BRIEFING NOTE

"DON'T JUST SIT THERE. DO SOMETHING!" CONTRACTOR OR INSURER: WHO PAYS THE COSTS OF MITIGATING THE LOSS?

Justyn Jagger
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Introduction

One of the more difficult areas of non-marine insurance law is whether an insured party is obliged to avoid or mitigate a loss and, if it takes steps to avoid or mitigate a loss, whether the insurer, that enjoys the benefit of such action, must pay the cost of taking those steps.

In the construction industry, there are two factual circumstances in which these questions may arise. The first is in connection with the possibility of loss or damage to the construction works themselves, for example by an approaching flood or typhoon. The second is in connection with the possibility of damage to third party property, for example by subsidence resulting from tunnelling or foundation works carried out as part of the construction works.

Pending Damage to the Insured Construction Works

The starting point is that, absent an express term of the insurance policy, the contractor is not under a duty to avoid or mitigate loss or damage to insured property. By extension, if the contractor does take steps to avoid or mitigate such loss or damage then the insurer, absent an express term, is not obliged to pay for the costs of the steps that are taken: see *Gerling General Insurance v Canary Wharf Group Plc [2005] EWHC 2234*. But that is only the starting point for two reasons, both of which turn on the facts of the case.

First, if the contractor does nothing and loss or damage follows then the insurer may refuse to indemnify the contractor for the costs of the repairs on the basis that the cause of the loss or damage was the contractor's recklessness or wilful act rather than an insured peril, such as the flood or typhoon. Second, and in the same vein, on the basis that the contractor breached any reasonable precautions clause included within the policy. The naming of that clause is somewhat misleading because to establish any breach, the insurer must show that the contractor acted recklessly, meaning that it recognised a risk and elected to run the risk, rather than negligently: see *Sofi v Prudential Assurance Co. Ltd. [1993] 2 Lloyds Rep 559*.

Pending Damage to Third Party Property

The position as to whether cover provided under a third-party liability insurance extended to indemnify expenses incurred to prevent damage to third party property was considered in *Yorkshire Water Services Ltd. v Sun Alliance and London Insurance Plc [1997] 2 Lloyd's Rep 21.*

In this case, the insured incurred significant cost in undertaking flood alleviation works to avoid additional damage to third party property. If the work had not been performed then the insured would have been liable in nuisance or negligence and the insurers would have had to indemnify the insured for the damages payable. Notwithstanding, the Court held that the insurers were only liable for the damages payable in respect of the cost of repairing or

reinstating damaged property. The policy did not oblige insurers to indemnify the insured for the costs incurred in avoiding or mitigating that damage and, absent express wording, such a term could not be implied into a liability policy because such a term was not required to make sense of, or give business efficacy to, the liability cover provided for damage to property.

Marine Insurance Policies

The position is different under marine insurance policies. Pursuant to Section 78(4) of the Marine Insurance Act 1906, the insured is under a duty to mitigate its insured loss. Hence Sue and Labour clauses within marine insurance policies that oblige the insured to take, and the insurer to indemnify the costs of taking, reasonable steps in mitigation of an insured loss.

What action should the Contractor take?

As the old saying goes, "an ounce of prevention is worth a pound of cure".

At the start of the project, when the terms of the "all risks" policy are being negotiated with insurers, the contractor should consider purchasing cover that extends to the costs incurred in avoiding or mitigating loss or damage to insured or third-party property.

If such cover is not purchased and, during the course of construction, the possibility of such loss or damage presents then the contractor should discuss the full or partial indemnification of the costs of avoidance or mitigation with its insurer. Although the law suggests that the balance of power within those discussions rests with the insurer, it is clearly in the interests of both parties to incur cost in avoiding or mitigating loss or damage that, should such loss or damage occur, would result in far greater costs being incurred in repair or reinstatement.

Justyn Jagger

justyn.jagger@sjlaw.com.sg
65 6694 7282 | 65 9154 9695