TT Live – Series 1: episode 5 – 09/12/2020
Contract review

Mitigating the risks

In this episode, Mike Yarwood, Managing Director Loss Prevention, talks with Kate Andrews, Underwriter for the TT Club about contract review.

Mike: "Welcome to this edition of TT's Podcast TT Live. In this edition, we are going to focus on the subject of contract review and my colleague Kate Andrews, Underwriter at TT, joins me.

In the context of liability insurance generally, the contracts that stakeholders enter into with their customers are fundamental to the risk exposure under the policy. Of importance to recognise is that your liability insurance cover is likely designed to protect your business only up to the level of your legal liability.

There are two primary considerations, the first being the commercial and financial exposure that you place your business in by entering a contract, the second to ensure that your liability insurance policy will cover the full extent of that exposure.

We will look a little later at one or two examples of how this works in practice. Most liability insurance policies however, will be based on the limitations under your standard terms and conditions or applicable international conventions. Where particularly onerous contracts are concerned, without sufficient scrutiny and express agreement with your insurer, in the event of a loss, you risk there being a gap between the value payable under the contract and your legal liability, being the value recoverable under the liability policy.

In short, in the absence of due care and attention, there is a very real potential for existential level financial exposures to your business, that should at least be recognised before entering into a contract.

Of course, certain risks could be considered remote and the commercial value of a contract might be so attractive that it is considered worth taking the risk of an identified exposure. The key message here is that it is important to duly consider and understand the risks and in doing so, be empowered to make informed decisions.

TT are regularly involved in contract reviews for our Members, while in our capacity as insurers, we are unable to provide legal advice to our Members, we are able to identify concerns and certain clauses that we can advise our Members to either challenge with their customer, seek legal advice on or highlight potential financial risks where insurance cover might not respond to the full extent of the risk.

Kate, welcome and thank you for joining us for this session. Contract review is an important topic and at some point, is likely to affect all stakeholders in the supply chain."

Kate: "Thank you Mike; just to briefly introduce myself I am Kate Andrews and I have been an Underwriter for the Club for 15 years. Having dealt with a variety of geographical regions during my time with the Club I have seen a number of contracts of different styles, length and complexity but we are fundamentally always looking for the same key points in order to enable us, as insurers, to assess how and for what the contract leaves the Member liable."

Mike: "A natural place to start I think is to consider the purpose of a contract in the context of a freight agreement. What are the underpinning principles and what are the fundamental aims."

Kate: "A contract is simply a tool for structuring the relationship and recording what the parties have agreed to do for and with each other. Within a freight agreement the contract needs to state as clearly as possible each parties responsibilities and subsequent penalties for failure to perform the agreed services. It should include basic facts such as the services to be performed, the types of cargoes involved (and some idea of values), where the contract will be performed (i.e. modes of transport and territories), whether the Member will be undertaking the services itself, or will be subcontracting some/all of the work.

It should then cover the penalties for failure to perform the services under the contract; these penalties or liabilities need to be assessed in conjunction with any applicable laws or pre-existing liability regimes. They should be fair to both parties, indeed a contract which is to one sided may end up being rejected in court which, obviously, adds to costs and complicates disputes. Force Majeure should be addressed within the contract and a good contract will not only address applicable law and jurisdiction and also set out pre agreed parameters for dispute resolution."

Mike: "Of course, we must appreciate that stakeholders are running a business and that businesses take risks every day, doing so is often a criteria for success. So is there anything preventing a stakeholder knowingly entering into a contract that presents a financial exposure to their business?"

Kate: "No, a business is at liberty to enter into any agreement/contract they wish to. This might provide for full liability including consequential losses and in extreme cases could be an existential risk. The key from our perspective is ensuring that the decision is an informed one and that it is clear where the extent of insurance cover rests so that there are no surprises in the event of a significant loss."

Mike: "Obviously we only have the opportunity to review contracts when approached to do so, is there an express requirement to approach your liability insurer to disclose this type of information?"

Kate: "Although there is no express requirement most insurers including the Club will not cover exposure under a contract that goes beyond certain pre-determined parameters unless they have reviewed contract and specifically agreed terms for that contract. We aim to work closely with our Members and brokers to ensure a thorough understanding of the extent of cover. We work to understand and agree details of the Members' STC's and the international conventions they are likely to operate under, which forms our risk appetite and assists in pricing the risk. We encourage Members to be mindful of this type of risk exposure and seek guidance where appropriate. We would always encourage Members to be "better safe than sorry" and discuss contracts with us before they are signed."

Mike: "What are the most common requests you receive in connection with contracts, appreciating that stakeholders must endeavour to cover as much of their risk exposure as possible."

Kate: "One common request we receive is to uplift the limit of liability of recognized terms and conditions. So for instance in the UK the limit of liability under the Road Haulage Association STC's is UK£1,300/t, a contract might specify a limit of liability at UK£3,000/t and so there is a request for an uplift in insurance cover to bridge the gap. Each request has to be assessed on its own merits, this type of uplift, when underpinned by an established set of terms and conditions is often acceptable at an agreed additional premium."

Mike: "To stress the point, if the liability uplift in the contract is either not identified or not brought to the underwriters attention and agreed, then in the event of a claim, insurance cover would only respond to the statutory limitation under the agreed terms and conditions, which could leave a financial liability with the stakeholder?"

Kate: "That is correct, yes."

Mike: "When reviewing a contract, appreciating that not everybody is an expert, what should a stakeholder be looking for? Are there two or three primary clauses of concern, which should be checked and understood above all else?"

Kate: "We would expect to see in all contracts a clarity and a relevance, liability linked to negligence, no liquidated damages or consequential losses, a law and jurisdiction and force majeure clause, time bar and no conflicting clauses. Clarity and relevance may sound obvious, but you would be surprised at the amount of contracts that we see which bear little relevance to the services being provided. Liability should be fault or negligence based, and it should be fair and represent a true reflection of the financial exposure to the business. It should take into account established conventions and limitation of the financial penalties. Jurisdiction should be clearly set out in the contract so both parties know the regimes that they are operating within and you don't end up in a position where either party is found forum shopping, trying to find the most favourable jurisdiction in the event of a dispute, which is costly in terms of both time and money. Force majeure, again it is obvious that no party should be liable for named events outside of their control. Finally you should make sure that the clauses do not conflict, either in the main body of the contract or in the appendices, this is more common than you would think, as you would expect, it just makes matters more complicated in the event of a claim."

Mike: "I myself have seen a number of contracts which appear to essentially be a corporate template document, which is being incorrectly used as a freight contract. Often many of the clauses are entirely irrelevant to the services to be provided, albeit potentially damaging in the event of a dispute. Is this something you see often and if so, what action do you recommend."

Kate: "Yes, this is something I see fairly frequently. In practice this is a combination of ignorance, a lack of understanding and sometimes lazy practices. As you mentioned, some clauses might be completely irrelevant and others often unsuitable. My recommendation in these cases is for the stakeholder to list out the clauses of concern and highlight these to their customer and challenge them. Often this leads to a greater mutual respect and collaboration rather than just agreeing and then having the potential fall out in reputation and customer relationship if something goes wrong. We have also often found that, if you talk to your insurer early enough the information that our insurer will not insure the contract because of "abc reasons" will give weight to your argument to change the contract."

Mike: "For longstanding contracts, how frequently should one look to undertake a review?"

Kate: "There is certainly importance to undertake periodic reviews of existing long term contracts. This is especially so where services provided evolve, both growing and shrinking, so there is always a need to ensure any contract remains fit for purpose. If for example you start to provide additional services for a customer which fall entirely outside of the existing contract wording, there are potential risks for both you and your customer."

Mike: "Yes, I guess a lot could change over a number of years, I suppose you only have to consider how quickly IT and technological capabilities evolve…"

Kate: "Indeed, and as an freight organisation a sound process for contract reviews may seem a hindrance but the potential fall out to your business not just financially but also in terms of reputational and custom relations can be severe if you do not have the right contracts in place. So this an area where organisations do need to remain vigilant now as much as ever."

Mike: "Kate, thank you for sharing your expertise on this important subject, do you have any final thoughts or considerations that those reviewing contract's should be mindful of?"

Kate: "Clarity of content with no contradictory clauses and clear fair pre-agreed conditions and penalties."

Mike: "In conclusion, reviewing new, renewing and periodic reviews of long term contracts holds great importance. Those undertaking such reviews must be sufficiently trained and capable of doing so. Able to identify the critical clauses and to understand the implications. Where appropriate, stakeholders should consider discussions with their liability insurers to ensure that adequate cover is in place (or develop a clear understanding of the potential exposures if not). Legal advice may also be necessary.

Thank you once again to our guest speaker, Kate Andrews and thank you for tuning in. Please join us next week when Geraldine Savin will join me to discuss incorporation of standard trading conditions."