



Tipsheet 12 Public Liability – Subcontractors

Client version
May 2009
Updated January 2011

Liability issues for subcontractors and the impact their public liability insurance

What is subcontracting?

The use of subcontractors is more common in many industries and is especially prevalent in the building and construction industry.

A subcontractor is a person or company who is appointed to provide part of the services that a contractor has agreed to provide to a principal.

Sometimes the services are professional in nature (eg designing or specifying something) and sometimes they involve the delivery of a product or outcome (eg construction of a building/works or supply of a manufactured product or servicing, repairing or maintaining something).

Example: A property developer (Mackerel Developments Pty Ltd) appoints a building construction firm (BrickCorp Ltd) to build and manage the construction of 12 luxury villas at Port Stephens (Giorgio Apartments).

Mackerel Developments is the principal and enters into a “Head Contract” with BrickCorp.

The Head Contract requires BrickCorp to engage all the consultants and contractors who will perform work on the site (including architects, engineers, surveyors, earthwork and demolition contractors, bricklayers, electricians, plumbers, joiners, plasterers etc). and to sign a subcontract with each and every subcontractor.

There are service standards, indemnities and insurance requirements in the Head Contract and the subcontract which are designed to

protect Mackerel Development’s interests and minimise its legal liability.

Liability issues when appointing subcontractors

Principals, head contractors and subcontractors all owe duties of care to each other and to any third party who is injured or has their property damaged.

The extent of their direct liability for a third party’s loss or damage depends on which of these parties was responsible for safety issues on the site and whose conduct caused the loss or damage.

It is possible that one or more people may have direct liability for third party loss or damage - it depends entirely on the circumstances that led to the damage or injury.

Example¹: A prospective buyer of a luxury villa in the “Giorgio” development is invited onto the construction site by Mackerel Developments.

While visiting the site, the buyer hits their head on a scaffolding cross bar which was erected by a subcontractor (Upright Scaffolding Pty Ltd). The injured buyer requires treatment and threatens to sue!

Upright Scaffolding negligently installed the cross bar. BrickCorp didn’t install a sign to alert people that they could hit their head nor did it take the cross bar down when it knew it hadn’t been installed properly. Each of them owes a duty of care to the injured buyer to exercise reasonable care for his safety. Each of their acts or omissions has contributed to his injuries.

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The 'principal and agent' relationship between principals, head contractors and subcontractors may also create a situation where one or more is 'vicariously' liable for loss or damage caused by the others. This is because at law a principal is vicariously liable for the acts of its agents. So the principal is vicariously liable for the acts of the head contractor and in turn, the head contractor is vicariously liable for the acts of the subcontractor.

For this reason:

- Head contracts usually contain indemnity clauses requiring the head contractor to indemnify the principal for its liability for any death, injury or damage caused by the head contractor and any subcontractors; and
- Sub-contracts usually have similar clauses requiring the subcontractor to indemnify the head contractor for its liability for death, injury or damage caused by the subcontractors.

The chain of liability can easily be broken if the indemnity clauses in each contract are not properly drafted to give each "principal" maximum legal protection.

Such contracts nearly always require each party to hold insurance to cover the indemnity they have provided - but the combination of an indemnity clause and an insurance clause can have unintended consequences in the event of a claim!

Example: The Sub-Contract between BrickCorp and Upright states:

"The Subcontractor must indemnify the Head Contractor and the Principal for any liability suffered or incurred by the Head Contractor or the Principal arising out of the performance of the Subcontract Works."

The subcontract requires Upright to hold a public liability policy:

- covering the liability referred to in the indemnity clause; and
- in the joint names of Upright and the Head Contractor; and
- covering each of them for their 'respective rights and liabilities'.

- *Upright's policy is not in joint names and doesn't cover 'respective rights and liabilities'.*

The injured buyer sues BrickCorp and Upright. The court finds that BrickCorp and Upright were directly liable - Upright for putting up the scaffolding cross bar that injured the buyer and BrickCorp for failing to remove it.

BrickCorp sues Upright to recover under the indemnity clause and alleges breach of contract for 'failure to insure'.

Impact on public liability insurance

Most public liability policies only cover the insured's legal liability for third party property damage or personal injury. They are not intended to cover another person's legal liability.

Example: In the legal proceedingsⁱⁱ, the court finds that Upright does not have to indemnify BrickCorp because BrickCorp's liability to the injured person was direct, not vicarious. In other words, BrickCorp's liability arose from its own negligence in failing to remove the cross bar. This liability did not come within the indemnity clause because it did not 'arise out of the performance of the Subcontract Works by Upright'.

The Court also finds that Upright was not required to hold insurance for BrickCorp's negligence because:

- *the contract only required the policy to cover BrickCorp's vicarious liability for the negligent acts of Upright; and*
- *it would be unusual for Upright to be required to buy insurance for Brickcorp's own negligence if the indemnity clause meant that Upright had no liability for Brickcorp's negligence.*

It is a lucky escape for Upright because the court decided that Brickcorp's claim did not come within the indemnity clause. This meant they never had to consider whether the insurance policy would cover a valid claim under the indemnity clause.

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Tips and traps for subcontractors

If there is a 'difference' between liability assumed under the contract and the liability under the Common Law, often the policy won't respond.

An insurance policy usually covers Common Law liability, not contractual liability. This means indemnity clausesⁱⁱⁱ in a subcontract may be a problem from an insurance perspective.

Example: An indemnity clause requires a subcontractor to assume liability for all loss or damage - regardless of who caused it. This may extend to the negligence of the head contractor if the clause is appropriately drafted.^{iv}

Example: "The subcontractor shall indemnify and keep indemnified the company against all loss or damage including but not limited to all physical loss or damage to property...and all loss or damage resulting from death or resulting from personal injury arising out of or resulting from any act, error or omission or neglect of subcontractor."^v

Example: "The subcontractor agrees regardless of any negligence on the part of the principal to release, hold harmless and indemnify the principal from and against all liabilities...of whatever nature, howsoever occurring which may accrue against or be suffered by the principal arising out of or in any way connected with the performance of the services."^{vi}

These are classic examples of where the 'contractual liability' exclusion is triggered. If this happens, you may be 'uninsured' for the liability assumed under the contract.

The courts may apply a more conservative approach to the construction of indemnity clauses – particularly where the indemnity clause is ambiguous.

Subcontractors are not usually liable to indemnify a head contractor for the head contractor's negligence. However this depends on the breadth of the indemnity.^{vii} If it extends to 'no fault' liability then the subcontractor may be liable under the terms of the indemnity.^{viii}

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Recent cases^{ix} show that an indemnity for the head contractor's own negligence requires very clear words – otherwise it is more likely the intent of the parties is for the subcontractor to indemnify the principal or head contractor for vicarious liability arising from the subcontractor's errors or default.

Rather than relying on the courts to interpret an indemnity clause, it is better for you to take your own legal advice. At a minimum, to see whether the clause will trigger the 'contractual liability' exclusion and whether there is coverage for principal's liability in your public liability policy.^x

If you who want maximum protection from your insurance either:

- Ask your broker about a policy that covers liability assumed under contract (eg umbrella liability)^{xi} or to make arrangements to have the policy endorsed and extended to cover liabilities assumed under the particular contract (e.g. have the a contract designated on the policy schedule^{xii}); or
- Re-negotiate the indemnity clause so it is consistent with your legal liability. This will involve incorporating elements of proportionate liability and contributory negligence into the wording of the indemnity clause or confining the indemnity to where the loss or damage is caused by the subcontractor's negligence.

For more assistance, or if you would like a legal review of your contracts and insurance policies, contact your broker for a referral.

ⁱ This example is based on the facts in a recent NSW case - *Erect Safe Scaffolding (Australia) Pty Limited v Sutton* [2008] NSWCA 114 (6 June 2008) except in that case the injured person was a worker employed by another sub-contractor and not an invitee. Nonetheless, the same principles apply.

ⁱⁱ This is also the outcome in the *Erect Safe Scaffolding* case.

ⁱⁱⁱ For more details about indemnity clauses, ask your broker for a copy of our Tipsheet 1.

^{iv} For example, if the words in the indemnity clause are so clear as to convey an intention that the parties agreed for the subcontractor to be liable to the principal even if the other party is negligent then the subcontractor will have such liability. In the case of *BI Contracting Pty Ltd v AW Baulderstone Holdings Pty Ltd* (2007) NSWCA 173, the court found that the indemnity clause used words of the widest import including "all liability" and "in relation to" and in the circumstances that meant the subcontractor had liability for the negligence of Baulderstone.

^v *Leighton Contractors Pty Ltd v Smith* (2000) MSWCA 250.

^{vi} *Qantas Airways Limited v Aravco* (1996) HCA 12

^{vii} Cases such as *Baulderstone, Leighton Contractors, Aravco* and *Samways* considered indemnity clauses with particularly wide terms and in each case, the courts concluded that the contractor was at risk for the other party's negligence. Terms such as "all liability relating to subcontract works", "all loss or damage in connection with or arising from" lend themselves to the widest possible import particularly where the commercial relationship between the parties and negotiations also support a broad interpretation.

^{viii} In certain cases, claims involving liability for economic loss and property damage may be affected by the proportionate liability legislation and this may render an indemnity clause between the principal and subcontractor inoperative – see Tipsheet 3 for more details.

^{ix} In the Western Australian case of *Westina Corporation v BGC Contracting Pty Ltd* (2009) WASC 213, the courts reviewed an indemnity clause in a 'wet hire' agreement. The court considered that the proper construction of the indemnity clause depended '...on the context of the hire agreement as a whole, the surrounding circumstances known to the parties, and the purpose and object of the transaction'. Taking into account all of those factors, the court concluded that the parties could only have intended for BGC to be liable to Westina for BGC's negligence and that of its driver. A different outcome was reached in the Qld case of *Samways v WorkCover Queensland & Ors* (2010) QSC 127 and this indicates that each case turns on its merits and the use of an indemnity clause in very broad terms may result in an outcome where the subcontractor is liable for the principal's negligence.

^x Principal's liability cover is often found in a public liability policy and it covers the vicarious liability of the principal in relation to the work performed by a subcontractor under an agreement between them. This cover can be used to meet contract requirements. See our Tipsheet 7 for more details – ask your broker for a copy.

^{xi} This type of insurance can be difficult to obtain and may only be available to insureds with a substantial business and insurance programme.

^{xii} This can be done on request to the underwriter. The Steadfast General and Products Liability policy makes provision for this to occur provided the underwriter agrees to accept the additional risk and designates the contract on the policy schedule.

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