

Allocation of Risk in Tug and Tow – contractual insurance and indemnity clauses

By David K. Jones

In an older tug and tow casualty case involving an insurance question, the Judge’s decision unusually began with his poem about the facts, as follows:

Koprino turned south off Cape Beale
with a Barge in tow not made of steel;

As Barge and Ship took the Island’s lee
both travelled well on a flat calm sea;

The voyage was easy well into the night
with Barge and tow line always in sight;

But off Carmanagh the wind grew stronger
The quiet sea was no longer;

The wooden barge soon went down –
But *Koprino* had not run aground;

The question is what caused the wreck –
The Crew, the Barge or the house on deck?

A second query may arise –
Who bears the loss insurance-wise?

That 2003 case, *Rough Bay Enterprises Ltd. v. Budden*, was referred to in a recent court decision – not for its poetic merit – but on an insurance issue relating to another tug and tow casualty.

The more recent decision, which is the subject of this article, is *Lehigh Hanson Materials Limited v. the Ship “Sea Imp XI” and Catherwood Towing Ltd.*, decided on September 2, 2022. The case provides an example of how insurance and indemnity arrangements can be structured, and the issues that can arise when the terms are considered when a loss occurs.

Parties to an agreement often include terms relating to the allocation or risk for the subject matter of the agreement. Indemnity and insurance clauses are common forms of these types of contractual terms.

The background to the *Lehigh* decision is a Barging and Towing Services Agreement (“Agreement”) whereby Catherwood agreed to tow Lehigh’s barges. A dispute arose about which party was responsible for repair costs following the grounding of two of Lehigh’s barges in the Pitt River while under tow by Catherwood’s tugs.

If not for the terms of the Agreement, Catherwood would be liable for the reasonable cost of repairing each of the two barges up to the statutory limitation of liability of \$500,000 in the federal *Marine Liability Act*.

For both tows, Lehigh had arranged for hull and machinery insurance on the barges as required by the Agreement, each barge was valued at \$800,000 with a \$500,000 deductible.

The Agreement also contained cross-indemnities from each party to the other for damages due to negligence or breach of contract.

An indemnity is commonly worded to have one party responsible for indemnifying, holding harmless and defending the other party in the event that the first party breaches the agreement or is negligent in the performance of its obligations under the agreement. A cross-indemnity is each party agreeing to indemnify the other for their own breach of contract or negligence in their performance of the agreement.

In addition to indemnity clauses, agreements may contain insurance clauses requiring one party or the other, or both, to obtain insurance for specified liability or perils.

In this case, Catherwood was required by the Agreement to obtain general liability insurance and hull and machinery insurance for its tugs.

Key to the decision was Lehigh's obligation to obtain and maintain hull and machinery insurance for its barges. There was no dispute that the hull and machinery insurance provided broad coverage for perils of the sea which included the events of the two groundings.

The issue in the case was the allocation of risk in contracts containing an indemnity from one party, and a promise to insure from the other.

To decide whether Catherwood's indemnity to Lehigh applied to make Catherwood responsible for the loss, or whether Lehigh's insurance covered the loss, the Judge reviewed relevant case law on the allocation of risk in such contracts, and summarized his decision that Lehigh's obligation to insure the barges was decisive by stating: the "cases consistently take the approach that it is reasonable to infer the parties allocated the risk to the party promising to insure against it unless the contract indicates otherwise."

The Judge referred extensively to the precedent of a BC Court of Appeal case decided in 2013, *Kruger Products Limited v. First Choice Logistics Inc.* In that case, Kruger stored its paper products in First Choice's warehouse. Kruger's inventory was destroyed by a fire caused by a forklift in the warehouse. The warehousing agreement between Kruger and First Choice included an indemnification to Kruger for First Choice's negligent acts. The agreement also required that Kruger insure its inventory and name First Choice as an insured with primary coverage for property damage.

In the *Kruger* case, the Court of Appeal decided that Kruger's agreement to insure should be interpreted to benefit the other party unless the contract provided otherwise. If not, the promise to insure would confer no benefit on the other party. Because of Kruger's covenant to insure, the parties in the warehousing agreement had allocated the risk of loss to Kruger, even where there

was an indemnity from First Choice to Kruger. As a result, a promise to insure should supersede an indemnity unless the contract indicates the contrary.

The Judge in the *Lehigh* decision referred to a number of other cases in support of this finding, concluding the issue with a quote from the *Rough Bay* case noted above, as follows:

In my view, the authorities amply support the proposition that if the owners of a barge covenant with the owner of a tugboat to insure the barge for the benefit of “all parties”, the owner’s insurance may not advance a subrogated claim against the tugboat and its owner for loss occasioned by the negligence of the tugboat, its operators or its owners.

Other cases referred to by the Judge in the *Lehigh* decision were examples cited by Lehigh where a court has found that despite an agreement to insure, the allocation of risk between the parties in the agreement was decided by an indemnity clause, not the agreement to insure. In those cases, it was the courts’ analysis of the specific terms of the contract between the parties that was the important difference in the outcome.

In all cases, the insurance and indemnity terms of the contract had to be carefully considered in a reading of the contract as a whole in the factual context of the particular circumstances of the case to determine the intention of the parties on the subject of the allocation of risk.

In the *Lehigh* decision, three factors were found to be key to the finding that the parties allocated the risk of damage to Lehigh, as follows:

- Lehigh covenanted to Catherwood that it would obtain hull and machinery insurance on the barges;
- Lehigh’s insurance coverage was required to be in a form acceptable to Catherwood, indicating that Catherwood was to have the benefit of the insurance;
- Another indicator of the intention of the parties for Catherwood to have the benefit of the insurance was a term that if a party failed to procure the required insurance, that party would be deemed to be the insurer or self-insurer, and accept and pay all claims which should have been insured.

Other ways that can signal an intention for one party to have the benefit of the second party’s insurance is:

- to have that first party named as an additional insured on the second party’s insurance;
- to include a waiver of any subrogation rights, meaning the insurer of the second party making the insurance arrangements cannot commence a subrogated action against the first party to recover the amounts paid by the insurance.

The significance of the *Lehigh* decision is that it provides a useful analysis of factors considered by a court in the event that a dispute arises after a loss and questions arise about what the parties intended in allocating the risk for losses. In drafting agreements, insurance and indemnity terms

must be carefully considered within the contract as a whole and in the factual context of the particular circumstances of the case to appropriately allocate risk to accurately reflect the intention of the parties.

A future article will update the *Lehigh* decision if the appeal proceeds to the Court of Appeal.