ADDLESHAW GODDARD

SUPREME COURT GUIDANCE: INTERPRETATION OF INSURING CLAUSES IN CONSTRUCTION CONTRACTS

Gard Marine and Energy Ltd v China National Chartering Co Ltd and another [2017] UKSC 35

- The insurance arrangements between co-insureds (e.g. the Employer and Main Contractor) may determine whether a subrogated claim can be brought by insurers against a defaulting sub-contractor down the contractual chain.
- In the absence of contrary drafting, the Employer and Main Contractor may be found to have agreed to look to insurers for indemnification in the event of a loss rather than to each other.

What's it about?

The dispute arose as a result of the total loss of a vessel in Japan during a storm and concerned the following charterparty chain:

- The vessel was chartered by the owners (Ocean Victory) to the demised charterers (Ocean Line).
- Ocean Line time-chartered to China National; and (iii) China National sub-chartered to Daiichi.

Clause 12 of the charterparty between Ocean Victory and Ocean Line broadly provided that Ocean Line should insure the vessel and that Ocean Victory was to be a named co-insured on the policy.

The charterparty, the time-charter and the sub-charter contained undertakings to trade the vessel between safe ports. In September 2006, Daiichi instructed the vessel to discharge at Kashima in Japan. The vessel was grounded and became a total loss.

The insurer sought to subrogate the rights of Ocean Victory and Ocean Line to bring a claim against China National for breach of the safe ports undertaking which in turn would be passed down the contractual chain to Daiichi.

This is a similar scenario to contractual structure adopted in many construction policies, where the Employer and the Main Contractor are joint insureds under an insurance policy purchased by one of them. Cover under such insurance may be triggered by a subcontractor further down the contractual chain acting in breach.

For present purposes, the relevant question before the Supreme Court was whether the existence of joint insurance precluded rights of subrogation by the insurers against a sub-contractor (who was not a co-insured) who caused the problem in the first place.

By a narrow (3:2) majority upholding the Court of Appeal's decision, it was held (obiter) that a defaulting sub-contractor may escape liability if there is no claim to pass down the chain. The Supreme Court held that the agreement to obtain insurance for the benefit of the Owner and the Charterer (i.e. the Employer and the Main Contractor in a construction context) extinguished claims between the Owner and the Charterer (irrespective of whether the insurance monies had been paid). The Owner and Charterer were held to have understood implicitly that there would be no claim between them because of the co-insurance scheme. This meant that there was no claim which could be passed down the chain by the Charterer to the defaulting sub-contractor. There was therefore no subrogated claim for insurers to pursue.

Why does it matter?

Whilst there is an established rule that in the absence of clear wording to the contrary co-insureds cannot claim against each other for an insured loss, this was the first time the Courts considered how the principle affected claims against a third party wrongdoer who is not a co-insured.

In a construction context, this decision could protect defaulting subcontractors from a subrogated claim by insurers who have paid the Employer for losses where the terms of the subcontract do not otherwise protect them. This is because the existence of insurance for the benefit of the Employer and the Main Contractor interrupts the flow of claims further down the chain.

The practical result of this is also that in the absence of wording to the contrary, parties who agree insuring clauses for their mutual benefit may be held to have agreed to have limited the sums recoverable to the amounts insured under the relevant insurance policy. This could cause issues where risks are under-insured or where insurance has not been procured as intended.

What now?

In light of this liberal interpretation of insuring clauses, parties should consider carefully the implications of the insuring clauses contained in their construction contracts. Best practice is to clearly set out the effect of any insurance arrangements including whether they exempt a party from liability.

Who to contact

VICTORIA POOL
Managing Associate

0161 934 6501
07725 732399

JOSIANNE EL ANTOURY
Associate

0207 788 5084
07701 309604