

Contractual risks and how to manage them

Risk Mitigation and Insurer Response

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Learning Objectives

- Contract Risk Management – why is it important and what can be achieved?
- What is (and what isn't) covered by your insurance programme
- Identifying clauses that could lead to problems / uninsured claims
- Managing these issues through
 - policy endorsements
 - contract negotiation and redrafting
- Risk management as a tool for dispute avoidance / resolution



Agenda



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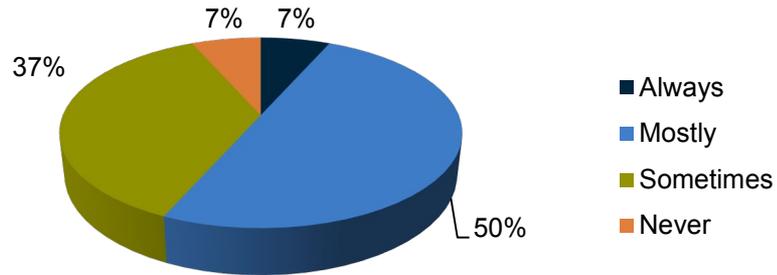
- General Principles
 - What is the law?
 - Managing relationships
- Insurance Cover
 - How will a policy react if you breach your contractual obligations

AGENDA

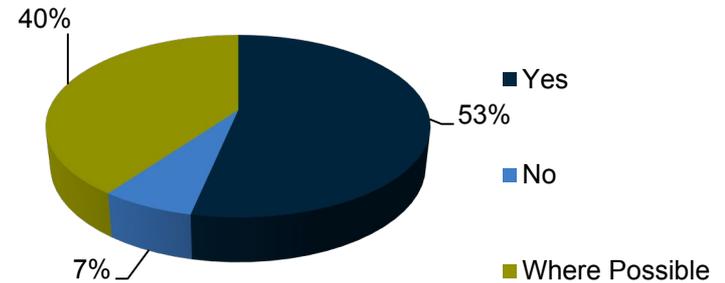


Survey responses

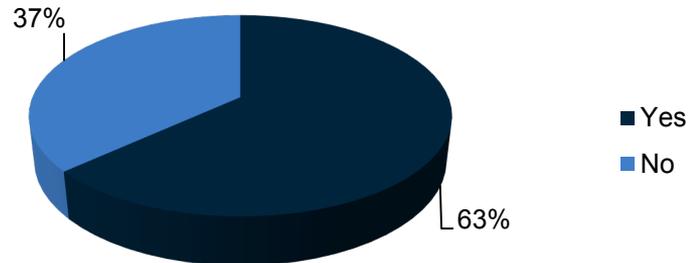
Insurance buyer involved at drafting stage



Liability under contract limited



Insurance policies respond appropriately



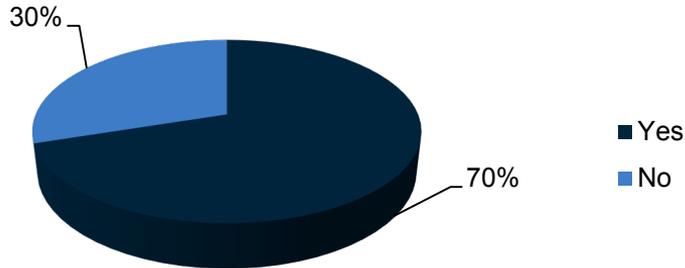
Survey responses



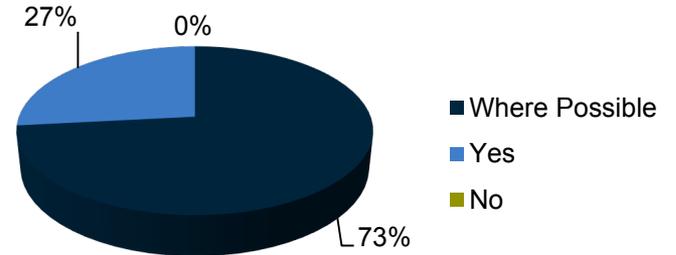
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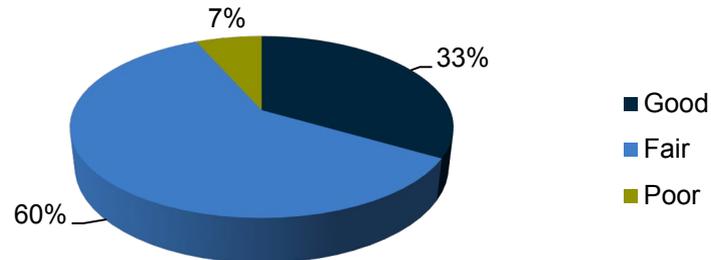
Clear understanding of contract aspects - insured vs uninsured



Sub-contractors mirror contract terms



Insurers approach & responsiveness



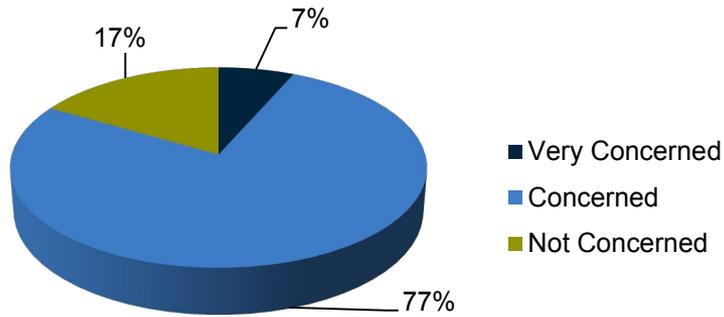
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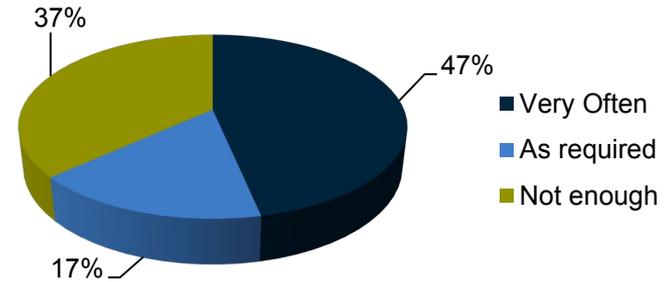
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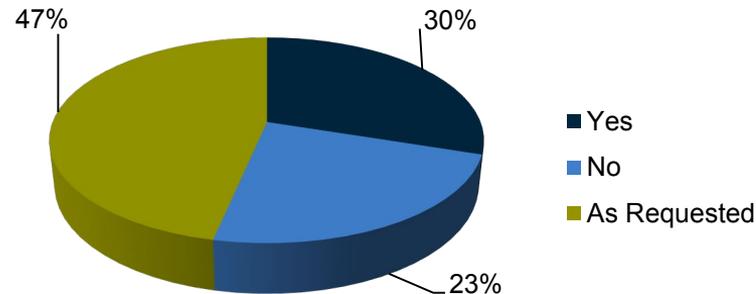
Concerns regarding gaps



Collaboration with legal team



Broker support





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Section 1

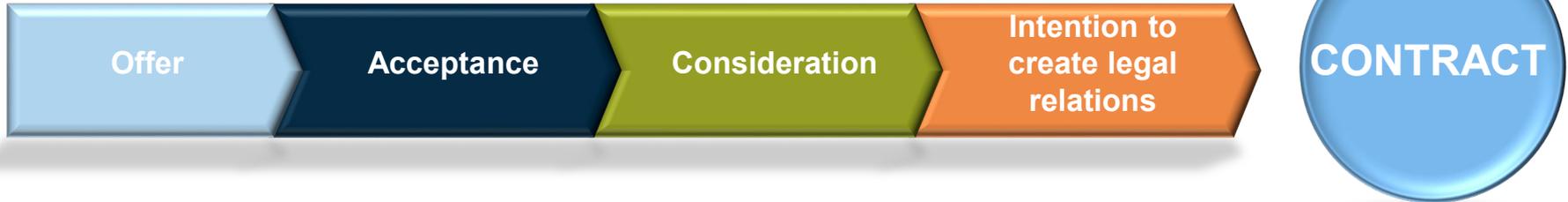
General Principles

Contract formation



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- Legally binding contracts can take many different formats
 - formal contract of appointment
 - letter of understanding
 - exchange of correspondence / emails
 - payment/acceptance of money in return for (promise of) goods or services
 - verbal agreement
- Important to be aware of this when agreeing “in principle”

Contract formation



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- If no written terms, implied duty upon professionals to act with “reasonable skill and care” (Supply of Goods and Services Act 1982)
 - *“Meeting the standard that another reasonably competent member of the profession would have met”*
- Terms can be implied from other related documents in the contractual chain
- Vital to ensure that you can comply with the contract requirements, including any implied terms
- No defence to argue you have not seen all of the documentation



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Consequences of uninsured loss

- Your contracts bind you, they do not bind your insurers
- Your expectation as an insured party may be that your Insurers will indemnify you in respect of any claims, but that is not guaranteed



Consequences of uninsured loss

- If Insurers will not provide an indemnity:
 - You are still liable to perform your contract
 - You may have to pay any sums due under the contract in respect of any losses occasioned by breach
 - You will need to factor in the defence costs of instructing your own lawyers to defend the claim
 - Consequences are potentially severe and could lead to financial hardship, even insolvency if the claim is substantial enough
 - Possibility of personal liability on directors depending on the terms of the contract
- Many Claimant Solicitors do not recommend pursuing claims against uninsured defendants
..... but do you want to take that risk ?

Understanding the contractual matrix



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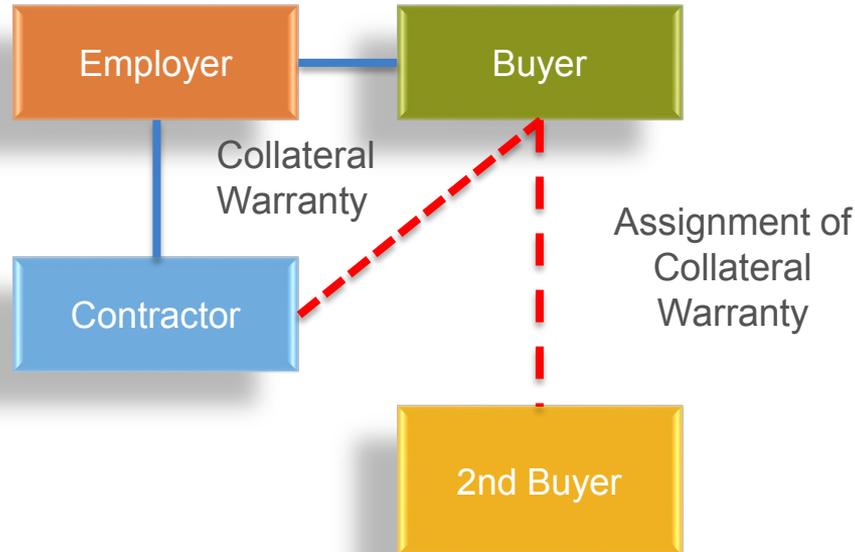
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- Contractual arrangements can be complicated
- You may not always contract directly with everyone involved
- Need ability to sue in respect of errors / omissions
- Use Collateral Warranties or Contracts (Rights of Third Parties) Act 1999





Privity of Contract

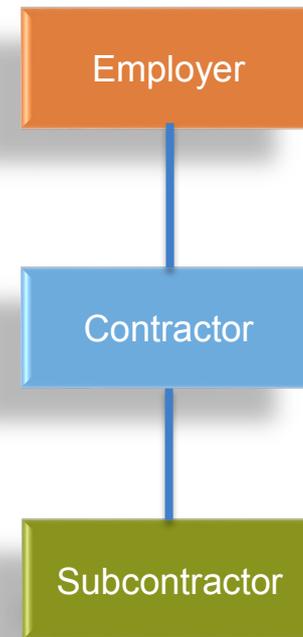




Privity of Contract

Sub-Contractors or suppliers

- If you employ others on behalf of the client then you will be accepting liability for their mistakes.
- Points to consider:
 - Can they be directly employed by the client?
 - Can they be required to provide a collateral warranty to the client?
 - Can you have a back to back contract?
 - Will their actions be covered by your PI?
 - Will their actions be covered by their own PI?





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Section 2

Insurance cover



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Insurance cover

- Breadth of insurance cover may vary across insurance market according to industry views and experiences from year to year. So shop around
- Be aware that past liabilities and commitments need to continue to be covered - eg deeds last for 12 years, so cover under future policies of insurance needs to indemnify these (particularly relevant for Professional Indemnity cover)
- No insurance policy will cover every eventuality arising under a contract and as such there may be areas of exposure for which you are not covered



Insurance cover



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- Manage contractual obligations
- Map contractual obligations to insurance cover – know you have cover / know where the gaps are
- Track projects and policies – a project in 2019 may give rise to a claim in 2031



Contractual terms



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Is contractual liability covered?

- Liability policies (Public liability, Product liability, Cyber liability, Professional Indemnity) will generally require the existence of a legal liability.
- Most policies will deal with contractual liability to some extent



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*“contractually assumed liabilities which **but for such contractual arrangements the Policyholder would not otherwise be liable** unless such indemnity is requested of and is granted by written endorsement to the policy”*

*“arising out of, based upon or attributable to any guarantee or warranty **except to the extent such liability would have attached to an Insured in the absence of such contractual duty, term or agreement**”*



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Contractual terms

Fitness For Purpose / Guarantees

- Arise in commercial contracts
- Onerous obligations impose absolute duties beyond the ordinary standard of reasonable skill and care in the performance of your services.



Contractual terms

Indemnity clauses

- Impose liability in respect of “all losses, claims, damages, expenses and costs” that are caused by (or linked to) a particular breach of contract or duty.
- Very onerous, as they operate regardless of any legal liability, mitigation or reasonable foreseeability
- Liability policy unlikely to provide cover, as implications potentially go far beyond common law.



Contractual terms

Liquidated damages

- Impose obligation to make a financial payment if fail to hit a contractual milestone
- Incentive to complete on time / Deterrant?
- Or compensation to building owner for loss of amenity?
- If a genuine penalty, not covered under insurance



Contractual terms

What practical steps can be undertaken to cover contractual liabilities which might fall into one of the categories we have discussed or which would otherwise not be covered?

- Contractual Extension clauses
 - Clause in one high profile case.....

“... liability assumed by The Insured under contract or agreement and which would not have attached in the absence of such contract or agreement shall be the subject of indemnity under this section...”
 - How far did this extension go?



Contractual terms

Contractual Extension: Tesco Stores Ltd v Constable [2008]

- Development was a tunnel over a railway line.
- Developer agreed to indemnify the train operator for any costs, losses and expenses from carrying out of the works.
- A section of tunnel collapsed and train operator called on the indemnity from the Developer for losses suffered.



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Contractual terms

Contractual Extension: Tesco Stores Ltd v Constable [2008]





Contractual terms

- Developer's Public Liability policy include an extension for "Contractual Liability":

"... liability assumed by The Insured under contract or agreement and which would not have attached in the absence of such contract or agreement shall be the subject of indemnity under this section..."

- Court found Developer could not recover under the extension.
- Very clear wording needed



Contractual terms

- Specifically negotiate cover for contractual liabilities
 - Is it sufficient if Insurers are simply provided with the contract?
 - What other steps are necessary?
 - Examples
- Collateral warranty clauses
 - Be aware of limitations, as discussed
- Practically – manage the contract terms and map the policies



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Contractual terms

Pro-active tips

- You should ensure you do not exceed the sums for which you are insured under your insurance policy under contract. Consider a “Cap on Liability Clause”.
- The level of insurance cover required of you should be appropriate for the level of the services you are providing on the project.



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Contractual terms

Pro-active tips

- Do not disclose your professional indemnity insurance policy to your client
- Always ask to see the whole contractual matrix
- Net Contribution Clauses
- Insurance gaps might be considered another “risk of business”. Whilst you might want to proceed without insurance cover, only do so if fully informed of risks
- Consider other products



Conclusion

- Have a good risk management strategy
 - Good connection between legal/risk and business
 - Know what clauses are being used and whether they are/are not insured
 - Seek specific extensions where required
 - Look to fill gaps where matters are not insured (e.g. by contractual means)
 - Good audit process to manage the time lag between projects and claims, particularly where policies are “claims made”

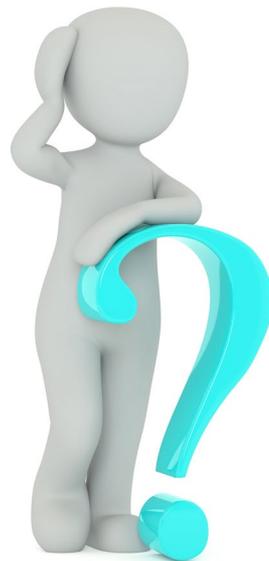
This is how you can demonstrate “added value” proactively helping the business in a function that many see as merely a remote cost.



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Q&A



Thank You!

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