The fit-out problem

by *Arash Rajai* and *Jon Ely*, RPC

Articles | Published on 24-May-2023 | England, Wales

An article considering the insurance strategy of fit-out works, which looks at co-insurance following the Court of Appeal's judgment in *FM Conway Ltd v The Rugby Football Union and others [2023] EWCA Civ 418*, the approach under JCT contracts, public liability insurance and the tenant's liability.

So, your client is a tenant looking to fit-out its newly acquired (or soon to be acquired) commercial premises that forms part of a high value multi-let building. Or, perhaps it's looking to revamp its current leased space.

As we are finding time and again, resolving the insurance strategy is throwing a spanner into the procurement of the fit-out works.

Preliminary insurance matters

Generally, multi-let buildings are insured by the landlord.

Where, for example, the office fit-out works form a small part of a City of London skyscraper, the contractor's liability for the reinstatement costs of the building is significantly disproportionate to its margin for the job. The contractor wants the work but needs protection from the existing structure risk.

The live issue for tenants procuring such works is that landlords are routinely resisting any firm commitment to the tenant to either:

- Co-insure: that is to extend the scope of the buildings insurance cover to co-insure the tenant and its contractor on the buildings insurance policy on a composite basis (at least for the specified perils); or, failing that:
- Procure a waiver of subrogation rights: that is, to obtain from its building insurer a waiver of subrogation rights in favour of the tenant and its contractor whereby the landlord's building insurers are precluded from pursuing either the tenant or its contractor under a subrogated claim.

Why the reluctance?

Landlords can't be certain of the insurance market's appetite for tenant or contractor policy protection and wish to protect building insurance policies from claims in order to preserve their risk profile.

Alternatively, if the best the tenant can expect is to be "noted" on the building insurance policy, it will only entitle the tenant to notification by the insurer of the cancellation or non-renewal of a policy and in some cases, of certain amendments to the terms of cover.

For more information, see Practice notes:

© 2023 Thomson Reuters. All rights reserved.

- *Insurance contract law: general principles*.
- *Insurance in construction and engineering projects*.
- *Leases: Insurance*.
- *Property insurance*.

Co-insurance

The ideal position is for the tenant and its contractor to be protected from the existing structure risk under both the lease or licence to alter and the building contract by having the co-insurance defence available to them.

The starting point is that the law does not allow an action between two or more parties where the same risk is insured under the same policy. By extension, the insurers would be unable to exercise rights of subrogation to bring a claim against a co-insured in this scenario (see *Co-operative Retail Services Ltd v Taylor Young Partnership Ltd [2002] UKHL 17*). Where there is a contract between the parties, the contractual arrangement on co-insurance governs the existence and extent of the insurance cover available for the benefit of the insured (see *Gard Marine & Energy Ltd v China National Chartering Co Ltd [2017] UKSC 35*).

Conway v RFU

The discussion is topical because, in April 2023, the Court of Appeal upheld the TCC's decision (in *Rugby Football Union v Clark Smith Partnership Ltd [2022] EWHC 956 (TCC)*) that the contractor's co-insurance defence failed even though the contractor was co-insured under the project insurance policy.

In *FM Conway Ltd v Rugby Football Union [2023] EWCA Civ 418*:

- Conway was employed under a JCT Standard Building Contract without Quantities, 2011 Edition, and was insured under the project policy as it was caught by a generic category of contractor and sub-contractor insureds and, due to RFU implementing the policy, the underlying contract was the key evidence as to the extent of coverage.
- JCT Insurance Option C applied. This provides that the employer co-insures the contractor on a composite basis for loss or damage to:
    - the existing structure due to the specified perils (JCT Option C.1) and
    - the works (or site materials) for the risks covered by the works insurance policy (JCT Option C.2).
- The RFU made a claim under the project policy for alleged defects in design and installation of the works. RFU was indemnified for these losses under the project policy.
- Conway argued that as a co-insured under the project policy, it was entitled to the co-insurance defence against both the RFU and the insurer under a subrogated claim.
- The Court of Appeal held that RFU and Conway were co-insured under the same project insurance policy but not for the same risk.

© 2023 Thomson Reuters. All rights reserved.

- The employer was only required to provide such insurance cover as required under JCT Option C. The JCT contract explicitly excluded the requirement to take out a joint names policy for the cost necessary to rectify any loss or damage to the works caused due to defective work or design (the same risk which RFU was indemnified for under the project policy).
- The all risks insurance was required to be taken out and maintained on a composite basis (separate contracts of insurance that protect the different rights and interests of the insureds) and, as such, coverage could differ between RFU and Conway.
- Consequently, the co-insurance defence was not available to Conway and neither was the protection afforded from the waiver of subrogation in the insurance policy, which only extended to matters for which Conway was insured against.

For more information on the judgment:

- At first instance, see *Legal update, Contractor not co-insured under a JCT joint names all risks Option C insurance policy (TCC)* and *Blog post: Co-insurance and subrogation rights under the spotlight once more*.
- In the Court of Appeal, see *Legal update, Contractor not co-insured under a JCT joint names all risks Option C insurance policy (Court of Appeal)* and *Article, The co-insurance defence: Court of Appeal confirms that underlying contract defines nature, scope and extent of co-insurance under project policy*.

JCT's approach

When discussing the approach to existing structure risk under JCT standard form contracts, it is helpful to use the JCT Design and Build Contract, 2016 Edition (DB 2016) as an example. The insurance terms are found in section 6 and Schedule 3 to the contract.

Under clause 6.2, the contractor is liable for and indemnifies the employer against loss or damage to property and (at least as a starting point) the existing structure. If co-insurance is achieved, the insurance position is relatively straightforward:

- In respect of the insurance provisions, JCT insurance Option C applies.
- In respect of the liability provisions (as JCT Option C.1 applies), the contractor's liability under the clause 6.2 indemnity will not extend to loss or damage to the existing structure caused by the risks required to be insured under Option C; parties intend that the insurance fund will be the sole recourse for this risk.

However, if co-insurance is not an option, can the tenant agree to procure the waiver of subrogation rights? The answer should be in the lease or licence to alter.

If the waiver can be procured, then:

- In respect of the insurance provisions, JCT Option C.1 should be disapplied. The employer is unable to discharge the co-insurance obligation in JCT Option C.1 and does not want to be in breach of contract for failing to do so. Whether this is done using a JCT C1 Replacement Schedule or in some other way is purely presentational, as the C1 Replacement Schedule is just a blank page that needs to address how liability and insurance issues will be resolved.
- In respect of the liability provisions, as JCT Option C.1 does not apply, the indemnity under clause 6.2 would extend to loss or damage to the existing structure.

© 2023 Thomson Reuters. All rights reserved.

The employer may expect that the contractor assumes existing structure liability to some extent, which the contractor must insure under the public liability insurance (the existing structure should be "other" property for this purpose) (see *Public liability insurance policy*).

Any cap on liability in the building contract for loss or damage to the existing structure as a result of the specified perils would then be capped to an amount commensurate with the amount of the public liability cover in place. The waiver of subrogation would then apply to claims in excess of this cap. Importantly, a contractor can rely on any cap onliability in the building contract as against the building insurer under the subrogated claim (see *Lister v Romford Ice and Cold Storage Co Ltd [1957] A.C. 555*).

For more information, see:

- *Practice note, Negotiating insurance provisions in the JCT Design and Build Contract, 2016 Edition*.
- *Standard document, JCT Design and Build Contract, 2016 Edition*.

Public liability insurance policy

Where neither co-insurance or waiver of subrogation are available and the contractor expects the public liability insurance policy to respond to existing structure risk assumed under the building contract, it should check that:

- The public liability policy does not treat the existing structure as excluded from the scope of cover for any reason (for example, the existing structure is deemed to be within the contractor's custody and control).
- The amounts covered under the public liability policy are sufficient to cover the cost of reinstating the building, although tenants should note that contractors will price taking out a one-off public liability policy for the project.
- As the public liability policy covers negligently caused damage, the existing structure liability under the building contract is triggered by negligence rather than a strict liability.

For more information, see *Practice note, Public liability insurance: an overview*.

Tenant's liability

Landlords normally insist that the lease or licences for works to a leased premises include a full indemnity from the tenant against any losses suffered in connection with damage to the building caused by the tenant or its contractors.

It is unrealistic to expect these indemnities will be back-to-back with the indemnities in the fit-out contract, particularly under a JCT form of contract incorporating the clause 6.2 indemnity (see *JCT's approach*). Tenants will likely be exposed to retained risks where such strict indemnities are agreed.

Tenants should avoid taking out their own insurance for building damage since this would risk vitiating the landlord's buildings insurance policy or the tenant's policy – generally limiting the prospects of recovery for both. This is why most leases will include a tenant's covenant against "*double insurance*".

For more information, see *Practice note, Property insurance: Double insurance*.

© 2023 Thomson Reuters. All rights reserved.

Conclusion

The key point for tenants here is to seek early landlord engagement so far as this is possible (and for new leases ideally during heads of terms on the lease negotiation), in order to secure a co-insurance solution that extends to its fit-out contractor. Certainly, you would expect landlords might be more open to discussion towards resolution in a new lease deal scenario, but less likely to engage in existing lease tenant works scenarios.

However, even in certain existing lease scenarios, particularly where the landlord is keen to retain an existing tenant or welcomes a proposed assignment to an attractive new tenant, the hope is that landlords will entertain tenant requirements in the interest of maintaining tenant relations and a "good landlord" market profile.

END OF DOCUMENT

© 2023 Thomson Reuters. All rights reserved.