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INSURANCE CLAUSES

Insurance Clauses in Commercial Contracts

Many commercial contracts include provisions requiring one or other of the parties to effect insurance. Such clauses are inserted into commercial contracts because the parties want to transfer to an insurer the financial consequences of one or more of the risks that may arise from the performance of the contract. However, as the case of *Allstate Explorations NL v Blake Dawson Waldron* [2010] WASC 97 demonstrates, each party must be careful to ensure that it properly understands the nature and extent of the insurance that is required to be effected, and to confirm that insurance cover of that nature and character is in fact available in the market.

The Facts

Allstate was the manager of the Beaconsfield Gold Mine in Tasmania. The decision has nothing to do with the collapse for which the mine subsequently became notorious. Rather, Allstate had retained Blake Dawson Waldron to advise on a complex construction contract for a mining and backfill plant. The contract included terms obliging the parties to obtain insurance for a range of potential risks. Relevantly, the contract provided for the contractors to take out professional indemnity insurance. The contractors did not meet the performance obligations specified in the contract and at a commercial arbitration were found liable to Allstate (and the owners of the mine) in an amount in excess of $60 million, including for claims of professional negligence. The contractors were unable to satisfy the judgment and went into liquidation.

The contract required the contractors to effect and maintain professional indemnity insurance for $20 million. However, when the contractors claimed on that insurance, the insurer denied liability on the grounds of material non-disclosure. Subsequently Allstate and the mine owners brought a claim against the insurer by virtue of Section 6 of the *Law Reform (Miscellaneous Provisions) Act* 1946 (NSW). That claim was ultimately settled with a payment, without admission of liability, of $13 million. Allstate and the owners then brought a claim against Blake Dawson for the balance of $7 million plus interest. The claim did not relate to the drafting and eventual settling of the terms of the insurance obligations in the contract. The plaintiffs accepted that those clauses accurately represented the agreement made and intended by them. Instead, they alleged that Blake Dawson failed to advise them that the professional indemnity insurance which was actually obtained did not meet the requirements of the contract. The plaintiffs' claim was dismissed. The importance of the judgment lies not in the claim against the solicitors but in the parties' competing interpretations of the relevant insurance clause.

The Insurance Requirement

The clause relevantly provided:

> 'The Contractor shall effect and maintain both project specific and general professional indemnity insurance:
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> (a) which covers liability arising from a breach of duty owed in a professional capacity, whether owed in contract or otherwise, by an act for omission of the Contractor or its employees in relation to the performance of the work under the Contract; and

(b) with a limit of indemnity of $20 million for any one claim and in the aggregate and in respect of non project specific professional indemnity insurance with provision for one reinstatement per period of insurance; and

(c) which names the Principal and the Contractor as the insureds.'

The plaintiffs argued that this condition required the contractors to obtain and maintain professional indemnity insurance which would cover Allstate (or all of the plaintiffs) not for any liability which they may have to others but for the contractors' liability to it or to them – so called first party loss. That is, the plaintiffs' case was that the insurance required by the contract effectively included an indemnity to them for the due performance of the contractual obligations by the contractors.

In support of their interpretation of the insurance clause, Allstate argued that the prospect of it incurring any 'liability arising from a breach of duty owed in a professional capacity..... in relation to the performance of the work under the contract' was very unlikely and was limited to the very small risk that Allstate, as manager, might incur vicarious liability for a breach of duty of the contractors or their employees. Allstate argued that the risk which the clause was designed to require insurance against was the more significant risk that the contractors might incur a professional liability to it which, for some reason (such as the non-disclosure for which the insurer had denied indemnity) meant that the contractors would not be covered for their own professional liability. Thus the risk that the plaintiffs intended to be transferred to the insurer was the risk that the contractors would incur a professional liability to the plaintiffs that they could not meet and that was not covered by the contractors' own insurances.

The defendants maintained that the insurance required did not extend beyond an obligation to obtain insurance for any professional liability of the plaintiffs, and the contractors, arising from the project. They argued that the clause on its proper construction should be taken to require only that Allstate should be covered for its own liability for a breach of a duty owed in a professional capacity in relation to the performance of the work under the contract on the basis that circumstances could well arise in such a contract where, because of a breach of duty by the contractor or its employees, some vicarious liability might arise for Allstate for which such cover would be desirable and prudent. The defendants argued that professional indemnity insurance cover is liability cover and that such cover would not have responded to the plaintiffs' 'first party loss' occasioned by the non performance of the contractual obligations by the contractor.

Further, the defendants submitted that at the relevant time there was no policy available in the insurance market which would have provided an indemnity to the plaintiffs in the way that the plaintiffs argued that the professional indemnity insurance required under the contract should have.

The Proper Construction of the Insurance Clause

In approaching the task of construing the insurance clause, Heenan J said:

> 'In the end the task of a court in construing a provision of a contract must be to have regard to the objective meaning of that provision in the context of the contract read as a whole and taking into account any special meaning, or shade of meaning, which the words of the provision should bear having regard to the origin, purpose, genesis, background and other circumstances known to the parties and identifying the commercial purpose which they were objectively pursuing at the time when the agreement was reached..... Where well defined, commonly used and standard terms are used in the contract such as, in this case, provisions dealing with public liability and third party property damage insurance, advance consequential loss insurance, contract works insurance, workers compensation insurance, marine cargo insurance and professional indemnity insurance it is to be expected, at least as a starting point, that such well known terms and concepts will be used in their standard and established meanings although, having regard to the setting in the particular contract and any

> relevant and admissible external evidence, there may be occasion to consider whether or not there has been any departure in the meaning of those terms from standard concepts or that some nuance or overlay or altered meaning should be give to such terms in order properly to reflect the objective agreement of the parties.'

Heenan J stated that in commercial contracts, particularly contracts dealing with insurance involving a multiplicity of parties such as brokers, underwriters, insurers and contractors, there is every practical reason for treating established concepts and terms as bearing their conventional meanings. Otherwise any certainty would quickly disappear in an area where, more than most, there is a need for certainty and consistency in the objective meaning of words.

The judge noted that the construction of the clause advanced by Allstate involved a type of cover outside the traditional and characteristic scope of professional indemnity insurance, being insurance to cover the insured for losses which the insured suffers by the breach of another entity and not insurance cover indemnifying the insured for its own legal liability. Having reviewed the history of the negotiations, Heenan J came to the view that the professional indemnity insurance to be obtained under the contract was never intended to be anything other than a conventional liability based cover indemnifying the insureds for their civil liability, if any, arising from actionable breaches of duty by the contractors. He noted that nothing else was ever mentioned nor did Allstate, or particularly its insurance broker, investigate the possibility of obtaining a professional indemnity policy which would also cover its 'first party loss'.

The Availability (or otherwise) of the Cover the Plaintiffs Wanted

Evidence was called from both the manager of the professional liability division at the insurer at the time and two expert witnesses. The manager was emphatic in saying that it was not his intention as underwriter to provide first party loss cover and that he would not have agreed to amend the policy which had been granted so as to provide such first party loss cover even if he had been asked to do so (which he wasn't). Whether such cover would have been obtainable at the time from another insurer, whether as part of a professional indemnity policy or otherwise, was the subject of contested expert evidence. Ultimately Heenan J was satisfied that the evidence did not establish that first party loss cover by an insurer for the kind of losses suffered by Allstate and the mine owners as a result of the negligence of the contractors was available or could have been procured in the insurance market at the relevant time.

Commentary

The decision highlights the importance of ensuring that insurance clauses in commercial contracts accurately describe the nature and extent of the insurances required and that very specific wording is used if the type of risk sought to be covered is different from or outside the traditional and characteristic scope of that type of insurance. In this instance, traditional professional indemnity insurance indemnifies the insured for its own legal liability. What Allstate argued should have been covered was outside this scope, being insurance to cover the insured for losses which the insured suffers by the breach of duty by another entity. It also highlights the importance of the parties to the contract understanding for themselves the characteristic scope of the types of insurance specified in the contract. It is not unusual for parties to contracts who are not familiar with insurance terms to think (wrongly) that simply being added as an additional insured or having their interest noted on a liability policy will give them the type of first party cover that Allstate argued for in this case.

It is also important for the parties to any commercial contract, before finalising the insurance clause, to check with their respective insurance brokers, or other specialists, that the type of insurance cover required by the contract is in fact available and the cost of potentially suitable policies. It is too late once the contract has been signed to find out that the insurance that you have agreed to obtain is prohibitively expensive. Further, specialist advice should be obtained in relation to the terms or likely terms of the proposed policies and whether they necessitate changes to the terms of the insurance clause in the contract. For example, it may

be appropriate to specify that the insurance should provide that non-disclosure by one insured does not prejudice the rights of any other named insured or it may be appropriate to require the deletion of standard exclusions, such as the common exclusion in a professional indemnity policy excluding cover for claims between co-insureds.

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