

QBE Update: Contractual Liability

16 September 2005

Disclaimer – This document is a general document only, it is not intended to provide legal advice regarding any particular document, but provide general comment on issues arising out of the use of contracts.

If you have any specific queries regarding a contract you should take appropriate legal advice prior to agreeing or signing the contract.

BACKGROUND

One of the largest exposures to any business arises from the way that it organises, enters into and manages its contracts.

A contract is formed at any time where there is an agreement between two parties. It can be set out in writing or agreed verbally.

The terms a business agrees in its contracts can greatly affect its liability exposure.

Liability may occur under contract, and this liability may be greater than the liability that would ordinarily apply if there were no contract in place.

There are two main ways that additional liability may occur from contracts that an organisation enters into:

- Where a party agrees to accept responsibility for matters for which they have no legal responsibility.
- Where a party agrees to waive certain legal rights that they may have against another party.

TYPES OF CONTRACTS

A business enters into contracts all the time, when it employs people, buys or sells goods, purchases services, leases a building or premises and any other time when it makes some form of agreement with another party.

Contracts that do not increase the business' legal liability

These types of contracts simply state that each party will be responsible for their own actions and negligence.

Contracts regarding the use of land, premises or facilities

It may be a condition of the use of the land or premises that the users will be responsible for any liability arising out of such use or damage to the land or premises.

Under these agreements the user can incur liability for a loss, which would normally be the responsibility of the party granting the use of the land or premises, even if the user has not been negligent.

Contracts relating to the supply of goods or services

These usually come in two forms either oral contracts, or the preferable written contracts.

Whilst oral contracts are generally enforceable they can be difficult to prove and are very easily disputed. A business should consider putting a procedure in place ensuring that all contracts are in writing.

By having written contracts you can ensure that all the parties in the contract have a clear understanding of what is expected of them.

Contracts relating to the hire of equipment and plant

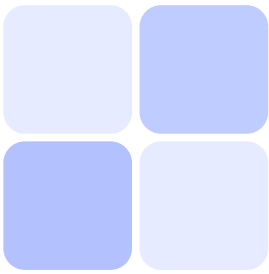
These contracts can be very similar to contracts regarding the use of land, premises or facilities.

The main requirement in a number of these contracts is the requirement that the hirer will be responsible for any damage to the equipment and/or plant. Whilst General Liability insurance can cover the business for damage caused when using the item, it cannot provide a blanket cover for any loss or damage to the item itself.

Example: ABC Contractors Ltd, hires a floor sander from a local hire firm to do some work on a building. In the hire agreement there is a clause that states that the hirer (ABC Contractors Ltd) is responsible for any damage to the floor sander. If, whilst using the sander ABC damages the building that they are working in, the damage caused may be covered under a General Liability policy.

If however a fire damages the sander whilst it is being stored in a building over night, the damage would probably not be covered by General Liability insurance, as there has been no negligent act by ABC Contractors Ltd.

There is a gap in the coverage. If the business requires this type of cover it should consult their property insurer.



PROBLEM AREAS

The three main problem areas with regard to general liability in contracts are as follows:

Indemnity

The contract may include an Indemnity Clause, which will state that the business takes responsibility for anything that happens, regardless of the cause, in connection with the contract.

What this is in effect saying is that the business will be liable for anything that happens even if it did not cause the incident.

Example: DEF Property Management Ltd hires a hall to run an information session. As part of the hire they sign a hire contract that includes a clause that says that they agree to indemnify the owner of the hall for anything that happens whilst they are using the hall. This is an Indemnity Clause.

At first look it does not appear too onerous. Whilst DEF are running their session a member of the public slips on a loose floorboard and breaks his laptop computer that he was carrying.

Because DEF signed the contract saying that they will indemnify the owner for anything that happens whilst using the hall, they will now be liable for the damage caused and any additional costs and expenses the person incurs.

They are liable for something over which they had no control, as they are not responsible for the upkeep of the hall.

Any Indemnity Clause that a business enters into should clearly state that each party involved in the contract is responsible for their own negligence. It should not include anything that allows the transfer of legal liability from another party to the other.

Hold Harmless (or waiving the right of recovery)

A Hold Harmless clause, or a clause which states that a business waives its right to recover any costs from another entity, has a very similar effect to an Indemnity Clause. What it means is that the business agrees not to pursue the other party for any costs that it may incur due to their actions and/or negligence.

Example: GHI Home Care Ltd hires a contractor to help install some wheelchair access ramps at a client's home. The contract contains a clause that states that GHI holds the contractor harmless for any anything that might happen.

During the installation the contractor damages the cladding on the house.

The client demands that GHI fix the damage. GHI then attempt to have the contractor pay to have the damage fixed, however the contractor refuses, citing the hold harmless agreement in the contract.

GHI (or their insurer) will have to pay the damages bill.

Again, a business should ensure that none of the contracts that they enter into contain hold harmless agreements, and that each party is responsible for its own negligence.

Joint/Co Insured

The terms Joint or Co Insured usually occur in an Insurance Clause of the contract. The clause will say that the business agrees to include the other party as a joint or co-insured on its insurance policy. What this essentially means is that the business agrees to include the other party in its insurance policy with the same rights on the policy as it has, ie; the right to claim directly under the policy.

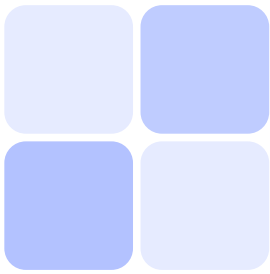
This is something that as an insurer we are not prepared to do on a General Liability insurance policy, as it has the potential to greatly widen our exposure to claims under the policy. This could also cause problems for the business as illustrated by the following example.

Example: JKL Plumbing Ltd enters into a contract to install piping and fittings in a building being built. They are a sub contractor to a larger contractor who is running the entire construction contract for a building developer.

As part of the contract JKL agrees to include both the head contractor and the developer as joint Insureds under their General Liability policy.

During construction there is some damage to the building due to some poor pipe work. At this stage it is not clear who actually did the work concerned.

As JKL has included the developer as a joint insured on their policy, the developer then contacts JKL's



insurer directly and makes a claim directly on JKL's policy, bypassing JKL. This will have a negative effect on JKL's claims history and make it harder or more expensive for them to purchase insurance in the future.

CONTRACTS

There are a number of ways that a business can minimise and control its risk when entering into contracts these include the following:

- Always try and put your agreements/contracts in writing
- Restrict authorisation for the entering into of contracts to a limited number of appropriately trained/briefed people
- Always check the contracts for the issues raised above
- If you are often entering into contracts, consider designing a standard format for regular use
- Make sure all contracts contain the following:
 - (a) Who is entering into the contract (full legal names, street address, phone number and principal contact at the minimum)
 - (b) Full details of the goods and/or services that will be provided
 - (c) When the goods and/or services will be provided (specify start and finish times if possible)
 - (d) Where the goods and/or services will be provided (full street address).
 - (e) Details of the cost of the good and/or service and when this is expected to be paid
 - (f) An appropriate Indemnity Clause stating that each party will be responsible for its own negligence
 - (g) An Insurance Clause that sets out that each party should take out its own appropriate insurance.

The business should also seek appropriate legal advice and check with their insurance advisor prior to agreeing to the contract.

QBE POLICY WORDINGS

There are a couple of important points to note with regard to the way that QBE's policy responds to problems with contracts.

The following is a summary of the QBE policy version GEL 0503 only. You should read the policy in full.

Principals

Our policy has a provision for the noting of other parties interests on the policy. This is contained in Definition 5.4 under the definition of the insured. We note these parties as principals under the policy. What this means is that we note that the business is undertaking work for the principal and agrees to indemnify them for any legal liability that might arise out of the activities of the business.

Contractual Exclusion

The policy also contains an exclusion (Exclusion 4) that restricts cover that a business might assume under any contract. What this means is that the policy will only respond to a liability if that liability existed even if there was no contract in place. If in the contract the business has accepted additional liabilities, these would not be covered unless agreed to by QBE in writing.

To discuss any of the issues raised please contact your QBE representative.



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