GOLD SEAL Assisting Beyond Expectation


Tipsheet 6
Insurance Clauses – Failure To Insure

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What happens if a party fails to insure when a contract requires them to do so?

When does a 'failure to insure' occur?

Contracts often require one party (*the contractor*) to hold insurance for the benefit of another party (*the principal*) or to protect the principal against loss or liability for unforeseen events.

Example: An office lease requires the tenant to purchase and hold public liability insurance for the benefit of the landlord.

The contractor will be in breach of the contract if the policy is not placed or the policy does not satisfy the requirements of the contract due to:

- the limitations of the cover (ie insuring clauses, exclusions etc);
- the contractor's failure to comply with pre-conditions of the policy (eg duty of disclosure);
- the contractor's failure to comply with policy conditions (eg to notify a claim within a particular timeframe); or
- the contractor's failure to name the principal as an insured or note their interest on the policy.[i]

What happens if there is a 'failure to insure'?

Generally a problem only arises when a claim is made which should have been covered by the insurance (eg a personal injury or property damage claim brought against the contractor and/or the principal by a claimant). If the contractor did not obtain the required insurance, some or all of the liability will be 'uninsured'.

Example: The tenant is a valuer of precious jewelry and artifacts. A client of the tenant trips on the carpet inside the tenant's office while carrying an expensive crystal vase. The vase is completely destroyed. The carpet has been damaged for some time and the tenant knew but hasn't done anything about it. The client sues the tenant and the landlord for negligence.

The lease contains an indemnity clause which requires the tenant to indemnify the landlord for personal injury or property damage claims that occur at the leased premises.

Even though the landlord has its own insurance, the lease contains an insurance clause which requires the tenant to hold public liability insurance which also covers the landlord for its "respective rights and liabilities". The tenant failed to have the insurance extended to cover the landlord.

The landlord and tenant may be liable to the client for damages for negligence (common law claim) for allowing the carpet to remain in a dangerous condition.

The tenant may also be liable to the landlord under the lease:

- *for any liability the landlord has to the client (indemnity clause); and*
- *for failing to obtain public liability insurance in accordance with the contract (insurance clause).*

Even if the principal has its own public liability insurance, this doesn't extinguish their claim against the contractor for damages. It doesn't matter if the principal has an insurance policy to meet the loss, the contractor is still liable 100% for the principal's claim – the liability is

not reduced to 50% (as if the contractor had been insured).[ii]

What is the impact of an indemnity clause?

Firstly, a 'no fault' indemnity requires the contractor to indemnify the principal for any liability regardless of whether they caused the injury or damage. The principal can recover 100% of their liability to the claimant from the contractor.

Example: If the court awards the client $100,000, the landlord can recover the full amount from the tenant under the indemnity clause.

Secondly, the principal's insurer can recover 100% of any amount it paid to the claimant from the contractor by enforcing the indemnity (the insurer has a right of subrogation under the policy).

The principal can recover additional costs of claiming under the policy (eg the excess) or any of its uninsured loss as damages for the 'failure to insure'. [iii]

Example: The insurer can recover from the tenant the $90,000 it paid. The landlord can recover from the tenant the $10,000 excess it paid towards the claim and any other out-of-pocket costs.

If the contractor had insurance and it was 'aligned' with the indemnity clause[iv], two policies would have been in place and the insurers would probably have shared joint financial responsibility for the court award (as there would have been 'double insurance')[v].

What is the impact of 'proportionate liability'?

If the indemnity clause in the contract is consistent with the proportionate liability legislation[vi] or 'contributory negligence' principles:

- the court apportions the claim between the principal and the contractor according to the share that each party was to blame;
- the contractor would only be liable for its share of the compensation claim.

Example: If the tenant had agreed to "indemnify the landlord for liability for personal injury or property damage caused by the negligence of the tenant", the position would be very different.

If the court decided each of them was negligent and that the tenant was 30% responsible and the landlord was 70% responsible. The tenant would be liable for $30,000 not $100,000.

The principal's insurer would pay the principal's share. The contractor would pay their own share (subject to any further claim the insurer may have for the contractor's failure to insure[vii]). Again the principal could recover the excess and out of pocket costs from the contractor because of the 'failure to insure'.

Example: The landlord can recover $10,000 for the excess, so the tenant would contribute $40,000 and the landlord's insurer would contribute $60,000.

Is there any insurance cover for 'failure to insure'?

Most public liability insurance excludes claims arising from a 'failure to insure'.[viii] If the contractor holds another policy (eg PI or management liability), they could seek indemnity under that policy for their legal liability for 'failing to insure'.

Example: If the professional services provided by a business include arranging insurance, the policy may cover a failure to do so (eg lawyers, conveyancers, real estate agents, insurance brokers).

However you should check with your broker as other policy exclusions may apply.

What to look out for:

- Contracts and leases should be reviewed carefully by the broker (or a lawyer) to make sure the policy meets the contract requirements. Otherwise the client could face financial ruin due to 'uninsured risks' and other legal action.

- Sometimes, legal advice may be needed to make sure the clauses of the contract or lease do not breach the terms of the policy. Otherwise you could face financial ruin due to 'uninsured risks' and other legal action.
- The indemnity clauses in a contract or lease have a big impact on whether the policy will respond.
- If the indemnity clause in a contract or lease is 'strict liability regardless of fault' or 100% of the liability is assumed by the contractor, your broker may need to contact the insurer regarding changes or endorsements to your policy or you may need to renegotiate the terms of the contract so the contract is more closely 'aligned' to your insurance cover.

Policies and contracts or leases can differ greatly –***contact your broker to obtain specialist assistance in this area.***

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[i] For more information about naming insureds and noting interests – see our Tipsheet 7. Ask your broker for a copy.

[ii] The plaintiff's entitlement to claim under a different policy does not reduce the damages that can be claimed from the defendant for breach of contract where there is a failure to insure in accordance with the terms of the contract: *Western Sydney Regional Organisation of Councils Group Apprentices v Stratona Pty Limited t/as Recycled Auto Electrical & Ors* (2002) 12 ANZ Ins Cases 61-530.

[iii] *Thiess Contractors Pty Ltd v. Norcon Pty Ltd* [2001] WASCA 364; *Hacai Pty Ltd v. Rigil Kent Pty Ltd* (Unreported decision SC NSW 29 August 1995); *Western Sydney Regional Organisation of Councils Group Apprentices v Stratona Pty Ltd* (Unreported decision FCA 31 October 1984).

[iv] For this to work the policy would need to have no 'contractual liability' exclusion or a policy that allows the contractor to have cover for liability assumed under an incidental contract like a lease.

[v] *Lumley General Insurance Limited v QBE Insurance (Australia) Limited* [2008] VSC 216 – this would be the case if one or both policies insure the parties to the contract (e.g. if the landlord's policy insures the tenant's liability or the tenant's policy also insures the landlord's liability). This decision was reiterated by the Victorian Court of Appeal in the later decision of *QBE Insurance (Australia) Limited v. Lumley General Insurance Limited* [2009] VSCA 124.

[vi] See Tipsheet 3 for details of the proportionate liability legislation. Ask your broker for a copy.

[vii] Depending on how the contract is worded, the insurer may have a claim against the contractor to recover 50% of the $60,000 it pays for the court award because if two policies had been in place the insurer would only have paid 50% of the principal's share.

[viii] This might be relevant where the client actually holds a public liability policy but the terms of the policy do not meet the requirements of the contract so the principal argues "failure to insure". For example, the contract may require $20m of cover and you only hold $10m.