

## BUILDING & CONSTRUCTION

### THIS ISSUE | AUG 2008

- Do you have it Covered?

Construction Contracts:  
indemnity of third party  
Co-insureds in Contract Works  
and Public Liability Insurance  
Policies

### KEY ISSUES

- Can contractors and subcontractors be covered by principals' policies of insurance even if they are not named on the policy?
- Will contract works insurance taken out by a contractor or subcontractor cover the whole of the works or only the works being carried out by that contractor or subcontractor?
- If a contractor or subcontractor takes out public liability insurance, will this cover the principal?
- If an insurer pays out a claim by a principal, can it recover the money from a contractor or subcontractor?

### DO YOU HAVE IT COVERED?

#### CONSTRUCTION CONTRACTS: INDEMNITY OF THIRD PARTY CO-INSURED IN CONTRACT WORKS AND PUBLIC LIABILITY INSURANCE POLICIES

Clauses of construction contracts relating to insurance and indemnities are often misunderstood by the parties to those contracts. These are often not given a lot of thought and the risks of failing to understand these clauses can be significant.

One of the ways to ensure that the required insurance is effected, is to provide your broker and/or insurer with copies of the relevant clauses of the contract to ensure that existing policies respond to the types of loss required to be insured.

Some issues to be mindful of when considering Contract Works and Liability policies are considered below.

#### CO-INSURED

A co-insured is generally someone who is named in the policy or falls within a class of persons, which are classified as "assured" or "insured". For example, a policy may define the "insured" as the principal "and its contractors, subcontractors and consultants". In the past, there was uncertainty as to whether a contractor could claim on a policy taken out by a principal, as it is not a party to the insurance contract. However, the High Court of Australia found that a named insured may have a right to indemnity from a policy, despite not being a party to the insurance contract.<sup>1</sup> This applies both to Contract Works policies (or property policies)

and Public Liability policies.<sup>2</sup>

#### INSURING THE WORKS

It seems logical for a head contractor to insure the works, and take out the insurance on behalf of itself, any subcontractors and consultants. The Courts have expressed the view that this is a commercially convenient way to deal with insurance in building and engineering contracts.<sup>3</sup>

Generally, if a principal effects insurance for the works and contractors are co-assureds, this insurance will cover each named contractor for not only the part of the works it is responsible for, but also any damage it causes to the whole of the works.<sup>4</sup> However, it will be necessary to consider the express words of a policy to ensure this is the intention of the parties.

In some construction contracts, each contractor (or subcontractor) will be responsible for care of the works from commencement to practical completion of the works. In these circumstances, it is generally necessary for the contractor to insure not only the works it is responsible for, but also damage it may cause to the whole of the works. This ensures that the contractor/subcontractor is covered against the risk that it may cause damage to the works which are not their responsibility. If all contractors and subcontractors assume this obligation under their respective contracts, this will result in duplication in the insurance as each contractor and subcontractor will individually insure the whole of the works.<sup>5</sup>

#### PUBLIC LIABILITY

Public liability insurance compensates the insured for loss which is actually suffered.

1 *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 80 ALR 574. This is also the position under section 48 of the *Insurance Contracts Act 1984*.

2 *Co-operative Buld Handling Ltd v Jennings Industries Ltd*, Supreme Court of Western Australia, 6 December 1996 – (Jennings)

3 *Petrofina (UK) Ltd & Ors v Magnaload Ltd and Anor* [1987] QB 127

4 *Jennings*

5 See *Petrofina (UK) Ltd and Ors v Magnaload Ltd & Anor* for the courts comments on the disadvantages of this allocation of the insurance obligation

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An example of a contract clause, which relates to “liability” is that under AS4000 which says:

*The Contractor shall indemnify the Principal against:*

- a) *loss or damage to the Principal’s property; and*
- b) *claims in respect of personal injury or death or loss of, or damage to, any other property,*

*arising out of or as a consequence of the carrying out of the WUC...*

A public liability policy would generally respond to this indemnity.

Often an organisation’s public liability insurance will be effected on an annual basis. It is also often the case that an insurer will not agree to adding another party to a policy as a named assured as they are only entitled to insurance in relation to the specific project and not the insured’s business carried out throughout the year. However, it is not uncommon for a public liability policy to include as the “insured”, “all contractors, subcontractors and suppliers”. In the event that the policy has a similar definition of “insured”, contractors who are not named on the policy but fall within that definition, will generally be covered for public liability.<sup>6</sup>

When a contractor relies on the principal’s public liability policy, it should ensure that the policy covers not only the property in respect of the principal’s (or a tenant’s) ordinary business, but also liability that may be occasioned from carrying out construction works at the property.

It is often the contractor’s responsibility to take out liability insurance. If this is the case and the contractor causes damage to a neighbouring property, the owner of the neighbouring property may sue the principal. Unless the contractor’s policy specifically covers liability of the principal, the principal may not be covered by the contractor’s policy for any damage and loss.

### JOINTLY NAMED INSURED AND SUBROGATION

Often if an insurer pays out a claim to an insured, it will subrogate to the rights of the insured, to take steps to recover its loss from the third party who caused the damage (that is, it will issue proceedings in the name of the insured to recover its losses). In the event that the third party is a co-insured, this raises a number of issues. In true joint insurance (for example in a partnership), there are no issue of subrogation against co-insured.<sup>7</sup> However, where there are co-insureds whose interests are different, particularly where the policy indicates that each insured is insured for “their respective rights, interests and liabilities”, subrogation issues may arise. In these circumstances, the insurer may have different obligations to the individual insureds.<sup>8</sup>

Australian courts have generally held that if a contract works policy which covers all contractors and subcontractors, the insurer can not bring a subrogated claim against a co-insured who is responsible for the loss resulting from damage to that property (obviously this is a general rule and depends on the specific terms of the policy).<sup>9</sup>

Policies of insurance can include a provision that acknowledges that each co-insured is separate and distinct and expressly waive

any rights an insurer would otherwise have to pursue a co-insured in respect of loss or damage it indemnifies. These are known as “cross liability” and “waiver of subrogation” clauses. Any contractor or principal who is relying on the insurance of others, should ensure that these clauses are included in both contract works and public liability policies.

### CONCLUSION

If a contract requires the other party to effect the insurance for either contract works or indemnity, best practice is to ensure that the party relying on that insurance is named on the policy, or can confirm that the policy covers it as a category of “insured”. An additional measure that should be taken to reduce the risk of any claim being denied is to ensure that there is a cross liability and waiver of subrogation clause, which expressly precludes the insurer subrogating to the rights of one “insured” to claim against another.

However, there is no substitute for reviewing the entire policy to ensure that there are no relevant exclusions from cover and that there is adequate insurance to cover any indemnities assumed under the contract.

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6 see *Trident*

7 See *Maxitherm Boilers*

8 *Federation Insurance Ltd v Wasson & Ors* (1987) 72 ALR 567.

9 This is due to the contractor having an insurable interest in the whole of the works – see *Jennings*.

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