not liable in respect of the same damage. It also means that, in a large construction project, it is extremely dangerous not to be insured by the same policy which insures everyone else, since this will make one an obvious target for any attempt to pass the parcel.

This point was expressly discussed in the House of Lords: the answer given that the contractual arrangements were contained in a very well known standard form and the defendants could have sought to be insured under the joint names policy. Of course, we do not know whether commercially an application to be insured in this way would have been likely to be well received. It is worth noting that the joint names policy covered the domestic electrical subcontractor, and the wording of the JCT contract certainly does not require a joint names policy to be extended to domestic subcontractors as opposed to nominated subcontractors, though of course it does not forbid it.

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'The object of the Society
is to promote the study and understanding of
construction law amongst all those involved
in the construction industry'

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