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THE CO-INSURANCE DEFENCE: COURT OF APPEAL CONFIRMS THAT UNDERLYING CONTRACT DEFINES NATURE, SCOPE AND EXTENT OF CO-INSURANCE UNDER PROJECT POLICY

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SUMMARY

The Court of Appeal has dismissed an appeal by FM Conway Ltd ("Conway") against the judgment of Eyre J in the Technology & Construction Court about the nature, scope and effect of co-insurance in the context of a contractor's liability for damage caused by defects on a construction project.

My note of the TCC's first instance decision from May 2022 provides a summary of the background to the case, including the works, defects, damage and losses claimed. In that note, I also summarised the TCC's reasoning for dismissing Conway's co-insurance defence, which the Court of Appeal has now roundly endorsed.

It was my view then that the TCC's judgment joined a growing line of important authorities on the relationship (and tension) between – on the one hand the allocation of risk between parties on a construction project – and on the other the scope and extent of insurance taken out in respect of such risks. Lord Justice Coulson's comprehensive analysis of the authorities and the reasons for his robust dismissal of this appeal render this Court of Appeal judgment all the more important when navigating this complex area of the law.

WHAT IS THE CO-INSURANCE DEFENCE?

As summarised in my earlier note:

- Parties to construction contracts routinely take out a single insurance policy to the benefit of all parties and against defined risks arising on the project (notably physical loss or damage to the works or property), including where the loss is caused by one of the parties.

- Where insurers have paid out money to an insured party in respect of such losses, they have a right to make a subrogated claim (in the name of the indemnified party) to recover those losses from the party or parties that caused them.

- However, where the parties are co-insureds under the same policy in respect of the same damage, (1) absent express wording to the contrary in the underlying contract between them, the parties cannot pursue each other in respect of that damage; and (2) by extension, the insurers cannot make a subrogated claim in the name of the indemnified party against the other co-insured parties.

The relevance of co-insurance was outlined by Lord Toulson in the 2017 judgment of the Supreme Court in *Gard Marine*:

> *"The critical question is whether the contractual scheme between the owners and the demise charterer precluded any claim by the former against the latter for the insured loss of the vessel. This is a matter of construction. It has become a common practice in various industries for the parties to provide for specified loss or damage to be covered by insurance for their mutual benefit, whether caused by one party's fault or not, thus avoiding potential litigation between them. The question in each case is whether the parties are to be taken to have intended to create an insurance fund which would be the sole avenue for making good the relevant loss or damage, or whether the existence of the fund co-exists with an independent right of action for breach of a term of the contract which has caused that loss. Like all questions of construction, it depends on the provisions of the particular contract…"*

In that case, the majority of the Supreme Court concluded that, as between the co-insureds, the insurance policy represented the sole route to recovery of the insured losses such that there was no liability for those losses as between the parties however they were caused.

TWICKENHAM STADIUM DUCTWORK

In this case, RSA (as insurer) sought to bring a subrogated claim in the name of the RFU to recover £3.3m from Conway and Clark Smith Partnership ("CSP"). RSA had paid those sums to the RFU as losses that the RFU had suffered as a result of damage caused to high-voltage cable pulled through ductwork designed by CSP and installed by Conway.

Conway argued that it was a co-insured in respect of the damage in question under the project policy taken out by the RFU. As such, it relied on the co-insurance defence on the basis that, as co-insured, it owed no liability to the RFU in respect of the damage the RFU had been indemnified for and (by extension) RSA was not entitled to bring the subrogated claim against it.

WHY DID THE CO-INSURANCE DEFENCE NOT ARISE IN THIS CASE?

In the first instance judgment, Eyre J decided that the co-insurance defence was not available to Conway. That was because the RFU and Conway were not co-insureds under the project policy to the same extent and in respect of the same damage.

And here is the most striking feature of this case: Eyre J reached this conclusion despite the wording of the project policy, on its face, extending cover for the damage to both the RFU and Conway.

Instead, Eyre J decided that the scope and extent of cover in favour of Conway was subject to the authority and intention the RFU had to procure the policy on behalf of Conway and that authority and intention was determined by the scope of the RFU's obligation to procure insurance under the terms of the underlying building contract. In this case, the parties agreed to "Option C" under the JCT standard form, which did not extend cover to Conway in respect of damage to the high voltage cables caused by defects in the ductwork.

So, although Conway was a named insured in the owner controlled insurance program (OCIP) policy procured by the RFU and although the wording of the policy appeared to extend cover to the losses in question:

- the cover provided to Conway was restricted by the extent of cover that the RFU agreed to procure for Conway pursuant to the terms of the building contract;
- the policy indemnified the RFU for those losses; and so
- because Conway was not co-insured for those losses, RSA could bring a subrogated claim in the name of the RFU against Conway.

In the Court of Appeal, Lord Justice Coulson endorsed Eyre J's analysis and conclusions. In reciting the relevant authorities and by reference to *Colinvaux's Law of Insurance (13th Ed)*, Lord Justice Coulson summarised the law on authority and intention of an agent (here the RFU) to procure insurance on behalf of its principal (here Conway):

> *"53.1 The mere fact that A and B are insured under the same policy does not, by itself, mean that A and B are covered for the same loss or cannot make claims against one another: see Colinvaux at 5-018 and Haberdashers' at [34] and [62].*
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> *53.2 In circumstances where it is alleged that A has procured insurance for B, it will usually be necessary to consider issues such as authority, intention (and the related issue of scope of cover). Such issues are conventionally considered by reference to the law relating to principal and agent: see Colinvaux at 5-022 – 5-028, National Oilwell and Haberdashers'. Although an alternative approach, referrable to the existence of a standing offer, was identified by Fraser J in Haberdashers', that was dictated by the particular facts of that case.*

53.3 An underlying contract between A and B is not a necessary pre-requisite for a proper investigation into authority, intention and scope: see Petrofina. However, as the same case shows, a contract may well be implied in any event.

53.4 On the other hand, where there is an underlying contract then, in most cases, it will be much the best place to find evidence of authority, intention and scope: see National Oilwell, CRS, Tyco, Gard Marine, Haberdashers' and SSE Generation. The underlying contract has been called "the most obvious source of authority" (National Oilwell) and "a powerful indicator" (Haberdashers').

53.5 That is not to say that the underlying contract will always provide the complete answer. Circumstances may dictate that the court looks in other places for evidence of authority, intention and scope of cover: see, for an example of that process, National Oilwell."

THE FIVE GROUNDS OF APPEAL

Conway advanced five grounds of appeal against Eyre J's first instance judgment; the first four concerning the reliance on the terms of the underlying building contract, the fifth relating to the effect of the "waiver of subrogation" clause in the insurance policy.

1. Firstly, although it accepted the need to look at the RFU's authority and intention to determine the scope of insurance cover procured, Conway argued that Eyre J was wrong to apply the test from *Gard Marine*, which (it said) concerned different circumstances. In particular, Conway said that Eyre J was wrong to place so much weight on the underlying building contract on this issue. Lord Justice Coulson decided that *Gard Marine* was directly applicable to this case and further dismissed this ground for the following reasons:

   - Eyre J had not confined his analysis to the building contract alone.
   - Just because both parties were insured under the same policy, it doesn't automatically follow that a co-insurance defence arises.
   - The building contract (and letter of intent that preceded it) were clear in defining the extent of the RFU's authority and intention to insure on behalf of Conway. This excluded cover to Conway for the recovery of losses from rectifying damage caused by Conway's defect.
   - Evidence of pre-contract discussions between party representatives, which supported a broader scope of cover was overtaken by the letter of intent and building contract.

2. Secondly, Conway argued that the terms of the building contract were irrelevant to determining the RFU's authority and intention because it was entered into three months after the insurance

policy. Lord Justice Coulson disagreed: Conway's argument ignored the existence and effect of the letter of intent and the overall contractual scheme. The letter of intent preceded the insurance policy and its terms were consistent with those of the building contract regarding the scope of insurance that the RFU was required to procure on behalf of Conway. Furthermore, Lord Justice Coulson recognised the retrospective application of the terms of the building contract.

3. Thirdly, Conway argued that since it was identified as co-insured (as opposed to an undisclosed principal) in the insurance policy, it was unnecessary to look at the building contract for the RFU's intention, and all that mattered was the nature and scope of the RFU's authority to procure the cover on Conway's behalf. Lord Justice Coulson rejected the distinction between named and undisclosed principals and repeated that, in any event, the extent of the RFU's authority and the scope of the cover extended to Conway was effected on the basis of Option C of the JCT form – both under the letter of intent and the building contract.

4. Fourthly, Conway argued that if it was an undisclosed principal – prior to the policy, Conway had authorised the RFU (and it was the RFU's intention) to procure the policy on the basis of the extended cover argued for by Conway. Conway argued that this was reflected by the terms of the policy itself and was consistent with the evidence from representatives of both parties regarding pre-contract discussions. Lord Justice Coulson dismissed this ground again on the basis of the clear terms and application of the letter of intent and building contract, which superseded any pre-contract discussions.

5. Lastly, Conway sought to rely on a clause in the insurance policy in which RSA waived its rights of subrogation against Conway. Lord Justice Coulson rejected this argument on the basis of the same rationale behind the rest of the judgment. If Conway's position were to be accepted, it would allow Conway to be insured "through the back door". If accepted, the waiver would have the effect of protecting Conway against subrogated claims for losses that it was not insured against. Lord Justice Coulson concluded that such a waiver of subrogation by RSA could only extend to the rights and interests of the co-insured. Because Conway was not co-insured to the same extent as the RFU, the waiver did not apply.

WHY IS THIS CASE STRIKING?

Despite that comprehensive analysis and the logic that the first instance and Court of Appeal judgments follow, why might this sit uncomfortably for some of us? I suggest that it is the conflict between the extent of cover that the RFU agreed to procure for Conway under their building contract and the terms of the OCIP policy provided by RSA.

The Court of Appeal has made it clear that the nature, scope and extent of cover is to be determined by the authority and intent of the party procuring the policy (here the RFU) on behalf of the principal (here Conway) and, in most cases, that is to be obtained from the underlying contract between them.

But what about the intention of the insurer? When one looks at the scope of cover extended by the policy itself in which Conway was named, it provided the cover that Conway contended it benefited from. One might ask what cover RSA expected to extend to Conway. If that cover was truly limited to that eventually set out in Option C of the JCT form incorporated into the building contract, then that could have been reflected in the wording of the policy and qualified accordingly. Notably, the parties to the policy agreed to a DE3 exclusion, which excludes from cover the cost of rectifying defects, but expressly covers the costs of rectifying damage to other property caused by those defects. Might a different decision have been reached, or other considerations been borne in mind, had the policy included a broader DE5 exclusion (offering the most generous scope of cover for consequential damage)? If not, what does that say about the negotiated terms of an insurance policy?

Further, it would appear that there was a disjoint between what (at least some) representatives of either or both of the RFU and Conway expected the cover to comprise (and which could reasonably be said to be reflected in the policy itself) and what others ultimately negotiated and reflected in the terms of the building contract. Again, any such ambiguity can be removed by amending the allocation of risk in the building contract to reflect the extent of cover that the contractor expects to benefit from.

Either way and more generally, I believe this case highlights the need to pay close intention to what is marketed as an OCIP policy. In particular, it is now clear that one cannot look at the policy alone to ascertain the nature, scope and extent of cover that it extends to the different parties involved in a construction project. The policy must be read in tandem with the underlying construction contracts by all of those involved in procuring, setting up and benefiting from the project policy.

To conclude, this case provides us with several important reminders:

1. Just because there is a single policy for a construction project, it does not mean that the named parties to that policy benefit from a co-insurance defence. The nature, scope and extent of the co-insurance is likely to be determined by the insurance provisions in each underlying construction contract.

2. In turn, “waiver of subrogation” clauses in the insurance policy must be analysed carefully. They may not have a blanket application to all co-insured parties under that policy. They will only apply to the extent a party benefits from cover under the policy.

3. Selecting Option C under the JCT form does not equate to fully comprehensive cover. The contractor’s right to insurance cover for damage arising from its own default is not included in Option C.

4. When considering the nature, scope and extent of cover for each party on a project policy (and whether it is intended that they are co-insured), it is necessary to ask whether the parties intend the effect of the insurance to be a fund to make good damage, howsoever caused, which is the

sole remedy for loss suffered by the client. Alternatively, is it intended that the insurance will co-exist with the right of action for breach of contract against the party that causes the loss?

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