



Liberty Technical Update 4 - Proportionate Liability

The Insurance Implications when “Contracting Out”

We hear the term “proportionate liability” often enough in our commercial dealings but what does it really mean and how does it differ from “joint and several liability” at common law? More importantly, what are the insurance implications if you decide to “contract out” of the operation of proportionate liability legislation (assuming this is legally possible)? This Technical Update will discuss these important issues.

Joint and Several Liability

In the United Kingdom and other common law jurisdictions such as Hong Kong and Singapore, the doctrine of joint and several liability continues to apply. This doctrine operates when one or more person has tortiously contributed to a plaintiff’s loss. The plaintiff is able to recover the full amount of that loss arising from the wrong from any one defendant or any combination of the defendants who caused the loss. If the plaintiff recovers the whole amount from a single defendant, that defendant is then permitted at law to seek recovery from the other defendants for their share of responsibility in causing that loss.

From a practical standpoint, plaintiffs are unlikely to choose to bring a claim against an insolvent defendant. Instead, they are likely to claim against defendants with “deep pockets” such as professional service providers who typically carry professional liability indemnity insurance. It is then up to the “deep pocket” defendant, and their insurers, to seek contributions from the other wrongdoers in order to reduce their liability. The risk of a futile contribution claim against an insolvent wrongdoer lies with the defendant and their insurers.

Proportionate Liability

Under immense political pressure, particularly from professional associations and their insurers, jurisdictions such as Australia and a large number of the States in the United States of America, have either abolished or modified the doctrine of joint and several liability.

In all States and Territories in Australia, for example, legislation now replaces the common law doctrine of joint and several liability with the principle of proportionate liability. Under this principle, the liability of each wrongdoer is limited to the portion for which he or she is directly responsible. That portion corresponds to the wrongdoer’s percentage of comparative responsibility.

Essentially, a defendant is liable to pay the loss apportioned by a court against it for its part in contributing to the plaintiff’s loss. The risk of seeking a claim against a defendant who cannot pay the amount apportioned against it by judgment now lies with the plaintiff.

It is notable that in all Australian States and Territories, proportionate liability applies only to claims (whether in tort, contract or under statute) for economic loss or property damage arising from a failure to take reasonable care. It does not apply to personal injuries claims - the doctrine of joint and several liability still applies in those circumstances.

In some industries such as the construction industry, it is not uncommon to refer disputes to commercial arbitration. Since most proportionate liability legislation in Australia refers to apportionment of liability by a “court”, it was unclear as to how, if at all, proportionate liability could be applied to commercial arbitration. There is now judicial authority which states that proportionate liability does not apply to arbitration proceedings: *Aquagenics Pty Ltd v Break O’Day Council & Tasmanian Water & Sewerage Corporation (Northern Region) Pty Ltd* [2010] TASFC 3. The Federal Court said in that case that the various provisions of the proportionate liability legislation (in Tasmania) suggest that the legislation was not designed to apply to proceedings before an arbitrator, in which other parties cannot be joined.

This may have significant insurance implications as an arbitration clause in a commercial contract may have the effect of contracting out of the proportionate liability regime and therefore triggering an exclusion under a professional indemnity insurance policy.

“If, for example, a party agrees to be responsible for the acts and omissions of its subcontractors, the party may have impliedly agreed to ‘contract out’ of the proportionate liability regime”





Contractual Risks Allocation and Proportionate liability

Risks allocation between contracting parties is an integral part of contractual negotiations. In order to clinch a deal, some insureds are often under commercial pressure to contract out of the effects of proportionate liability legislation. For instance, contractors to a major project may agree that each will be jointly and severally liable to the principal which means that the principal could recover 100 percent of their loss from any one of the defendant contractors, even if each of those contractors caused only a part of the principal's total loss. Furthermore, the contractors themselves may also include appropriate indemnities in their agreement so as to share liabilities as between themselves in proportions that may differ from the proportions that may be determined by a court.

Some proportionate liability legislation expressly permits the "contracting out" of the application of the legislation. Most proportionate liability laws are silent on the issue whilst some (eg. in Queensland) specifically prohibit the practice of "contracting out".

For insurance purposes, it is especially significant that an agreement which apportions liability between parties differently to any applicable proportionate liability laws may operate as if the parties had "contracted out" of proportionate liability laws. If, for example, a party agrees to be responsible for the acts and omissions of its subcontractors – a term that is typically contained in most Design & Construct contracts – the party may have impliedly agreed to "contract out" of the proportionate liability regime. By doing so, that party may be voluntarily assuming a greater liability than its liability at law, without realising it. This has important insurance ramifications as discussed below.

Insurance Implications of Contracting Out

Most insurance policies contain Contractual Liability Exclusions that exclude any contractual liability assumed by the insured. Some policies include "write-backs" to the effect that the exclusion would not apply to liability that would have attached to the insured in the absence of the contractual agreement.

By "contracting out" of a proportionate liability regime, whether expressly or by implication, a party agrees to assume liability that may be greater than the liability which would have been imposed on it at law under the proportionate liability regime. An insured may therefore be assuming liability that "would not have attached in the absence of the contractual agreement".

Policies that contain the usual Contractual Liability Exclusion with the usual write-back would only cover an insured for the portion of the loss that a court, under the relevant proportionate liability regime, attributes to it because that would be the liability that would have "attached in the absence of the contractual agreement".

Any additional liability a party voluntarily assumes by virtue of having "contracted out" of the proportionate liability regime would be excluded from the insurance policy coverage. Such a party may therefore have a "gap" in coverage. Insurance policies should be reviewed carefully to identify any such financial risk exposures.

LIU provides a solution in this instance by offering insureds a Proportionate Liability Optional Extension. Click [here](#) to view this optional extension in our new Australian Design & Construct Professional Indemnity Insurance Policy. Unlike other policies, this extension has the benefit of covering an insurance "gap" that might be created by an insured's commercial agreement which, whether expressly or impliedly, "contracts out" of proportionate liability laws.

LIU's Extension specifically provides that the Contractual Liability & Commercial Risks exclusion in the policy will not apply to the extent that the insured has assumed liability under a contract by virtue of having contracted out of the operation of the proportionate liability legislation. It therefore covers the gap caused by the difference between the insured's liability under the proportionate liability laws and its increased liability caused by "contracting out" of those laws.

This LIU Proportionate Liability Extension clearly offers a significant advantage to insureds because it allows them more contractual freedom in their negotiations without the burden of putting at risk their financial liability in the event of a claim.

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