Insurance requirements for acquisition and service contracts

2015

Foreword and introduction

This paper has been prepared to assist readers to draft and negotiate insurance clauses in acquisition and service contracts.

It does not deal with mergers and acquisitions of companies and businesses, which raise separate insurance considerations.

If readers have any questions or comments regarding this paper please contact
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ABOUT THE AUTHOR

Rehana is a leading advisor on insurance issues to government and private sector companies including in relation to placing and auditing corporate insurance programs, broker tenders and the use of insurance to manage risks in M&A transactions and for service, procurement, construction and infrastructure contracts.

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Parts of this paper are sourced from the Australian Government, Department of Defence, ASDEFCON Insurance Handbook V2.0, also authored by Rehana Box.

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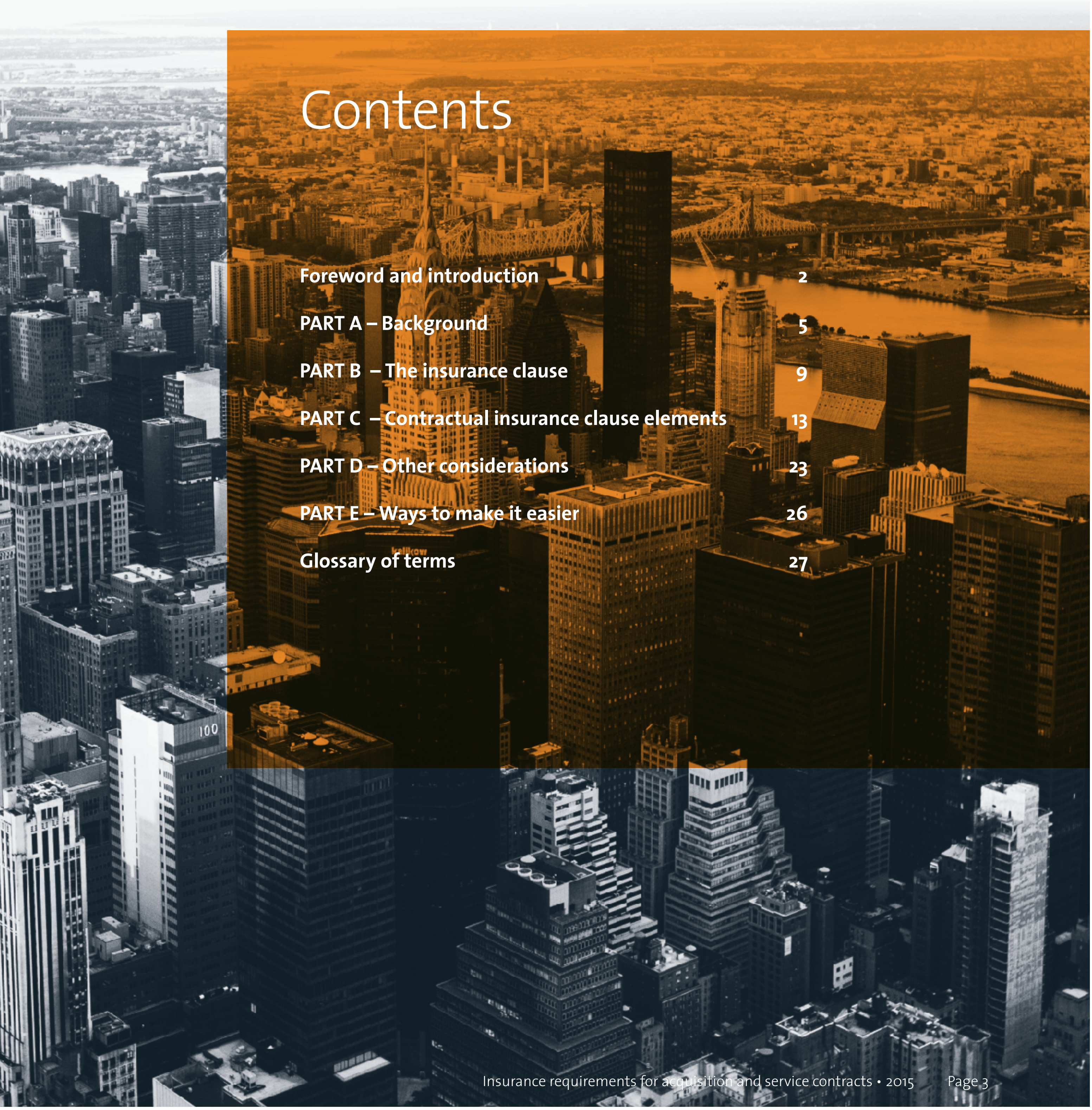


Insurance is intended to ensure contractual risk allocations are effective and that the contractor can survive a large loss or liability.

PART A

Background

Why require contractors to have insurance?

1. There are three main purposes for requiring a contractor to effect and maintain insurance:

   a) The first is to ensure that the allocation of risk under the contract is effective. If the contractor incurs a liability to the principal or to a third party, insurance can reduce the risk that the contractor will not have the financial resources available to meet that liability. In particular, where a contractor cannot meet a liability it incurs to a third party arising out of its performance of a contract, the principal may also be liable to the third party and may become the unintentional indemnifier of the contractor for that liability.

   b) The second is to ensure that the contractor will be able to fund its own losses and liabilities and stay in business and still be able to perform its obligations under the contract. The importance of this purpose will vary depending on the ease with which the contractor can be replaced and the length of the contract. For example, it may be important to the principal that the contractor remains in business in order to complete its obligations under the contract and to supply ongoing maintenance and support for an extended period. Having a contractor collapse financially during the performance of a contract can lead to delays and extra costs.

   c) The third is to reduce distractions for the parties to the contract and facilitate payment of liabilities without unnecessary delay or conflict by putting the claim in the hands of a third party insurer.

2. In considering these objectives it is relevant to think about the financial capacity of the contractor in the absence of insurance. For example, if the principal is dealing with a large, financially secure entity, it may be acceptable for the contractor to wholly or partly rely on self-insurance, either by retaining and managing the risk internally or, by transferring it to a Captive Insurer – see paragraphs 4 to 7 of Part D for more information. However, even if the contractor is financially strong, insurance may still be desirable in order to reduce the potential for disputes and to facilitate payment in the event of a claim by the principal or a third party on the contractor. Having an insurer involved can also provide an additional incentive and discipline for good risk management practices by the contractor.

3. Where the contractor is financially weak or its ongoing financial capacity is questionable, or where the potential losses and liabilities which may arise in the course of performing the contract may exceed the contractor's ability to self-fund those losses or liabilities, insurance becomes very important as it provides security that the contractor will be able to fund its own losses and meet its liabilities to the principal and third parties, and continue to perform the contract without distress.

4. Where a contractor is unable to obtain insurance for a usually commercially insurable risk, this could be the result of the contractor's past claims experience and this may require further investigation to determine if this represents a risk to the principal.

5. A third party guarantee may not provide the same level of comfort as insurance. Usually any payment made by the Bank or other non-related party guarantor will be repayable by the guaranteed entity. If so, this may only delay the financial collapse or distress of the contractor rather than avoid it.

Uninsured risks and prudent risk management

6. Whatever insurance is required of the contractor or held by the principal there will nevertheless be uninsured risks under any contract which must be allocated by the contract terms and managed, to the extent possible and appropriate, by other risk management techniques. For example, a contractor cannot insure against its own wilful or reckless acts and may not be able to insure liabilities which it assumes by contract (for example, by way of an indemnity).

7. Even those risks which are insured should be the subject of further risk management as insured events are generally undesirable and often cannot be fully compensated by money alone (for example, employee injury). A poor claims history will also affect the availability and cost of insurance in future years. In addition, insurance companies sometimes require the insured to undertake certain risk management activities as a condition of the policy, and failure to do this may jeopardise the ability to claim on the policy.

The principal's own insurance cover

8. In considering the insurance requirements to impose on a contractor, it is relevant to consider the insurances maintained by the principal. Some risks may already be adequately insured (for example, first party loss of, or damage to, property of the principal by acts of God). Imposing obligations on the contractor to also insure such risks may simply lead to double insurance and unnecessary premium costs being directly or indirectly passed back to the principal.

9. Most governments have self-insurance schemes of one type or another. For example, most Australian states and territories have self-insurance schemes which insure state or territory risks. Some of these schemes also insure contractor risk. For example, the SiCorp scheme in New South Wales can accommodate principal arranged insurances[1] covering commercial contractors for state infrastructure projects.

10. Local councils may self-insure or partly self-insure many risks through mutual pools whereby they pool their joint insurance requirements to buy insurance cover and, as the pool matures, to retain risk and self-fund losses.

1 See paragraph 21 of Part A for a discussion of principal arranged insurances.

11. Commonwealth departments, agencies and companies insure or self-insure many risks through the Commonwealth's self-managed insurance schemes known as Comcover (general insurance) and Comcare (workers' compensation insurances). In the case of Commonwealth departments, these schemes are self-insurance as the Department, Comcover and Comcare are all part of the same legal entity, being the Commonwealth, and so there is no transfer of risk from one legal entity to another. These schemes cover the Fund Members' own losses and liabilities and the losses and liabilities of their officers, employees and, in some cases, others such as volunteers. Contractors are generally not insured under these schemes.

12. A principal's right to indemnity under its own insurances or under government self-insurance schemes or mutual arrangements will be subject to limits, exclusions, conditions and deductibles. In the event that a principal incurs losses or liabilities that are covered by the insurance, scheme or pool, the insurer, scheme or pool generally expects to have the right to pursue any third party (including contractors) responsible for the loss or liability indemnified to recoup the payment made. This is called the insurer's rights of subrogation. Where the right to recover from a contractor is waived or reduced by contract, the principal's right to indemnity under its own insurances, or from a scheme or pool, may be prejudiced. Care should be taken to consider the principal's own obligations under its own insurance, scheme and pool arrangements in limiting the principal's rights of recovery from a contractor.

13. Insurers, schemes and pools may also exclude cover for losses and liabilities that the principal assumes by contract (for example, by indemnifying a contractor for a risk which the contractor would otherwise bear at general law). Cover is sometimes available for contractually assumed risks but this should not be assumed. Contractually assumed risks can arise as a result of risk allocations, indemnities or liability caps.

What insurances should be required from contractors?

14. The answer to this question will depend on an analysis of the risks of the particular contract, the decision as to which of the risks are to be borne by the contractor and a consideration of which of these risks are capable of being insured on commercially acceptable terms. The last two of these considerations inform each other. Of those risks which can be insured, a decision must be then made as to which, and how much, of these risks should be insured by the contractor. The fact that a risk cannot be insured may lead to a decision that the risk should not be borne by the contractor. Who bears the risk may affect its insurability as the nature of the risk may change from a first party loss risk to a liability risk. Appropriate advice should be sought from an insurance adviser in relation to any contract involving significant or unusual risks to be insured.

15. Accordingly, every contract must be individually considered. For this reason template insurance provisions should only ever be considered as guidance to drafters with respect to what insurances should be requested from contractors and not as prescriptive.

16. In considering which risks remain the responsibility of the contractor, consider the whole of the contract including indemnities, liability caps and general allocation of risk provisions. Think carefully about moving risks from one party to another by contract. Most standard term liability insurance policies will not cover the insured for contractually assumed risks. It will not always be possible to have insurances extended to cover such risks and, where it is possible, this may incur additional premium costs. Where a principal requires a contractor to take on risks that the contractor would not otherwise have at common law (for example, by requiring the contractor to adhere to a higher standard of care than usual or to be liable for losses caused by third parties for whom it is not otherwise responsible, or by contracting out of proportionate liability legislation) then the contractor is accepting a contractually assumed risk. As a result, the contractor may be exposed to an uninsured contingent liability. This may be commercially unacceptable to the contractor. In this context it is relevant to consider if the principal is already insured for such risks under its own commercially placed insurances, a self-insurance scheme or pool arrangement. If so, it may not be necessary for the contractor to also insure against the same risk. For example, a risk

that the principal's property will be damaged by an act of God such as hail will usually be insured by the principal's property policy, so requiring the contractor to also insure this risk may be unnecessary.

17. The contractor should not be required to insure against all risks which it has accepted by contract, for example, under an indemnity clause. It is not possible to insure all risks because all insurances will be subject to exclusions and limitations.[2] For example, in the case of an indemnity against loss of or damage to the property of the principal, the contractor will not be able to insure its own intentional destruction of such property. A principal must be specific and realistic with respect to the risks to be insured by the contractor. Similarly, a contractor cannot generally insure its liability arising from a simple failure by the contractor to perform the contract.

Changes to the scope or risk profile of the contract

18. If the scope of the contract works or services, risk profile or contractual allocation of the risks between the contracting parties changes, insurance requirements must be reviewed and, where appropriate, amended to reflect such changes.

Project-specific insurances

19. In some circumstances, it will be appropriate to require project-specific insurances to be effected by contractors. This means that the contractor must effect an insurance policy solely for risks arising from the contract rather than rely on its general insurances which cover other activities of the contractor and possibly also other insureds (for example, related bodies corporate). This will usually result in higher insurance costs, but can be desirable where, for example:

    - the risks under a contract are unique;
    - various unrelated parties are to be insured under the one insurance policy;
    - the policy is to be placed for an extended period (for example, a period of construction); or
    - the type of insurance has an Aggregate Limit of Indemnity for all claims. An Aggregate Limit of Indemnity could be exhausted by claims unrelated to the contract or contractor. Project-specific insurance ensures that there is an available insurance limit dedicated to claims arising from the performance of the contract.

20. Where project-specific insurances are appropriate, tailored amendments may need to be made to template insurance clauses.

Principal Arranged Insurances

21. A principal may elect to effect and maintain the required insurances itself. This is commonly known as "Principal Arranged Insurances" (PAI). In this circumstance, the principal will have responsibility for and control over the placement of the policy and the control of claims. Often this is seen as cost effective and a way to reduce the risk of a failure to insure by any contracting party. PAI can cover all contractors, sub-contractors and the principal and thereby reduce the risk of coverage disputes between insurers and the risk of uninsured losses and liabilities. The principal may be required to provide the insurers with underwriting information, including details of the risk, the insureds' claims history and other information about the contract. Most of this information may be within the knowledge of the contractor. It will therefore be necessary to contractually oblige the contractor to provide underwriting information as required by the insurers. Tailored amendments may need to be made to template insurance provisions.

2 However, note that the term 'all risks' has a particular meaning in relation to property insurance – see paragraph 45 of Part C.

PART B
The insurance clause

Named insured, insured, additional insured, noted party or loss payee?

1. The terms named insured, insured and additional insured do not have settled meanings in the insurance industry, particularly overseas. That is, these terms may mean different things depending on the terms of the specific policy at issue. As a result, there is often confusion surrounding the use of these terms. For example, a named insured or policyholder often refers to the party to an insurance contract which is the insured responsible for the payment of premium and is nominated to receive all notices from the insurer on behalf of all of the other insureds. However, this is not always the case. The term additional insured may refer to an insured who has only limited cover under the policy, or it may refer to a party with an interest in the risk insured. There are however a myriad of different uses of these and other similar terms. In all cases, the actual policy wording must be reviewed to determine the rights of each party.
2. The question is often asked as to whether it is sufficient for a party to be noted on a policy of insurance for its interests. Again, being a noted party is not a term of art and may have different results depending on the rest of the terms of the contract and governing law of the insurance contract.
3. In relation to property policies it would be appropriate for a party to be insured (not noted) for its interests where the party has, or will have, an insurable interest in the property to be insured at any time during the policy period. For example, in the case of a principal, this would include policies covering the principal's property against the risks of loss or damage. With respect to financiers, it would be appropriate for the financier to be named where the policy is in respect of property the subject of a mortgage. It is common practice for mortgagees to be insured for their "respective rights and interests" on property policies covering property the subject of the mortgage.

4. With respect to liability policies it is generally not appropriate for a third party to be named on another party's professional indemnity policy as an insured except for vicarious or principal's liability. In particular, a professional indemnity policies may not cover the liability of one insured to another (ie they may not include cross-liability cover). In such circumstances, being named is usually not in the principal's interest as the policy will then not cover the liability of the contractor to the principal.

5. It is possible to be named as an additional insured on a contractor's public and products liability policy or contract works liability policy. In most cases an insurer will agree to insure a principal for its vicarious liability arising from the acts or omissions of the contractor no additional premium. In most cases this is sufficient for the principal as the principal should rely on its own public or products liability insurances with respect to liabilities arising from its own acts or omissions. The contractor's public and products liability policy will usually extend to cover the contractor's employees and possibly agents and subcontractors.

6. Project specific policies are an exception, where it is not unusual to have all parties to a project named as insureds under a liability policy for their own acts or omissions. For example, under one public and products liability policy or contract works liability policy.

7. Financiers and principals often seek to be named as Loss Payee on policies (particularly in respect of construction projects). This is only appropriate on property insurances where the property or construction works the subject of the policy is security for the loan or where the property insured belongs to the principal. This provision ensures that in the event of an insured loss, the financier or principal, not the insured, receives the insurance monies. A financier should note that where a property cover is combined with a business interruption or advance consequential loss cover it will usually be up to the insurers discretion as to whether it allows the insured to elect to take a payout in the event of loss or damage to the relevant property or construction works. This is because the insurer usually has an interest in the associated business interruption or advance consequential loss cover and, in order to minimise its liability under those policies, will want to ensure that any insurance monies paid out under the property covers are applied towards the reinstatement or replacement of the lost or damaged property without delay. A financier or principal should consider whether it should have a contractual right to direct the contractor to exercise any rights it has under the contract of property insurance in respect to seeking a payout from the insurer (even if such a payout is ultimately at the insurers discretion). Where a cash settlement is allowed, it will usually be for the indemnity value of the property and not the reinstatement or replacement value and this is usually a lower amount.

8. It is not appropriate for a principal or a financier to be named as "Loss Payee" on a liability policy as monies paid by the insurer will be in respect of the insured's liabilities to third parties and not monies to the account of the insured.

9. Template insurance clauses should avoid using such potentially ambiguous terminology to ensure that the cover required is clearly specified. Whether the required cover is called by one name or another, it is ultimately irrelevant, provided the cover required by the insurance clause is actually provided. If this leads to disagreement, then this is better dealt with at the time the contract is negotiated or insurance placed rather than at the time of a claim.

First party loss and third party liability insurances

10. There are many different types of insurance, and they can be categorised in various ways. One distinction which drafters of insurance clauses should understand is that between:

    a) first party loss insurances; and

    b) third party liability insurances.

11. First party loss insurances provide cover for losses suffered by the insured as a consequence of an insured peril. For example, property insurance is a first party loss insurance – it covers the insured for its interest in insured property which is lost or damaged as a result of an insured peril (eg possibly fire, flood, theft, or malicious or accidental damage).

12. Third party liability insurances, on the other hand, provide cover for the liability of the insured to compensate a third party for loss or damage suffered by that third party as a result of the acts or omissions of the insured. For example, public and products liability insurance is a third party loss insurance – it covers the insured for its liability to third parties who suffer loss or damage as a result of the insured's acts or omissions.

13. The distinction between first party loss and third party liability insurances is not always absolute, however, as a single insurance policy may contain both types of cover under different insuring clauses. For example, most liability insurances also contain an element of first party loss insurance to the extent they cover the insured's own legal expenses in defending a claim.

14. The insurances commonly required by template insurance clauses in acquisition and services can be generally categorised as follows:

First party loss insurances	Third party liability insurances
Property	Workers compensation
Business interruption	Public liability
Transit	Products liability
Contract works	Professional indemnity
Advance consequential loss	Motor vehicle liability

Claims-made versus occurrence based insurances

15. Another distinction drawn between different types of liability insurances is in respect of the basis on which the policy is written – occurrence versus claims-made.

16. Liability insurances written on an occurrence basis cover claims arising from occurrences (as that term is defined in the policy) happening during the policy period (irrespective of when the claim is made against the insured). Liability insurances covering short(er)-tail liability risks are typically written on an occurrence basis (eg public and products liability insurance). This is because there is typically only a short delay between the date of the occurrence and the date the claim is made against the insured.

17. Liability insurance written on a claims-made basis however covers claims made during the policy period (irrespective of when the occurrence giving rise to the claim happened). Liability insurances covering long(er)-tail liability risks are typically written on a claims-made basis (eg professional indemnity insurance).

18. First party loss insurances are written on an occurrence basis.

19. A word of warning, some insurances can be written on more than one basis. For example, while most public and products liability policies are written on an occurrence basis, these insurances are sometimes written on a claims made basis.

20. Insurances commonly required by contractual insurance clauses in acquisition and services can be generally categorised as follows:

Occurrence basis	Claims-made basis
Workers compensation	Professional indemnity
Public liability (most)	Public liability (some)
Products liability	
Property	
Business interruption	
Transit	
Motor vehicle liability	
Contract works	
Advance consequential loss	

PART C

Contractual insurance clause elements

Introductory provision

1. The insurance clause should commences with an obligation that the contractor effect and maintain (or cause to be effected and maintained) the insurances stipulated in the balance of the clause. This obligation recognises that contractors are often insured under insurances effected by others (for example, by a parent company).

2. Given the numerous ways in which insurance programs can be structured, particularly where the contractor's insurance program is arranged on a group basis or from overseas (such as by a contractor's foreign parent company), the insurance clause should provide that the contractor does not need to double insure any particular risk. That is, provided each risk required to be insured by the clause is insured, the principal is not generally concerned with which particular insurance policy within the contractor's insurance program provides the cover or whether one or more policies are used.

3. Further, the requirement for the contractor to effect and maintain (or cause to be effected and maintained) insurance should not extend to require the contractor to insure risks which the principal has expressly retained.

Subcontractors

4. The insurance clause should oblige the contractor to use its best endeavours to ensure that each of its subcontractors are insured as is appropriate given the nature of the services or work to be performed by those subcontractors.

5. A best endeavours obligation recognises that contractors cannot directly control whether or not their subcontractors (or any other third party) effect and maintain insurance.

6. The determination of the appropriate insurances to be required from any subcontractor is usually best left to the contractor (unless the subcontractor is in reality the entity to perform the contract) and should be informed by the insurance requirements of the insurance clause that are imposed on the contractor and the work to be performed by the subcontractor. Usually the insurance requirements for a subcontractor will be a sub-set of the insurance requirements imposed on the contractor as the risks of a subcontractor are a subset of the risks of the contractor under the contract.

7. This approach provides flexibility to contractors in ensuring that their subcontractors are insured in a prudent manner which takes due account of the potentially widely varying circumstances in which (and the work for which) subcontractors are engaged by the contractor.

8. In some cases, it may be appropriate to specify minimum insurances to be maintained by the subcontractor. For example, the contractor may be a project company which itself has no or few employees, formed to allow a consortium of companies (subcontractors) to perform the contract. In many cases this will simply require the insurance requirements to apply to both the contractor and the specified subcontractors.

Workers' compensation insurance

9. Workers' compensation insurance (and employers' liability insurance) cover an insured for the insured's liability at common law and under statute for bodily injury, disease, illness or death of a worker engaged (or deemed by law to be engaged) by the insured.

10. All Australian jurisdictions have a statutory requirement for an employer to maintain workers' compensation insurance or for the employer to be a licensed and regulated self-insured or an exempt employer. These schemes provide additional cover for liabilities arising outside of the scheme at common law in those states and territories where this is still relevant.

11. However requirements vary in overseas jurisdictions. Not all overseas jurisdictions require all liabilities of an employer to its workers to be insured which can lead to uninsured gaps. Also the definition of who is a worker can vary, again, potentially leading to uninsured gaps.

12. Where there is a gap between the potential liability of the employer and cover provided by the statutory workers' compensation insurance, additional insurance is required to fill this gap.

13. Where all work pursuant to the contract is to be undertaken by workers in Australia, generally it is sufficient to require the contractor to maintain workers' compensation insurance as required by law.

14. Where work pursuant to the contract will be undertaken by workers engaged by the contractor outside of Australia, the insurance clause should minimise the potential for uninsured gaps by requiring both workers' compensation insurance as required by law and employers liability insurance which responds to risks not covered by the relevant statutory workers' compensation insurance. Also, the insurance clause should refer broadly to any persons engaged in the work under the contract (or their dependants) rather than by reference to a definition of worker or employee which can vary between overseas jurisdictions.

15. There may be a requirement for vicarious liability cover for the principal. Vicarious liability cover (also called principal's liability cover) does not insure the principal for its liability for its own acts or omissions. Rather, vicarious liability insures the principal for its vicarious liability for the acts or omissions of the contractor. In the context of workers' compensation insurance, vicarious liability may arise in circumstances where the principal is deemed to be the employer of an individual who was injured

or killed during performance by the contractor of the contract. If this is a risk, vicarious liability cover for the principal under the contractor's statutory workers' compensation (to the extent the relevant scheme allows) and employers' liability insurances should be required by the contract. Vicarious liability cover is only available under the statutory schemes of certain of the states and territories in Australia (currently Western Australia, Tasmania and the Northern Territory).

16. For statutory workers' compensation the Limit of Indemnity of the policy will determined by the statutory scheme and does not need to be stipulated.

17. For employers' liability insurances, a minimum Limit of Indemnity per occurrence should be stipulated.

Public and products liability insurance

18. Public and products liability insurance (which is sometimes referred to as combined general liability insurance) covers the insured for its legal liability (generally as a result of negligence) for:

    a) loss of, damage to, or loss of use of tangible property; or

    b) bodily injury, disease, illness or death of any person (other than an employee of the insured),

    suffered by third parties as a result of the operations or activities of the insured or the manufacture, processing, alteration, repair, installation, supply, distribution or sale of products by the insured.

19. The reference to third parties above includes any person who is not the insured making the claim. For example, the principal is a third party in this context.

20. In most cases both public liability and products liability insurance is required. But sometimes only one or the other is needed.

21. Public liability insurance is required where there is a risk of the contractor causing bodily injury or death or property loss or damage in the course of performing the contract and these events could involve or concern the principal.

22. Products liability insurance is required where the contractor will manufacture, process, alter, repair, install, supply, distribute or sell any tangible products (as opposed to intangible products such as software) pursuant to the contract.

23. The required territorial limit[3] of the policy should be stipulated.

24. An Australia only territorial limit may be sufficient where the works under the contract will occur only in Australia and any acquired products will not be used outside Australia.

25. A worldwide territorial limit should be required where the works under the contract will occur in whole or part outside of Australia and acquired products may be used outside of Australia.

26. The Limit of Indemnity for public and products liability insurance is typically as follows:

    a) For public liability claims, the Limit of Indemnity applies per occurrence (although some policies, particularly foreign policies also impose an Aggregate for all occurrences in any one policy period).

    b) For products liability claims, the Limit of Indemnity applies per occurrence and is subject to an Aggregate for all occurrences in any one policy period. Usually this limit is the same as the limit per occurrence for public liability claims.

27. The Limit of Indemnity per occurrence usually applies to all liabilities arising from a series of related occurrences. Whether a particular set of circumstances constitutes a series of related occurrences is always a question of fact (ie it will depend on the specific facts of a particular case) and may differ depending on the wording of each particular policy. A series of related occurrences could include where a number of individuals suffer an illness or bodily injury as a result of consuming contaminated products produced in a single batch.

28. The contract should require that the insurance cover the liability of one insured to another insured. For example, the liability of one worker to another worker in respect of injury or property damage should covered. Another example would be that the liability of an agent of the contractor to the contractor is covered.

29. Vicarious liability cover for the principal may be required. Vicarious liability cover will not insure the principal for its liability for its own acts or omissions. Rather, vicarious liability insures the principal for its vicarious liability for the acts or omissions of the contractor or other insureds. By having vicarious liability cover, the principal can claim directly on the insurance of the contractor in the event a public or products liability claim is made against the principal founded on an act or

3 See paragraphs 22 to 28 of Part D for more information on territorial limits.

omission of the contractor. Most principal's will rely on their own public and products liability insurance for cover for their own acts or omissions.

30. This insurance is usually written on an occurrence basis. This means that it will cover claims arising from occurrences (as that term is defined in the policy) happening during the policy period (irrespective of when the claim is made). This insurance can however be written on a claims-made basis. Although this is not common in Australia, it is common for policies written in certain other countries. Claims-made insurance covers claims made during the policy period (irrespective of when the occurrence happened). If the public (and products) liability insurance policy is written on a claims-made basis, it must be current at the time the claim is made against the contractor and accordingly the policy must be maintained for a period after the end of the contract. It is therefore preferable for the policy to be written on an occurrence basis.

31. Public and products liability insurance policies exclude risks covered by more specific insurances (eg professional indemnity risks; workers compensation risks; motor vehicle / aviation / marine liability risks). They will also, in general, exclude cover for the following:

    a) construction risks;

    b) pollution risks (except for sudden and accidental pollution events, however only limited cover for such events may apply);

    c) software and other IT-related risks (where there is no resultant tangible property damage);

    d) asbestos-related risks;

    e) nuclear risks; and

    f) war and terrorism[4] risks.

32. Public liability insurance also generally excludes cover for the insured's liability for the loss of or damage to property in the insured's "care, custody or control" subject to certain write backs to the exclusion (such as in relation to occupation of leased property and a small limit for employee effects). Cover can be extended to cover a broader range of principal's property in the contractor's "care, custody or control" (such as supplied equipment or supplies) albeit subject to a Sub-Limit, which the contract should must specify. Principal's should be aware that this Sub-Limit is not always able to be increased to a sufficiently high enough amount and can be costly to increase. For this reason the risk of loss of or damage to the property of the principal in the contractor's "care, custody or control" is often better insured under a property policy. A property policy also has the benefit of not requiring negligence on the part of the claiming insured in order for cover to be invoked.

Professional indemnity insurance

33. Professional indemnity (or errors and omissions or civil liability) insurance covers the insured for its liability for economic loss suffered by third parties[5] as a result of the negligent performance of professional services by the insured. There is no requirement for the occurrence to involve bodily injury or property damage in order to trigger the policy to respond. In other words, this policy will respond to a claim for pure economic loss such as costs thrown away by relying on incorrect advice. It will also cover the insured's liability to a third party for personal injury or death or loss of or damage to property arising from the insured's negligent performance of professional services.

34. Professional indemnity insurance does not cover the costs incurred by the insured to resupply or correct its own poorly performed services (for example, providing a corrected advice or design). It will cover the insured where the insured is liable to compensate a third party who obtains the corrected design or advice from another third party.

35. The scope of cover provided will be limited by the definition or description of professional services in the policy.

36. Limits of Indemnity usually apply to each claim or series of related claims. There is usually also an Aggregate Limit of Indemnity for all claims during the policy period. This Aggregate Limit of Indemnity is usually best set at the same as the per claim Limit of Indemnity (so that the whole limit is available in the event of a claim). The insurance clause should provide that the policy must have one automatic right of reinstatement of the Limit of Indemnity in the event that the original Limit of Indemnity is exhausted. Note the requirement for an automatic right of reinstatement is not generally available in respect of other (non-professional indemnity) types of insurance and is therefore only included in this part sub-clause.

37. There are various extensions to this insurance (sometimes automatic and sometimes optional), which may or may not be appropriate given

4 However, the ***Terrorism Insurance Act 2003*** (Cth) renders inoperative terrorism exclusions in certain insurance contracts governed by Australian law in respect of certain terrorism events occurring in Australia.

5 A third party means any person who is not the insured making the claim (for example, the principal).

the nature of the services to be provided by the contractor pursuant to the contract. These include cover for:

a) software and IT risks;

b) unintentional breaches of intellectual property rights;

c) unintentional breaches of trade practices laws; and

d) document recreation costs (which is subject to a Sub-Limit to be specified by drafters – usually this Sub-Limit is relatively low and in the modern times this extension is of much lesser importance as most documents are electronically stored and most relevant where there would be cost in having documents re issued).

38. Contractual requirements that the policy include these cover extensions should be included where appropriate for the services to being provided by the contractor. For example the optional cover extension for:

a) software and IT risks would be relevant in a contract which includes the provision of software by the contractor. (Where this extension is required, the clause should also require that the policy have worldwide territorial and jurisdictional limits as software events could occur anywhere in the ether – see paragraphs 22 to 28 of Part D for more information on territorial and jurisdictional limits);

b) unintentional breaches of intellectual property rights would be relevant if the contractor is providing design services (for example, in relation to a product or process), but not if the contractor is providing transport services;

c) unintentional breaches of trade practices laws would be relevant where there could be allegations of misleading or deceptive conduct; and

d) document recreation costs would be relevant where a large number of original documents would need to be reissued by a government authority (for example, title deeds).

39. Professional indemnity insurance is written on a claims-made basis. This means that the policy must be current at the time a claim is first made against the insured (or circumstances leading to a future claim first come to the insured's attention). For this reason, professional indemnity insurance must be maintained for a period of time after the completion of the professional services provided by the contractor pursuant to the contract.

40. Professional indemnity insurance policies are typically subject to a retroactive date. This means that the policy will not respond to claims which relate to alleged negligent acts or omissions of the insured which occur prior to the retroactive date, irrespective of the date on which the claim is actually made. The retroactive date of the professional indemnity policy should be no later than the date on which the contractor commenced work pursuant to the contract, including any preparatory work before contract execution (for example for tender purposes).

Property insurance

41. Property insurance generally covers loss of or damage to tangible property owned by the insured, and/or property for which the insured has assumed responsibility or responsibility to insure before its loss or damage. Property insurance is a first party loss cover. This means it covers losses suffered by the insured. Property insurance is not a liability insurance, so it does not cover the insured's liability to third parties.

42. Property insurance may be required for:

a) the tangible supplies or deliverables,

b) property of the principal in the care, custody or control of the contractor; and

c) other property, plant and equipment in the care, custody or control of the contractor material to the contractor's ability to perform its obligations under the contract.

43. It is possible to effect business interruption insurance[6] along with property insurance which can covers the increased costs of working and loss of profits, among other things, incurred by the insured in the event of property damage covered by the property insurance. This cover will be limited to a number of weeks as noted in the policy. Determining the appropriate number of weeks for a contract will depend upon the unique risk profile of that contract. Business interruption insurance is commonly arranged for a period of 26 or 52 weeks.

44. The contractual requirement should require that the property insurance cover the interests of the contractor and the principal in the property insured where the policy will cover property of the principal in the contractor's care, custody or control,

6 Business interruption insurance cannot be effected on its own without accompanying property insurance effected with the same insurer.

or property which is to become the property of the principal (particularly where there have been part payments). This is important as, depending on the policy terms and the law of the policy, the insurer may otherwise be entitled to only cover the interest of the contractor in the property even though it has charged a premium for the full value of the property. Thus, the requirement for cover for the principal's interest in insured property ensures that the full benefit of insurance is available in the event of a loss. Where property is insured for its full replacement of reinstatement value, but the contractor's interest in such property is less than full, an insurer may seek to reduce a claim payment to the amount of the interest of the contractor. Including cover for the principal's interest in the insured property (eg as owner) can eliminate or reduce this risk.

45. Property insurance is usually written on either a specified perils basis or on an all risks basis. When written on a specified perils basis, the property insurance will only cover loss of or damage to the insured property which is caused by a peril specified in the policy (eg fire, flood). It will not however respond to cover loss of or damage to the insured property caused by a peril which is not specified. Conversely, a property policy written on an all risks basis covers loss of or damage to insured property caused by any peril (subject to exclusions). Most property policies today are written on an all risks basis with specified exceptions and this is preferred.

46. The contractor should be required to insure the property for the full reinstatement or replacement value of the property insured. This is particularly important where the property insurance contains an Average or Co-insurance clause (which permits the insurer to reduce a claim payment to the proportional extent to which the property was underinsured). It is not desirable or appropriate to require property insurance to the value of the contract or any other arbitrary amount.

Transit insurance

47. Transit insurance is a first party loss insurance which covers property of the insured (or property for which the insured is responsible to insure) which is lost or damaged during transit and loading and unloading. Transit insurance will also cover the risks of loss of or damage to property occurring whilst in temporary storage during transits.

48. Property insurance may exclude all or some transit risks and therefore transit insurance should be an express requirement where it is relevant. However, the contractor may satisfy this requirement by its property insurance if that insurance includes cover for transits of property and that cover is wide enough to include all transits required to be insured (for example, consideration should be given as to whether transits will be by land, air or sea and, whether they be domestic transits only or also international).

49. Transit insurance should generally be for no less than the full reinstatement or replacement value of the property insured, plus freight and insurance on an indemnity basis. This ensures that incidental expenses associated with property lost or damaged in transit are covered by the transit insurance.

50. This insurance is relevant property will be transited during or for the purpose of the performance of work by the contractor.

51. Where the property in transit is the principal's property, the risk of loss or damage during transit is sometimes best retained by or transferred to the principal and covered under the principal's own property insurances or scheme or pool arrangements as commercial insurance can be costly or simply unavailable.

52. For the same reasons as set out in paragraph 44 of this Part C, the clause requires that the principal be an insured for its interest in the property to be transited.

Motor vehicle liability and first party loss insurances

53. Motor vehicle liability insurance covers the insured for its liability for:

    a) loss of or damage to tangible property; or

    b) bodily injury, disease, illness or death of any person (other than an employee of the insured),

    suffered by third parties[7] as a result of the insured's use or ownership of registered and unregistered motor vehicles.

54. In Australia, this cover is provided by a combination of two policy types: compulsory third party insurance (**CTP**) and comprehensive motor vehicle liability insurance.

55. CTP insurance is statutorily required and covers the insured for its liability for bodily injury suffered by third parties as a result of the insured's use or ownership of registered motor vehicles.

56. Comprehensive liability motor vehicle insurance covers the insured for its liability for property damage suffered by third parties as a result of the insured's use or ownership of registered motor vehicles, as well as for the insured's liability for bodily injury or property damage suffered by third parties as a result of the insured's use or ownership of unregistered motor vehicles.

57. In other countries however, these insurances may be provided by a different combination of policies.

58. Motor vehicle insurance can also cover the vehicle itself against the risk of loss or damage. This type of cover is usually not required by contractual insurance clauses because it is a decision more appropriately left to the contractor unless the vehicles are material to the contractor's performance or the deliverable is a motor vehicle.

Contract works insurance

59. Contract works insurance covers the loss of or damage to property in the process of construction, plant and equipment and any other property on site. It may also cover the loss of or damage to property, plant and equipment whilst in transit to and from the site.

60. Property insurance will not normally cover property undergoing construction or being worked upon. Hence, separate insurance is required.

61. Where the works and the materials forming part of the works (ie the insured property) cannot be readily replaced, or where the loss of or damage to the works will adversely affect the normal business operations of the contractor (such as by delaying the progression of the works), there may be a requirement for cover for the financial losses of the contractor arising from the delay, such as loss of rent and increased costs of completion of the works (which is known as advance consequential loss insurance). This cover can be effected along with the contract works insurance (but not separately) with the same insurers.

62. Contract works insurance is a first party loss insurance. It is important not to confuse contract works insurance with a combined insurance product commonly called contractor's all risks insurance. Contractor's all risks insurance normally includes contract works insurance and third party liability insurance (which is similar to public and products liability insurance but only covers these risks where they arise as a result of the insured's contract works activities) in a single policy. Provided each risk required to be insured is insured, the principal is usually not concerned with which particular insurance policy within the contractor's insurance program provides the cover or whether one or more policies are used. Thus, in certain circumstances, a contractor's all risks insurance policy may be suitable to satisfy the requirement for public and products liability and for contract works insurance, however, each case needs to be assessed on its particular facts.

Other insurances

63. Depending on the risk profile of a contract, other types of insurances may also be required, for example:

    a) where the project involves aircraft or marine risks additional or alternative insurances may be required; or

    b) where the contract involves works which could result in damage to the environment, in such a case, pollution liability (also known as environmental impairment liability) insurance may be required.

64. Drafters are encouraged to seek specialist assistance where particular contract risks may require additional insurance treatment.

7 As noted at paragraph 19 of this Part C, a third party means any person who is not the insured making the claim (for example, the principal).

Periods of insurance

65. Insurances written on an occurrence basis respond to claims based on events or occurrences happening during the policy period and so are required to be maintained for the duration of the contract and thereafter until all work pursuant to the contract is completed (including any works to be carried out after the end of the contract, for example, pursuant to defects corrections periods).

66. There are however three exceptions to this. Transit insurance, motor vehicle insurance and contract works insurance may only be required for the time during which the risk insured against is actually present. The insurance clause should specifically stipulate the relevant time periods for these insurances.

67. Insurances written on a claims-made basis (such as professional indemnity insurance) are prudently maintained for seven (or in some cases, ten) years after work pursuant to the contract has been completed. As discussed at paragraph 39 of this Part C, claims-made policies must be current at the time a claim is first made against the insured (or circumstances leading to a future claim first come to the insured's attention) and so must be maintained for a period after the work is completed to allow for claims to be brought.

68. Some contractors may have cover on a claims-made basis, notwithstanding any requirements of the contract to have insurances written on an occurrence basis. For example, a contractor may have public liability insurance written on a claims-made basis even though the public liability insurance is usually written on an occurrence basis in Australia. In those circumstances, the contractor should be required to effect such insurances written on a claims-made basis for a period after the contract.

69. Usually either seven or ten years as the period of time after work has been completed in the period that the professional indemnity insurance is required to be maintained. A longer period of potential latent defects may justify a longer period. In most cases, seven years will be sufficient. However, where the risk of latent defects being discovered later exists (such as in construction contracts), a ten year period may be prudent.

70. Where a contract includes provision for the supply of products, it may be appropriate to require the contractor to maintain products liability insurance for a period after completion of the contract. This is because a defect in the products may not manifest itself or be discovered during the contract period and the contractor's liability to compensate the principal for any loss in respect of such defect may not crystallise until after the contract period. For example, a defect could be discovered in the products and damage suffered five years after the products were supplied. The period for which the products liability cover should be maintained will usually depend on the likely life of the goods in question. Where this will be a number of years (eg 20 years), a commercial judgement will need to be made regarding the period to be required.

Terms of required insurances

71. The insurance clause may stipulate a number of terms which must be included in the required insurances (except for those insurances whose terms are dictated by statute, such as compulsory workers compensation and CTP).

Approved insurers

72. The insurers of the required insurances should be of good financial standing. It may be appropriate to require that insurers (other than insurers of compulsory insurers) have a financial security rating of, say, "A-" or better with Standard & Poors (or the equivalent with another recognised rating agency) at the time the insurances are effected, unless otherwise approved by the principal.

73. This requirement is intended to ensure that the insurers of the required insurances are of such financial standing as to be able to meet their obligations to indemnify the contractor (or the principal) as an insured under the policies they issue.

74. See paragraphs 5 and 6 of Part D for guidance on considering insurers which are put forward by contractors who do not have the requisite financial security rating.

75. Principal's sometimes require that insurers (other than insurers of compulsory insurers) are APRA regulated. However, this is not always appropriate as the insurance program may be placed with overseas insurers as part of a global insurance program or for other good reasons. The fact an insurer is not APRA regulated is not a reason, on its own, to reject an insurer as being acceptable.

Severability and non-imputation

76. Where a liability policy of insurance covers more than one party, it is prudent to require that the policy include certain provisions to protect the rights of each insured.

77. Severability is one such provision. It requires that the insurer treat each insured as though a separate policy of insurance had been issued to each (except in respect of the Limit of Indemnity, which is not increased as a result of the inclusion of a severability provision).

78. It may also be prudent to require that the insurer agrees not to impute:

a) the failure of one insured to comply with the terms of the insurance policy to another insured for the purposes of determining the availability of cover; and

b) the knowledge of one insured to another insured for the purposes of determining the availability of cover.

Proportionate liability legislation

79. The contract may exclude the operation of the proportionate liability to the extent allowable at law.

80. Nine Australian jurisdictions have enacted "proportionate liability" legislation. The key feature of proportionate liability is that, where there are two or more defendants (ie *concurrent wrongdoers*) to a claim based on financial loss or property damage arising from negligence, a breach of a contractual duty of care or misleading conduct, the defendants are not jointly and severally liable but are liable in proportions determined by the court.

81. By contracting out of the proportionate liability regime, the contractor takes on a contractually assumed risk. As discussed in paragraph 16 of part A, most commercial insurance policies will not cover the insureds for contractually assumed risks. For this reason, it is necessary for the contract to specifically require the contractor to ensure its liability insurances (with the exception of statutory insurances) cover this contractually assumed risk.

Evidence of required insurances

82. The insurance clause should oblige the contractor to produce, at certain times (eg on execution and / or before the commencement of the performance of the contract and then on each renewal) and otherwise on the principal's written request:

a) sufficiently detailed Certificates of Currency from the contractor's insurer or Broker evidencing the required insurances;

b) copies of the required insurance policies, except:

i) copies of policies whose terms are dictated by statute (eg workers compensation, CTP) do not need to be provided; and

ii) copies of policies which are commercially sensitive (eg professional indemnity) do not need to be provided, however the principal and/or its advisers should be given the opportunity to inspect such policies;

c) any other evidence reasonably required by the principal.

83. Please see paragraphs 8 to 33 of Part D for further guidance on the review of required insurances.

84. In the event that the contractor fails to comply with the requirement to produce satisfactory evidence to the principal of the currency and terms of the required insurances, the principal should have the right to place the relevant required insurance(s) and the contractor must co-operate to enable the principal to do so.

Contractor's obligations in respect of required insurances

85. The contract should impose a number of obligations on contractors in respect of the required insurances, to ensure that the required insurances are not prejudiced or the available Limit of Indemnity impaired in a manner which adversely affects the required insurances.

86. The insurance clause should oblige the contractor to do all things reasonably necessary to enable the principal (or any other person entitled to claim under a required insurance) to recover monies from the insurer.

87. In addition, the insurance clause should prohibit the contractor from doing anything which may prejudice any insurance maintained by, or indemnity available to, the principal conditional upon the principal providing written notice to the contractor that a relevant act or omission of the contractor would so prejudice the insurance maintained by, or indemnity available to, the principal.

Changes to the required insurances during the term of the contract

88. The risks involved in the performance of a contract may change over time or perceptions of the risk may change. For example, experience may indicate that higher liability limits are required or as the contract progresses some risks may dissipate or disappear. The insurance requirements in the contract may no longer be appropriate. The principal may be under protected or paying for unnecessary insurances.

89. The insurance clause can include a mechanism whereby the principal can:

    a) increase or decrease the Limits of Indemnity for the required insurances; and/or

    b) change the types of the required insurances.

90. For example, the principal could have a right to make such changes to the required insurances at each renewal of the relevant insurance by providing 3 months written notice to the contractor.

91. The principal could agree only to exercise its right to increase the Limit of Indemnity for a required insurance or to require additional insurances if the principal has received a reputable Broker's (or other professional's) report which indicates that the intended change to the requirement is appropriate and in alignment with current market practice at the time for corporate insureds with similar risk profiles to that of the contractor.

92. This right to increase or decrease the Limits of Indemnity or to change the types of required insurances will generally only be required for contracts of 3 years or more in duration.

Uninsurability

93. In the event that a particular risk which is required to be insured under the contract becomes Uninsurable during the contract term, the insurance clause can include a mechanism whereby that Uninsurable risk can be managed other than by way of insurance.

94. For example, the insurance clause can provide that the following steps shall be taken in the event that a risk becomes Uninsurable:

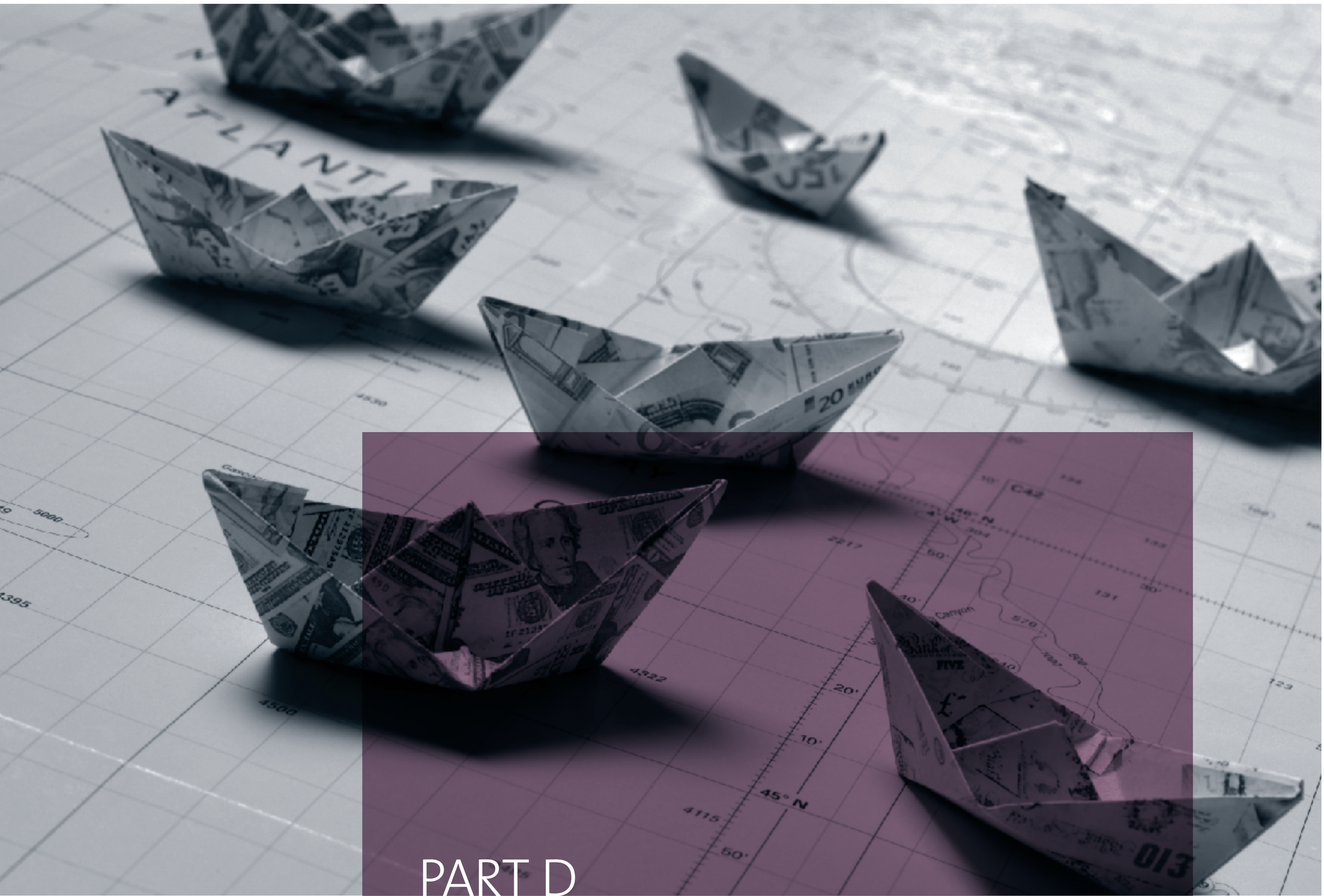
    a) the contractor shall promptly inform the principal of details of the Uninsurability of the risk and the steps which the contractor will take to manage the risk while it remains Uninsurable;

    b) the contractor and the principal shall meet to discuss and agree on how the risk will be managed while it remains Uninsurable (including, for example, that the principal may agree to provide an indemnity to the contractor); and

    c) if the contractor and the principal cannot agree on how the Uninsurable risk will be managed, either party may terminate the contract (except in the circumstance where the principal has offered an indemnity to the contractor on terms no less broad than the insurance held by the contractor for the risk immediately prior to it becoming Uninsurable).

95. While a risk remains Uninsurable, the insurance clause should oblige the contractor to monitor the availability of insurance for the risk and report to the principal details of attempts made to obtain insurance for the risk. Further, if and when insurance becomes available for the risk, the contractor must effect such insurance.

96. Many other forms of this regime are possible. For further guidance on alternative approaches further advice should be sought.



PART D

Other considerations

Alliance and modified alliance contracts

1. Alliance and modified alliance contracts adopt a different risk allocation methodology which requires particular attention by drafters as traditional liability insurances will generally not effectively transfer risks to insurers.

2. In particular, traditional professional indemnity policies generally will not operate as intended as there may be no liability of one party to another in respect of professional negligence. Specialised insurance products have been developed by insurers to deal with alliances and modified alliances, which allow for some cover to be provided.

3. Drafters should seek advice when considering insurances for an alliance or modified alliance contract.

Self-insurance/ Captives/ Mutuals

4. If the contractor self-insures (ie does not insure) any of the risks required to be insured, this is acceptable, then the contract will need to reflect that the contractor is permitted to self-insure. This may require deletion of the insurance requirement altogether.

5. Some contractors insure via a Captive insurer of the contractor. If this is acceptable, then the contract will need to be amended to reflect that the contractor is permitted to insure via a Captive. For example, the Captive will not have a financial security rating

of "A-" or better with Standard & Poors (or the equivalent with another recognised rating agency) and may not be able to insure third parties (for example, the principal for its vicarious liability).

6. It should be noted that some insurances which appear to be commercial insurance may in fact be mutual arrangements. This is particularly common for aviation and marine insurances and local government risks. Some property insurances are also insured by mutuals. Mutual insurers insure the mutual members by pooling the premium contributions of members and relying, in some cases, on reinsurance. Care should be taken in agreeing to accept these insurances, particularly where the principal is paying the premium. For example, calls may be made on members of a mutual in the event of a short fall in reserves to meet anticipated claims.

7. Where a contractor proposes to self-insure, or insure via a Captive or a mutual arrangement, drafters should seek further advice.

Ensuring contractor compliance

8. It is important that principals have procedures in place to check that the required insurances are effected and maintained as required by the contract.

9. Requirements that contractors provide Certificates of Currency and/or copies of policies on each renewal must be enforced and included as part of standard contract management practices by principals.

10. If these requirements are not enforced, there is the potential that they will not be complied with and the protections which the insurance requirements of the contract are intended to afford, may be wholly or partially illusory.

11. Drafters should be particularly mindful of insurances written on a claims-made basis that must be maintained after the end of the contract (eg professional indemnity insurance).

12. When reviewing Certificates of Currency and/or copies of policies, careful attention should be paid not only to the specific terms required by the contract (eg Limits of Indemnity), but reviewers should also consider, among other things:

    a) the levels of any Deductibles, Self-Insured Retentions or Co-insurance; and

    b) the exclusions.

13. Often, a Certificate of Currency issued by the contractor's Broker will contain insufficient information to satisfy the principal as to the terms of the required insurance held by the contractor and compliance with contractual requirements. The insurance clause can specifically require that Certificates of Currency provide particular details or assurances from the Broker to allow the principal to better confirm contractual compliance.

Territorial and jurisdictional limits

14. There is often misunderstanding and confusion regarding territorial and jurisdictional limits in insurance policies.

15. Territorial limits refer to the territory or geographical area in which an occurrence or event must occur in order for the policy to respond.

16. Jurisdictional limits, on the other hand, relate to the legal jurisdiction (eg courts) and/or law pursuant to which claims can be brought in order for the policy to respond. For example, many policies in Australia will not respond to claims brought in the courts of, or in any court applying the laws of, the USA or Canada (and their respective territories and protectorates).

17. Generally, limits will be defined as one of the following:

    a) Australia wide;

    b) worldwide excluding USA and Canada and their territories and protectorates (cover for these particular jurisdictions often further increases the premium and is not always available from all insurers); or

    c) worldwide.

18. Where a required insurance covers software or IT risks, the geographical territory must be worldwide to avoid any dispute as to the geographical location of the occurrence (which is not necessarily easily identifiable, particularly in respect of online activities).

19. The public and products liability insurance clauses include options for territorial limit. The worldwide territorial limit option should only be selected where works under the contract will be undertaken outside of Australia or where acquired items may be used outside of Australia.

20. When reviewing contractor's insurances, it is important to ensure that appropriate territorial limits and jurisdictional limits are included in the required insurances.

Limits of Indemnity

21. With respect to property insurances, the general rule is that property should be fully insured for its full reinstatement or replacement value and appropriate incidental costs such as extra costs of reinstatement, demolition costs and professional adviser fees. Where property is in transit, it is prudent to insure it for 100% of its value and for incidental costs such as the costs of carriage of replacement items.

22. With respect to liability insurances, Limits of Indemnity are best set by reference to the Maximum Probable Loss derived from the risk assessment. The level of cover needs to consider all liabilities (to the principal and third parties) that could arise from the one occurrence or event, or series of related occurrences or events. The level of cover required also needs to take into account the costs of acquiring insurance and its availability.

23. In setting the required Limits of Indemnity for liability insurances, drafters should bear in mind that the value of the contract may bear no relation to the risks that may arise from its performance. However, the value of the contract will influence the commercial sense of requiring the contractor to incur large premium costs for high insurance levels.

24. Drafters should also consider whether the Limit of Indemnity for a required insurance is subject to an Aggregate Limit of Indemnity. This is particularly important where one Aggregate Limit of Indemnity is shared across multiple activities of the contractor. In such cases, it may be appropriate to require a higher Limit of Indemnity than would otherwise be required. The issue is however less of a concern where the policy is being effected solely for the project (ie project specific insurance).

25. The insurance clause may provide for Limits of Indemnity to be reviewed periodically by the principal in long term contracts (see paragraphs 88 to 92 in Part C). The insurance clause should not make Limits of Indemnity subject to indexing as Limits of Indemnity are not increased or decreased incrementally.

PART E

Ways to make it easier

There are various things which can be done to make drafting, negotiating, and ensuring contractor compliance with contractual insurance requirements easier including:

- **Template clauses:** Ensure template contracts have up to date template insurance clauses appropriate for the common circumstances in which the template will be used. Include options where appropriate. Ensure that the template clauses are commercially achievable.
- **Handbooks and Guidance:** Ensure drafters and negotiators have handbooks or other guidance available to explain the template clause requirements and the options available. Training sessions may be appropriate.
- **Centralise management:** Create a centralised centre of excellence for insurance within the organisation with a greater understanding of the template requirements and insurance generally. Centralise compliance checks, particularly annual checks of certificates of currency.
- **Pre-approval:** Consider pre-approving regular or strategic contractors. Carry out an annual review of their insurances rather than on a contract by contract basis. Gain a deeper understanding as to how these contractors manage their risks.
- **PAI:** Consider effecting some required insurances yourself for major projects or, effecting a floater policy covering your contractors to give certainty of the currency and terms of insurance. PAI can reduce costs and the risk of coverage disputes and give you control of claims.

Glossary of terms

Glossary of terms

This glossary of terms includes definitions of terms which appear in this paper as well as definitions of various other terms in common use in the insurance industry.

This glossary is not authoritative and is provided for ease of reference only. Further, it is not necessarily reflective of the precise usage of these or other similar terms in overseas jurisdictions, which can vary from Australia.

Term	Definition
Aggregate (or Aggregate Limit of Indemnity)	The Aggregate Limit of Indemnity in an insurance policy is the maximum amount the insurer will pay for all claims in any one policy period, irrespective of the number of claims.
Assessor (or loss adjuster or loss assessor)	A person appointed to investigate the cause and circumstances of a loss and to assess the quantum of the loss, usually appointed by the insurer.
Average	An Average clause in an insurance policy operates to reduce the amount the insurer will pay for a claim where the property which is lost or damaged (and is the subject of the claim) was insured for less than its full replacement or reinstatement value. Whilst the precise operation of Average clauses varies somewhat, they typically result in a proportional reduction in a claim payment which reflects the extent to which the relevant property was under-insured. In effect, the Average clause penalises insureds for underinsuring their property. The premium for property insurance is typically calculated by applying a rate to the declared value of property to be insured. The Average clause mitigates the potential for insureds to under-declare the value of their property in order to minimise the premium payable by them. There are statutory provisions in the *Insurance Contracts Act 1984* (Cth) which govern Average clauses in insurance policies subject to Australian law.
Binder	An arrangement between an insurer and a Broker pursuant to which the Broker is authorised to accept risks on the insurer's behalf.
Broker (or Insurance Broker)	An intermediary acting on behalf of the insured in the placement and management of insurance(s). However, in certain circumstances, a Broker may act on behalf of the insurer (eg pursuant to a binder).
Captive	A company established to act as an insurer of the risks of a particular contractor (and its related bodies corporate) which is itself a related body corporate of the contractor.
Certificate of Currency	A document evidencing the existence of an insurance policy at a particular point in time, which is typically issued by the insurer of that policy, or by a Broker. The Certificate of Currency does not affect or alter the terms of the actual insurance policy in any way.
Claims-made basis	Liability insurance written on a claims-made basis covers claims made during the policy period (irrespective of when the occurrence giving rise to the claim happened). Liability insurances covering long(er)-tail liability risks are typically written on a claims-made basis (eg professional indemnity insurance). Liability insurance written on a claims-made basis can be contrasted with liability insurance written on an occurrence basis.
Co-insurance	Co-insurance means that the insured and the insurer together share the risk insured, at least to an extent. There are a myriad of ways Co-insurance can be used in insurance policies, but the most common provides that the insured will contribute a certain percentage to the amount of each and every loss that the insurer pays.

Term	Definition
Cover note	An interim or temporary contract of insurance (or other document evidencing same) which is issued pending the issuance of the formal insurance contract document.
Cross liability	Whilst this term can encompass a variety of nuances, a cross liability clause generally is a clause in a liability insurance policy which provides that the insurer agrees to insure the liability of one insured to another insured under the same policy.
Deductible	The Deductible is the amount which the insured is required to contribute towards the payment of a loss by an insurer. A Deductible is sometimes called an excess or a Self-Insured Retention. However, strictly speaking, a Self-Insured Retention operates slightly differently than a Deductible (or excess) in that a Self-Insured Retention does not form part of the Limit of Indemnity, whereas a Deductible does. The following example is illustrative. Assume a professional indemnity insurance policy has a Limit of Indemnity of $1million per claim and in the aggregate per policy period, and a deductible of $100,000 per claim. In the event of a $1.5million claim, the insured would pay the first $100,000 and the insurer would pay up to the Limit of Indemnity of the policy (being $900,000). The $1million aggregate Limit of Indemnity has been exhausted and the remaining $500,000 is uninsured. Now, let's assume that same professional indemnity insurance policy (with a Limit of Indemnity of $1million per claim and in the aggregate for all claims per policy period) but is subject to a Self-Insured Retention of $100,000. Under this policy, in the event of a $1.5million claim, the insured would still pay the first $100,000, but the insurer will pay the full Limit of Indemnity (being $1,000,000) leaving only $400,000 uninsured. In any event, it is important that the terms of the actual insurance policy in question be carefully reviewed as the use of the terms Deductible, excess and Self-Insured Retention are not necessarily always indicative of their operation.
Duty of disclosure	The *Insurance Contracts Act 1984* (Cth) imposes a statutory pre-contractual duty of disclosure on every insured. The duty requires that every insured disclose to their prospective insurer every matter known to them which is a matter relevant to the insurer's decision to accept the risk and on what terms. If an insured fails to comply with the duty of disclosure, the insurer will be entitled to certain remedies, including reducing its liability for a claim (even to nil). There is a similar duty owed at common law.
Endorsement	A term added to an insurance policy varying the standard terms. Endorsements are usually annexed or included in the policy schedule.
Excess policy	An insurance policy providing cover for losses in excess of losses covered by another underlying insurance policy.
Exclusion	The perils, losses, liabilities, property or circumstances for which cover is excluded by the terms of the policy.
First party loss	Insurance cover for the insured's own loss, not the insured's liability to third parties.
Institute Clauses (or AVN Clauses)	A set of standard form clauses which have been developed and are commonly adopted by insurers, particularly in the fields of marine and aviation risks. AVN Clauses are a set of Institute Clauses produced by the Aviation Insurance Clauses Group and are used in various forms of aviation-related insurance policies.
Insurer (or Underwriter)	The party to an insurance policy to whom the risk is transferred and who has the obligation to pay claims.
Limit of Indemnity (or Limit of Liability)	The maximum amount the insurer will pay under an insurance policy.
Loss adjuster (or loss assessor)	See Assessor.

Term	Definition
Loss payee	The person specified on a first party loss insurance policy as the person to whom the proceeds of an insurance claim are to be paid.
Maximum Probable Loss (MPL)	The Maximum Probable Loss represents the financial consequence (to the principal and to any third party) of a risk event occurring after taking into account any risk treatments that mitigate consequence – it is NOT discounted by the likelihood of it occurring.
Occurrence basis	Liability insurance written on an occurrence basis covers claims arising from occurrences (as that term is defined in the policy) happening during the policy period (irrespective of when the claim is made against the insured). Liability insurances covering short(er)-tail liability risks are typically written on an occurrence basis (eg public and products liability insurance). This is because there is typically only a short delay between the date of the occurrence and the date the claim is made against the insured. Liability insurance written on an occurrence basis can be contrasted with liability insurance written on a claims-made basis. First party loss policies are written on an occurrence basis.
Principal's liability	See vicarious liability.
Principal Arranged Insurances (PAI)	Insurances arranged by a principal for the benefit of a contractor and possibly also other contractors, sub-contractors and the principal. Often project or contract specific, but the insurances can be "floater" policies covering a number of projects.
Proposal	The document (and any information or other documents attached thereto) which is completed by the insured providing relevant information to the insurer in order to apply for insurance.
Reinsurance	Insurance taken out by insurers in respect of all or part of the portfolio of risks the insurer has insured.
Renewal	The placement of a new policy of insurance in replacement for a policy which has just expired.
Retroactive date	The date stipulated in a liability insurance policy written on a claims-made basis (particularly, professional indemnity insurance) as of which the acts or omission of the insured giving rise to a claim(s) will be covered by the policy. Claims which arise from acts or omissions of the insured which occurred prior to the retroactive date are not covered by the policy.
Risk Assessment (LRA)	Risk Assessment be undertaken to provide the basis for determining limitation of liability amounts and insurance requirements.
Run-off cover	Liability insurances written on a claims-made basis do not (with some exceptions) provide cover for claims arising after the end of the policy period. Thus, where there exists a risk that claims could arise after the end of the policy period (and the policy is not replaced) which relate to acts or omissions that occurred prior to the expiry of the policy period, run-off cover needs to be arranged to provide cover for such claims. The period of time for which it is prudent to maintain run-off cover varies. However, it is usually recommended that a period of 7 years be arranged in order to allow for the 6 year general limitation period for the bringing of claims plus 12 months for the serving of an originating process issued by a court.
Salvage	The damaged property (or amount of money representing the value of such damaged property) recovered by an insurer after it has paid the full value of an insured's claim for such damaged property.
Self-Insured Retention (SIR)	The Self-Insured Retention is the amount which the insured must bear before the insurer's obligation to contribute to the payment of the loss arises. As noted above in the definition of Deductible, there is inconsistent use of the terms Deductible, excess and Self-Insured Retention. It is therefore important that the terms of the actual insurance policy in question be carefully reviewed to ascertain the actual operation.

Term	Definition
Schedule (or policy schedule)	A document forming part of an insurance policy which is issued each renewal by the insurer setting out variable information in relation to the policy including the name of the insured, period of cover, premium, Deductible, Limits of Indemnity, etc.
Self-insurance	Refers to the retention of a risk by a person. Self-insurance properly means that the person simply retains the risk and will fund its consequences themselves. However, sometimes it is used to mean that the entity has insured the risk with a Captive.
Severability	Refers to a term in an insurance policy which provides that the policy operates as though a separate policy was issued to each individual and entity comprising the insured, except that the Limit of Indemnity is not thereby increased.
Slip (or placing slip)	A document evidencing the terms of an insurance contract which has been proposed and agreed to.
Sub-Limit	A Limit of Indemnity which applies to a particular risk that is typically less than the Limit of Indemnity otherwise available for claims under an insurance policy.
Subrogation	The right of an insurer, after settling a claim or indemnifying the insured in respect of a claim, to sue in the insured's name any third party who was partly or wholly responsible for the loss, in order to make recoveries and reduce the insurer's net loss.
Underwriter	See insurer.
Uninsurable	Liability to obtain insurance – this term should be defined. For example, it could be defined as: a) the required insurance is not available in the international insurance markets with insurers with a financial security rating of "A-" or better by Standard & Poors (or the equivalent rating with another reputable rating agency); or b) the premium for insuring the risk is at such a high level or terms and conditions which are such that the risk is not generally being insured against in the international insurance markets with reputable insurers by prudent corporates with a risk profile comparable to the contractor.
Vicarious liability (or principal's liability)	Refers to the liability of one person for the negligence of another person, without the first person being at fault. The most common relationships giving rise to such liability are employer and employee, principal and agent, and in limited cases, a person who engages an independent contractor and the contractor. An employer is liable for the negligent conduct of an employee committed in the course of employment – the employer is vicariously liable for the negligence of its employee.
Waiver of subrogation	Refers to a provision in an insurance policy wherein the insurer agrees not to exercise its rights of subrogation. In the absence of such a waiver, an insurer who has paid a claim is generally entitled to step into the shoes of the insured and take any action available to the insured to recover the insured's loss against any person who caused or contributed to that loss (which the insurer has paid to the insured pursuant to the terms of the insurance policy). Where multiple unrelated parties are insured under the same insurance policy, it is often appropriate to seek that the insurer waive its rights of subrogation, at least in respect of the insureds under the policy. Where the principal is not insured under the contractor's insurances for its liability for its own acts or omissions, there is no direct benefit to the principal whether or not the insurer waives its rights of subrogation in a contractor's insurance policy.

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