



# Insuring success.

The fundamental role of project insurance in risk mitigation

The complexity and scale of construction and infrastructure projects give rise to a variety of risks that can jeopardise the viability of a project, making insurance a crucial component of project management. From time and cost blowouts to liquidation and litigation, project insurance is designed to mitigate losses resulting from unforeseen events during and after construction. Comprehensive insurance coverage safeguards all stakeholders, especially the Principal, against loss. This article explores the types of project insurance, the importance of risk mitigation and the key considerations for effective implementation of project insurance in the construction and infrastructure sector.

Insurance plays a vital role in managing the significant risks inherent in construction and infrastructure projects, to such an extent that it has become standard practice for construction contracts to require risk mitigation through insurance. Contractual indemnity clauses typically rely on insurance policies to provide the associated financial protection. Essentially, insurance policies act as the 'guarantee' for the obligations outlined in the indemnity, ensuring there are funds available to cover potential claims or losses. Many financial institutions also now require project insurance to be held as loan security. Typically, the contractor bears the responsibility of obtaining such insurance under the contract.

## Types of project insurance

This article will focus on the following types of project insurance:

- insurance of the works;
- third party liability insurance; and
- professional indemnity insurance (which is applicable when design services are involved).

Other insurance policies may also be required depending on the nature of the particular project, including (but not limited to):

- plant and equipment insurance;
- workers compensation insurance;
- transit/marine cargo insurance; and
- motor vehicle insurance.

## Category 1: Insurance of the works

Works insurance policies address a range of risks associated with the physical construction of a project. Although this type of policy will typically obligate the contractor to reinstate any damaged works, it is important to consider the policy's reinstatement clause to ensure that coverage resumes promptly after an incident without a reduction in coverage limits. It is also essential to review the works policy for any excepted risks, carve-outs or uninsurable risks. These risks must be assessed and mitigated in an alternative manner, for example, by an express indemnity or limitation of liability clause in the contract terms.

## Category 2: Third party liability insurance

Third party liability insurance is designed to protect against claims made by others (third parties) for property damage or personal injury arising from the construction works. Unlike works insurance, which is occurrence-based, third-party liability insurance responds to claims as they arise. Third party liability coverage must be continuous throughout the duration of the project to ensure that all potential claims are caught.

## Category 3: Professional indemnity insurance

Professional indemnity insurance protects against claims of professional negligence. Most professional indemnity insurance policies are offered on a 'claims made and notified' basis, meaning that the claim will go against the policy in place when the incident is first notified. If the policy is not active, or a different policy period has commenced, there is no valid insurance claim. To ensure that a professional indemnity claim will be covered, the policy holder must notify the insurer as soon as a claim is made, or (ideally) as soon as a potential claim arises. In any event, the insurance claim must be made within the same policy period as the period in which the client brought the issue to your attention.

**Example:** Consider a scenario with three consecutive policy periods.



If faulty design work occurs in November 2021 (policy period 1), and the client makes a complaint regarding that design work in August 2022 (policy period 2), when should the insurer be notified under a 'claims made and notified' policy?

In this case, the insurer must be notified within policy period 2 (i.e. before 31 March 2023). If a claim is not lodged with the insurer until policy period 3, despite an active professional indemnity policy still being in place, the insurer may decline the claim.

## Inspection of insurance policies

Given the complexity of insurance and the critical nature of timely claims made in accordance with policy terms, it is essential for both principals and contractors alike to carefully review and familiarise themselves with the terms of their insurance policies. It may also be beneficial to engage specialist insurance advisers or brokers to assess the scope of coverage required for each project. Insurance is not 'one size fits all' – policies must be tailored to include coverage for the risks that, given the nature of the particular project and the parties involved, pose the greatest threat. It is also important to determine adequate coverage limits based on the risks and costs involved.

**Risk allocation**

A commonly cited method of reducing risk is to pass on that risk to subcontractors, suppliers and consultants. Whilst this method, often referred to as ‘back-to-backing’, is good in theory, it is necessary to consider whether it will provide adequate protection in practice. When properly implemented, this method can streamline the claims process and ensure that all stakeholders are aligned in managing potential risks. However, the efficacy of this method depends in large part on the financial stability and insurance coverage of the party ‘receiving’ the risk. Before purporting to rely on a back-to-back arrangement, principals must exercise due diligence and conduct thorough investigations at the outset of the project. Throughout the project, Principals should also actively monitor and reassess whether this approach provides sufficient risk mitigation.

**Indemnities**

An indemnity is an enforceable agreement by one party to provide protection and compensation to another party if specified loss or damage occurs. Indemnity clauses in construction contracts typically cover loss of property, injury, death, negligence, and any associated carve outs. However, there is no one way to structure indemnity arrangements.

When drafting or reviewing contracts, consideration should be given to:

- the types of loss covered by any indemnities;
- any limitations of liability – including any caps; and
- any exclusions of liability.

Careful consideration should be given to the wording of indemnity clauses, as the indemnity will be interpreted in accordance with its terms. If the terms are unclear, courts will not generally interpret ambiguous clauses in favour of the indemnified party. The drafting of an indemnity clause must be clear and unambiguous.

**Proportionate liability**

Proportionate liability legislation has been implemented in all Australian jurisdictions, displacing the traditional common law position of ‘joint and several’ liability. In contrast to joint and several liability, where multiple parties can be held fully responsible for a single loss, the proportionate liability framework means that a defendant’s liability is limited to the proportion of the loss reflecting their degree of fault. Although it is possible to contract out of the proportionate liability regime in certain jurisdictions, it is not permissible in Queensland.

The proportionate liability principle is governed by various State based Acts, including the Civil Liability Act 2003 (Qld), which provides:

*In any proceeding involving an apportionable claim... the liability of a defendant who is a concurrent wrongdoer... is limited to an amount reflecting that proportion of the loss or damage claimed that the court considers just and equitable having regard to the extent of the defendant’s responsibility for the loss or damage...*

It is important to be aware that the proportionate liability framework can have significant implications for the amount recoverable by a plaintiff. Where proportionate liability applies:

- a defendant deemed to be 20% liable will only be responsible for 20% of the damages awarded to the plaintiff; and
- if one defendant becomes insolvent or uncontactable, the remaining defendants cannot be held accountable for their share.

The proportionate liability legislation effectively shifts the risk associated with insolvency or disappearance of a defendant back to the plaintiff.

**How we can help**

Project insurance is a fundamental element of risk mitigation in the construction industry. By understanding the various types of insurance, the importance of timely notification of claims and the nuances of indemnity clauses and liability structures, stakeholders can better protect themselves against potential loss.

Every construction project is unique, necessitating tailored insurance solutions that align with the risk profile of the project. As specialist lawyers in construction and infrastructure projects, we are here to assist you in navigating the intricacies of project insurance and risk mitigation. Our team offers contract administration training to the full range of legal services, from contract review to drafting to ensure your contracts contain clear and effective indemnity clauses, limitations of liability, and appropriate risk allocation strategies tailored to your project’s needs, to claims management in the event of a dispute or claim.



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Disclaimer: The information contained in this article is intended to be a guide only. Professional advice should be sought before applying any of the information to particular circumstances. While every reasonable care has been taken in preparing this article, Muscat Tanzer does not accept liability for any errors it may contain



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