Risk Bytes
Good neighbour agreements

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Summary/introduction

This Risk Byte provides a snapshot of the risks associated with so-called 'good neighbour' agreements and why you and the neighbour you share resources with must have adequate insurance in place*.

Key issues:

- Be clear on where risk and liability rest
- Undertake thorough due diligence to protect your business
- Carefully formalise agreements in a written contract

The Risk Byte series aims to simplify complex insurance-related topics by providing easily accessible and digestible information and guidance.

* This Risk Byte has been prepared focused on an English law perspective. Members are encouraged to seek local legal guidance in case of queries in other jurisdictions.

What are good neighbour agreements?

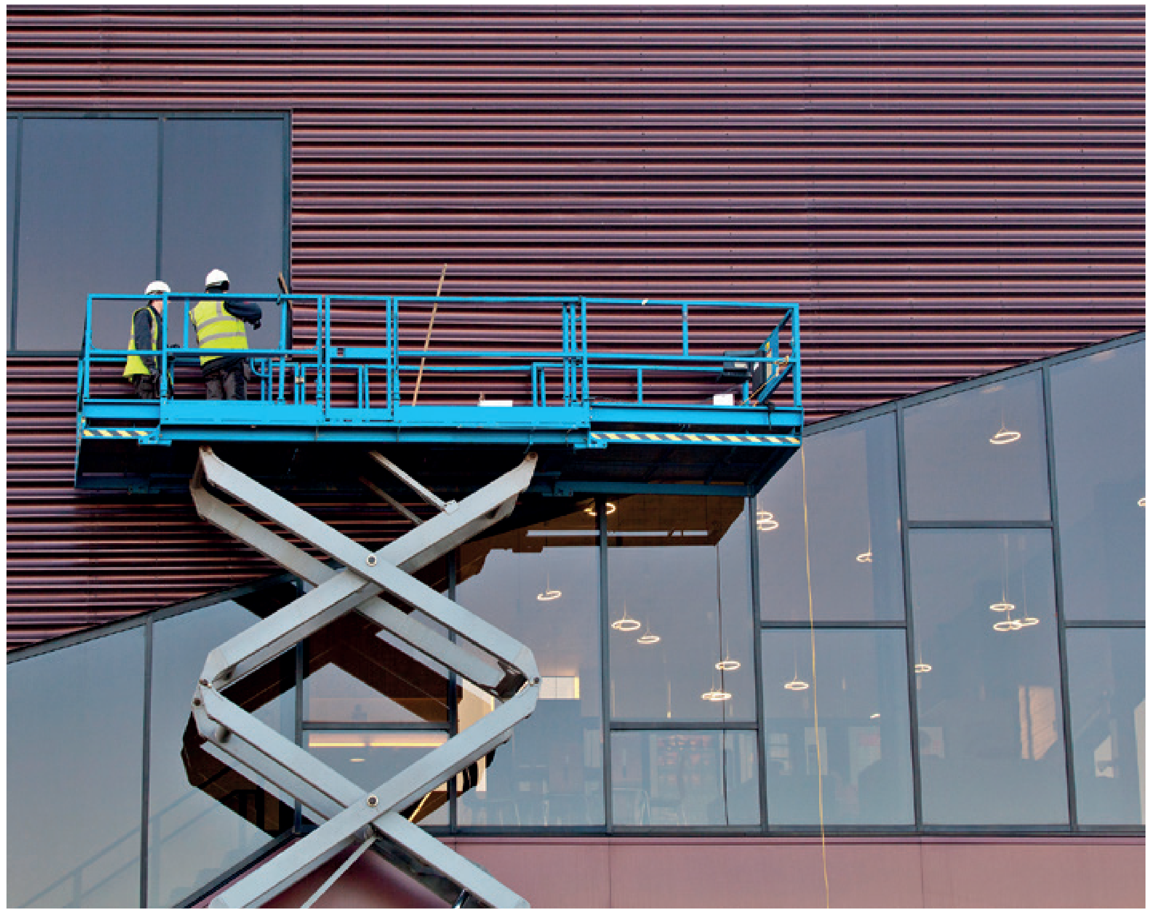
A good neighbour agreement describes the situation where operators with a close working relationship arrange to borrow or lend equipment, vehicles and staff for a certain period.

Why do they exist?

Good neighbour agreements are beneficial to both the borrower and the lender. They are usually reciprocal arrangements, with both parties having something the other may need at one time or another.

Benefits:

- ✓ Avoids buying equipment that is only used infrequently
- ✓ Gives greater flexibility of operations
- ✓ Means working with someone you know
- ✓ Avoids hiring staff for short periods
- ✓ Results in significant cost savings
- ✓ Gets additional revenue from otherwise under-used resources
- ✓ Creates reciprocal opportunities



Sharing equipment

When your neighbour takes possession of your property, or the other way around, several legal relationships can arise under English law:

- You may have a verbal contract between you, with express or implied terms
- You might have a duty of care (tortious duty in negligence) to your neighbour to exercise reasonable care and skill
- You may have created a 'bailment', where you the 'bailor' grant exclusive possession of your equipment to your neighbour, the 'bailee'
- You might instead have a licence, where you the 'licensor' grant non-exclusive possession of your equipment to your neighbour, the 'licensee'.

Each of these relationships can give rise to different legal duties and obligations, shifting the legal burden of proof in cases of dispute. Before entering a good neighbour arrangement, you should protect your position by putting your agreement in writing.

Without a written agreement there could be any number of issues, for example:

- Under a bailment there is, in effect, a temporary transfer of property rights from you to your neighbour. Your neighbour is entitled to the exclusive use of your equipment during the period of the bailment. This means that if your operational needs suddenly change, your will not be entitled to get your equipment back until the bailment has come to an end.
- If your neighbour damages your equipment then, in the absence or a specific contractual provision, you may not necessarily recover sufficient compensation to repair or replace it.
- If your equipment is defective, and your neighbour or someone else's property is damaged, or a someone is injured, even though it is not your fault you could get caught up in legal proceedings and have to make contributions for the losses suffered by someone else.
- If your equipment is not defective but is damaged or causes damage or injury while in your neighbour's possession, but with neither of you being at fault, there could be a dispute as to which of you is liable.
- Your manufacturer's warranty could become void, either by giving your equipment to your neighbour or because your neighbour breached the warranty conditions by not being aware of them, resulting in loss or damage.

Having a written contract helps you to define what your equipment is being used for, how long for, and your respective rights, duties, obligations, liabilities and insurance needs.

You should also undertake due diligence checks prior to entering an agreement. For example, you ought to be satisfied that your neighbour's employees have sufficient training to use your equipment. Ensuring adequate training will mitigate the risk of damage to the equipment as well as reducing the chance of accidents involving it.

Sharing staff

It is not uncommon for neighbouring operators to share their staff. However, if an accident occurs involving your employees on loan, determining where responsibility and liability lies is often much less clear because they were being managed by your neighbour.

In the event of a loss or accident, there is likely to be debate over who was ultimately responsible for the loss: were your staff still acting within the scope of their employment with you, or had your neighbour assumed responsibility?

Both you and your neighbour must consider these issues carefully and make provisions for apportioning liabilities in the written agreement. Without doing so, any loss could result in lengthy and expensive legal proceedings for both of you.

Sharing both equipment and staff

There may be even less clarity in situations where your employees are operating your equipment but on your neighbour's property. In the event of an accident or loss, then all the factors considered above may have a bearing on who is ultimately liable for any losses suffered. This is often only decided following legal proceedings.

It is also important to consider how your insurers would respond if an incident occurred while borrowing or lending both equipment and labour.

A written agreement clearly defining expectations, responsibilities and liabilities of both lender and borrower would help to avoid long, drawn-out disputes for both parties.

Risk outline

While good neighbour agreements can be beneficial, due to their casual nature it is important for both borrowers and lenders to be aware of the potential risks and be clear about where liabilities and responsibilities rest.

The primary risk is a loss occurring during the loan period that leads to a significant financial exposure. If you do not have enough insurance cover, or your insurer is unaware of the agreement, your loss might not be covered. This might severely impact your business operations and finances, cancelling any benefit gained from the good neighbour agreement.

While a formal written agreement defining the precise conditions of your loan may mitigate the risks, you must advise your insurer of such arrangements. In doing this, you are protecting your business by ensuring that any liabilities are covered, whether they arise under a written contract or not.

If your insurer denies cover, it might be possible to recover costs directly from your neighbour. But without a written contract, this may involve lengthy and expensive legal proceedings.

When considering contract terms, it is best to consult a lawyer to ensure the contract accurately reflects your intentions and secures the greatest certainty of outcome should a loss or accident take place.

While a written contract might provide additional peace of mind, due diligence – in other words knowing your neighbour – is vital. For example, are you certain they are financially stable and have sufficient insurance to meet the contract requirements? Are their staff trained and competent to use your equipment? Do they provide a safe and healthy workplace for your staff? Undertaking simple checks before the agreement starts will help protect your business.

Remember:

- Both parties need to be aware of the risk of loss
- If your insurer is unaware of the agreement, they may deny cover
- Writing a contract does not ensure your business is protected, especially if the wording is unclear or if the borrower is financially unable to fulfil the terms
- Be aware of the lengthy and costly legal proceedings that are often required to recover uninsured costs
- Conducting due diligence is vital before entering a good neighbour agreement

Case Study

M Distribution and Storage Limited operates a general purpose warehouse at Unit 2, Progol Logistics Park. M Distribution stores cargo for N Furnishings Limited long term, which is kept in racking. M Distribution has a forklift truck to access the cargo on the racking, but it is used infrequently and not maintained.

N Furnishings asks M Distribution to undertake a stocktake, which would require all of its stored goods to be lifted from the racking. On the morning of the stocktake, M Distribution realises that its forklift truck is inoperable. So as not to impact the planned stocktake and risk inconveniencing its important customer, M Distribution approaches O Storage Limited, which occupies Unit 3 in the logistics park, to see if it could lend one of its forklift trucks for the day.

O Storage has spare capacity and agrees to loan a forklift to M Distribution. Due to the short lead time and the fact that the two companies are familiar with one another, very few questions are asked. The two companies agree a day rate for the loan of the forklift truck and an employee of M Distribution collects the forklift truck and drives it back to Unit 2.

The forklift truck is a different brand and design to the truck that the M Distribution employee is used to and importantly, the controls are not the same. During the stocktake, the employee loses control of the forklift truck, which collides with a section of the racking. The collision damages the lower section of the racking and causes an entire row of racking and cargo to collapse on and around the forklift truck. Fortunately, nobody is hurt in the incident, but there is significant damage to the racking, cargo and forklift truck.

M Distribution files a claim against its liability insurance policy in relation to the incident, including damage to the cargo, racking and forklift truck. M Distribution's insurers accept to cover the cargo and racking claim, but deny cover for the forklift truck, which they were unaware of under the policy. M Distribution must now have a very difficult discussion with O Storage because the forklift truck that it borrowed for the day has been severely damaged and the costs of repair or replacement are not covered under M Distribution's insurance policy.

Upon learning about the incident, O Storage files a claim with its insurer in relation to the damaged forklift truck. O Storage's insurer investigates the incident and quickly discovers that the forklift was damaged at an uninsured location, while being operated by a third party. Further investigations conclude that the M Distribution employee's training certificate had expired several months prior to the incident.

O Storage's insurer denies the claim for the damaged forklift on the basis that, unknown to the insurer, O Storage had loaned the forklift truck to a third party. Moreover, O Storage conducted little due diligence and therefore failed to recognise that the operator of the forklift was not adequately trained at the time of the incident.

Both M Distribution and O Storage made significant errors throughout this exchange. M Distribution's key error was not notifying its insurer of the agreement to borrow a neighbour's equipment. M Distribution should also have been aware of its employee's expired training certificate. O Storage should have conducted thorough due diligence and established a contract with M Distribution that would ensure it was protected should an incident or loss occur. Both companies now face significant monetary losses, business interruption and a damaged working relationship.

Summary

As a lender in a good neighbour agreement it is vital to conduct thorough due diligence to know who will be using your equipment and how it will be used, remembering that any equipment warranty may be affected.

As a borrower you must consider whether you are able to meet your contractual obligations if you damage the loaned equipment.

It is your responsibility to notify your insurer of any good neighbour agreements to lend or borrow equipment or staff.

You must declare all equipment to your insurer to be covered under your policy, including new property acquired during an account year and equipment borrowed for temporary use. **If it is not declared, it will not be covered.**

If it is not declared, it will not be covered

Checklist

Before entering a Good neighbour agreement always check:

- [x] Is your insurer notified of any agreements?
- [ ] If loaned equipment is returned damaged, are you able to meet your contractual obligations?
- [ ] Is there a risk of any warranty being void in the way that the borrower intends to use your equipment?
- [ ] Is the equipment to be borrowed declared to your insurer?
- [ ] Are the people using the equipment qualified to do so?
- [ ] Has an experienced qualified lawyer been consulted when considering appropriate contractual terms?
- [ ] Is the borrower financially stable and do they have sufficient insurance cover in place to meet the requirements under the contract?

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For more information

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