

# Insurance Clauses in Construction Contracts

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# Introduction

This paper discusses the basics of insurance and what it covers, how insurance responsibilities affect the parties' risks and the potential cost of a project, and issues arising from the general conditions and how they are sometimes amended.

The paper uses the 2013 NZS suite (3910, 3916, and 3917) as the standard construction contracts, although the principles also apply to other standards such as NZS3915, the NZIA standard conditions of contract, FIDIC, NEC, and other international standards. The 2013 NZS suite was chosen as it accounts for approximately 2/3 of the contracts that Marsh reviews for our clients.



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# The Basics of Insurance

Insurance is a contract between the Insured (the first party) and the Insurer (the second party) that sets out the Insurer's promise to pay a specified amount at a future time if a defined event occurs. These events broadly break down into the following groups:



## DAMAGE TO SPECIFIED PROPERTY OWNED BY THE FIRST PARTY OR THAT THE FIRST PARTY IS RESPONSIBLE FOR, SUCH AS:

- Buildings, contents, and stock (Material Damage / Industrial Special Risks / Property Damage)
- Property in the course of construction, erection, demolition, alteration (Contract Works / Construction All Risks / Erection All Risks / Ship-builders)
- Property in transit – either internationally or within the country (Marine Cargo / Marine Transit)
- Vehicles or mobile plant required to be registered for road use (Motor Vehicle)
- Watercraft (Marine Hull)
- Aircraft – powered or unpowered, includes unmanned aerial devices / drones (Aviation Hull)



## BODILY INJURY TO FIRST PARTIES (INCLUDING EMPLOYEES)

- Cover for medical costs incurred due to defined injury or illnesses (Medical insurance)
- Loss of income arising from accident and in some cases from illness (Income Protection)
- Capital benefit for permanent disablement / impairment arising from injury or illness (Personal Accident)
- Capital benefit payable to the estate of the deceased on their death from any cause (Life Insurance)



## LOSS OF PROFIT FOLLOWING DAMAGE TO PROPERTY OWNED BY THE FIRST PARTY

- Reduction in revenue
- Increase in expenses



## LIABILITY TO THIRD PARTIES FOR LOSSES THEY SUFFER RESULTING FROM FIRST PARTY ACTIVITIES

- Property damage or injury arising from the use of first party property:
  - use of motor vehicles (Motor vehicle liability)
  - use of aircraft (Aviation liability)
  - use of watercraft (Marine Liability)
  - business activities (Public / general liability)
  - damage caused by the first party's product once it has been handed over (Products liability / completed operations)
- Failure to supply goods or services following damage to property
- Financial loss arising from first party provision of professional advice or professional services (Professional Indemnity)
- Fines and penalties arising from accidental breach of certain statutes (Statutory Liability)

## When does a policy respond to an event?

For an insurance policy to respond, the insuring clause must be triggered – i.e. there must be an event that fits within in the criteria of the insuring clause, such as damage to insured property for a Material Damage policy or an allegation of damage to property owned by a third party for a Public Liability policy.

Assuming that the policy trigger has been met, the second test for insurance cover is to determine whether a policy exclusion applies. Policy exclusions are added to policies for various reasons, including:

- Business risks (such as failure to meet a specified standard, or poor workmanship)
- Inevitable damage (such as wear & tear, gradual deterioration, although consequences of such are usually covered)
- Moral hazard / public policy issues (such as deliberate acts, failure to comply with law)
- The accumulation across multiple policies arising from one event would be too large for the insurance industry (e.g. war, nuclear risks, terrorism)
- Liability assumed by agreement beyond what would exist at common or statute law (commercial decisions to accept a higher standard of responsibility than would otherwise apply)
- The exposure is more specifically insured under another policy (such as excluding liability for motor vehicle operations under a public liability policy)

Some of these exclusions are limited to the direct cause only with the consequent damage being covered (for example, defects exclusions will typically exclude the defect itself but write back cover for damage or loss caused by the defect), while other exclusions operate to totally exclude all cover for loss arising from the excluded peril (for example war and terrorism risks).

## What makes up an insurance policy document?

A complete insurance policy contains several sections that each has their own purpose:

- The Policy Schedule – the specifics of a particular policy (who the parties are, what the amounts of insurance are, the duration of the insurance, etc.)
- The Insuring Clause – what the trigger is (what is the risk that is being addressed by the policy)
- Policy Conditions – how the policy is administered, and what each party's obligations are under the policy
- Exclusions – what is not covered by the policy
- Extensions / Memoranda – any extensions or modifications to the policy

Insurance policies can also be amended by adding endorsements to extend or reduce cover on a case by case basis.

An insurance policy document fits together in a similar manner as a construction contract; to use the 2013 NZS suite as an analogy:

INSURANCE POLICY ITEM	NZS SUITE EQUIVALENT
Policy schedule	First schedule
Insuring clause (policy trigger)	Contract agreement
Policy conditions, exclusions, and extensions	General conditions of contract
Policy special endorsements	Second schedule



# Policies not referred to in 2013 NZS suite

Most standard contracts will address the insurance specifications for contract works, existing structures, public liability, motor vehicle liability, damage to contractor's equipment, and professional indemnity.

However, the 2013 NZS suite is silent on the following types of insurance (although not all of these policies will be necessary or appropriate for every project):

- Delay in Start Up (DSU) / Advance Loss of Profits (ALOP)
- Marine cargo (International shipments only – contract works policies are usually required to insure materials for incorporation into the works whilst in transit within the country)
- Use of aircraft / drones
- Use of watercraft
- Pollution insurance
- Statutory liability

## DSU / ALOP INSURANCE

DSU / ALOP insurance provides cover for a loss of revenue or increase in the cost of working that is caused by damage to the works of a type that would be covered by the contract works policy. The contractor usually has no insurable interest in this policy, so the contract does not generally need to address this cover, although the principal should consider the exposures for this type of insurance before making a decision on who is to be responsible for arranging the contract works insurance; this is because the DSU / ALOP insurance must be placed with the contract works insurer. While it can be possible for the contractor's insurance adviser to arrange DSU / ALOP insurance for the principal, where DSU insurance is required, it is generally best for the principal to supply the contract works insurance.

## MARINE CARGO

Marine cargo insurance should usually be the responsibility of the party responsible for ordering the materials from overseas suppliers, (although where DSU / ALOP insurance is appropriate the principal is usually better served to arrange the marine cargo insurance for the project). Generally, the responsibility for marine cargo insurance is left with the contractor to arrange as they are normally arranging the purchase of insurance.

Depending on the terms of purchase and transfer of the risk of damage, supplier's marine insurance can be used instead of the contractor arranging this insurance. Care should be taken when relying on supplier's insurance as:

- Incoterms<sup>1</sup> set out who is to arrange the insurance, but do not specify anything further such as the level of cover, the basis of settlement, or the policy deductible.
- Overseas suppliers will generally have arranged insurance with insurers in their home territory, which can lead to issues when dealing with the insurer in the event of a claim such as language barriers, access to insurance representatives, and a lack of commercial relationship to leverage in the claim negotiations.

## USE OF AIRCRAFT / DRONES

While the use of small drones can be accommodated under standard general liability policies, if a large drone or a manned aircraft is intended to be used for the construction project, it is appropriate to add some specifications for aviation insurance. If a project will require the use of manned aircraft, then aviation liability insurance will need to be addressed by the contract – usually in the form of requiring that the aircraft operator have adequate liability insurance and that the principal and contractor are covered for their vicarious exposures arising from the use of the aircraft.

## WATERCRAFT

General liability policies will usually include cover for liability arising from the use of small watercraft (typically up to 8m in length, although some insurers will agree to increase the maximum length), however where larger vessels (including barges or pontoons) are required for a project, specific marine liability insurance should be addressed by the contract in the same manner as discussed above for aviation liability.

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<sup>1</sup> Incoterms rules or International Commercial Terms are a series of pre-defined commercial terms published by the International Chamber of Commerce. They are widely used in International commercial transactions or procurement processes. A series of three-letter trade terms related to common contractual sales practices, the Incoterms rules are intended primarily to clearly communicate the tasks, costs, and risks associated with the transportation and delivery of goods.

## POLLUTION

Most insurance policies will contain exclusions relating to pollution damage or liability. Generally, insurance will exclude pollution unless it can be traced to a specific event lasting no more than 24-72 hours (depending on the policy).

Traditionally it has been time consuming and expensive to get any insurance cover for pollution with extensive testing of specific sites required to obtain cover, but over the last 5-10 years insurers have developed a wider appetite for pollution cover with two policies insuring pollution liabilities becoming more readily available on commercial terms:

- Contractors Pollution Liability – covers the exacerbation of an existing pollution condition or the development of a new pollution condition as a result of construction works
- Premises Pollution Liability – covers new pollution conditions that occur as a result of operational activities

In addition to covering liabilities to third parties, these policies can also cover actions by regulators (such as requiring that a spill into a stream be remediated), damage to first party property, and interruption to business.

Pollution liability cover should be considered for projects involving removal of asbestos, remediation of contaminated land, or work in or adjacent to environmentally or culturally sensitive land.

## STATUTORY LIABILITY

This policy insures defence costs, reparation costs, and fines arising from accidental and non-reckless breach of statute; breach of specific acts are not covered, typically those where criminal intent is required, and fines and penalties under WorkSafe legislation cannot be insured.

The 2013 NZS suite does not require that this insurance be arranged, and not all contractors choose to purchase this insurance as the construction industry is seen as high risk by insurers making the insurance uneconomic for some insureds.

Principals can sometimes seek to be added to the contractor's insurance for loss that they incur arising out of the contractor's acts or omissions. This is something that insurers will strongly push back on, and it is unlikely that this requirement will be accepted by insurers; the only way for this requirement to be met is for a project specific policy to be placed, which will add cost to the project.

Aside from issues with dual insurance<sup>2</sup>, the principal has separate duties to the contractor under WorkSafe legislation; when a principal is prosecuted, they are being charged for their own breaches rather than the contractor's breaches, so vicarious liability cover does not respond.



<sup>2</sup> Dual insurance – where multiple policies potentially cover the same loss, the insurer for whichever policy is claimed upon can seek a contribution from the insurer of the other insurance policy unless there is a clear priority between the policies as to which policy is to apply.

# 2013 NZS Insurance Clauses

## CLAUSE 5.6.6 / 8.1.6

### EXCEPTED RISKS & FORCES OF NATURE TO BE INSURED

Clause 8.1.6 sets out the perils of the forces of nature that are required to be insured; while this is specifying insurance cover, it also acts as a risk allocation between the contractor and the principal. The perils that are required to be insured are considered to be a contractor's risk, while perils that are not required to be insured are a contractor's risk only to the extent that an experienced contractor could reasonably foresee or make provision for.

One common trap is to replace a "Yes" or "No" under 8.1.6 with "As per policy"; this results in a circular error – clause 8.1.6 specifies what forces of nature the contract works insurance is required to cover, and is part of the risk allocation for the excepted risks under 5.6.6. The original intent of clause 8.1.6 was to expand the information provided so that the parties had certainty as to what forces of nature were insured; by using the phrase "as per policy" moves the allocation of risk from a positive decision by the parties to a passive reaction to what the policy wording states.

Aside from earthquake perils, there is no separate pricing for the forces of nature, so there is no potential premium saving for reducing the perils that are required to be insured. From a contractor's perspective, they will still want the forces of nature to be insured as they retain the risk of damage to the works to the extent that they could reasonably foresee or make provision for, and depending on the project the cost of this damage could still exceed the policy deductible.

Earthquake perils will have a large policy deductible (typically 1 to 5%<sup>3</sup> of the completed value of the works at the time of loss) so a contractor should be considering their exposure to earthquake risk carefully, and may seek to make seismic perils a specifically excepted risk under 5.6.6 (g).

The effect of specifying seismic risks as a specifically excepted risk under 5.6.6 (g) is that rectifying damage to the works arising from that risk is treated as a variation giving the contractor a claim for time as well as cost.

While the general conditions provide a default deductible allocation, this may need further review depending on the project and who is responsible for arranging insurance.

## CLAUSE 8.1.4

### DEDUCTIBLE RESPONSIBILITY

The default allocation of responsibility for insurance deductibles is that:

- where the contractor arranges the insurance, the contractor is responsible for all deductibles
- where the principal arranges the insurance, the principal is responsible for all deductibles, except to the extent that the loss or damage arises from the act or omission of the contractor, in which case the contractor is responsible for the deductible amount stated in the special conditions.

The responsibility for the deductible represents a significant risk allocation factor for contractors to consider, especially when the deductible is high relative to the size of the contract (and thus the amount of contractor's margin). This responsibility is particularly important for deductibles relating to seismic risks, given their expected size – especially towards the end of the project.

## CLAUSE 8.3.3, 8.8

### CONTRACT WORKS

#### NEED FOR CONTRACT WORKS INSURANCE

Not all contracts will need contract works insurance – for example demolition contracts may not need contract works insurance unless there is an expectation that a damage event could increase the cost of the demolition (examples include loss of salvageable materials, increased demolition costs (deconstructing damaged buildings is more expensive than deconstructing sound buildings), or additional clean-up costs arising from a damage event). Projects involving many small work packages may also not gain significant benefit from contract works insurance unless there are several packages under way at one time giving the potential for accumulated values to mean that a wide area event could generate a significant loss.

#### ADDITIONAL PARTIES TO BE INSURED

The general conditions already require that the principal be insured; this item is intended to allow for parties such as financiers, local authorities, or other parties with an insurable interest to be added as required.

<sup>3</sup> 1% of constructed value is typically available for works in Auckland, Northland, and sometimes Southland, 2.5% of constructed value typically applies to the rest of the Country other than Christchurch and Wellington regions, where 5% of constructed value will usually apply.

## AMOUNTS TO BE INSURED

The amounts to be insured in addition to the contract price can sometimes be mistaken for similar elements within the contract price, rather than what these items are intended to cover:

- Demolition – this is an allowance for the costs of cleaning up following a loss so that repairs can commence
- Professional Fees – this is an allowance for professional fees incurred as a result of damage (such as additional consents, re-design costs, engineering fees)
- Materials to be incorporated into the works – this represents materials or goods that the principal is providing to the contractor in addition to the contract price (also known as free issue materials).
- Additional Costs – effects of inflation, increased construction costs due to the damage, etc.

The contractor needs to be comfortable that the contract works insurance provides adequate levels of cover for these items taking into account the size and nature of the project, as the care of work provisions of clause 5.6 means that the contractor will carry the risk that the cost of reinstatement exceeds the amount of insurance available under these extensions unless the cause of the loss is an expected risk. Where the contractor is responsible for arranging the insurance, the contractor needs to review the amounts specified to ensure that their policy will comply with the contract. Some annual contract works insurance policies provide cover for these additional items “to the extent required by contract, subject to a maximum of X% of the contract price” so an amount will need to be specified in the contract in order for the item to be covered. Additionally, if one or more of these items is specified with an amount exceeding the policy maximum, the project may not be covered by the policy at all as the project may not meet the policy definition of a “covered contract”.

## CLAUSE 8.4

### CONTRACTOR ARRANGED PLANT INSURANCE

The principal’s only concern relating to the contractor’s construction plant insurance is to have confidence that the contractor has the resources necessary to repair or replace damaged equipment promptly to minimise interruption to the performance of the contract.

In some cases, the key items of equipment necessary for the project are owned by subcontractors rather than the contractor; the requirement to insure key equipment should still be included in the contract to ensure that the obligation is transferred through the contractual chain, but the conditions could be amended to refer to insurance by subcontractors – especially if the head contractor is a project manager or a large portion of the works are to be subcontracted.

## CLAUSE 8.5

### CONTRACTOR ARRANGED PUBLIC LIABILITY

Where the contractor is required to arrange public liability insurance, the principal is only insured for the principal’s vicarious liability (i.e. liability that arises from the contractor’s performance of the works – there is no cover for the principal’s own acts or omissions, nor for the acts or omissions of any party that the principal is responsible to the contractor for (such as the Engineer, or designs / specifications produced by the principal’s consultants.)

It is normal for liability policies to include sub-limits for certain types of liabilities, and the First Schedule contains provisions for sub-limits for:

- Vibration, weakening or removal of support (VRS)
- Liability under the Forest and Rural Fires Act (F&RFA)

VRS liability is usually capped at \$250,000 to \$500,000, although prudent contractors will usually purchase higher limits. Where the works include high risk activities (in the context of VRS) such as structural alterations, use of vibratory equipment, or excavation, a substantial VRS limit should be specified, however where the VRS exposure is low a nominal amount for the sub-limit can be accepted.

The F&RFA limit was incorporated into the 2013 NZS suite as the F&RFA contained provisions that allowed a Rural Fire Authority to recover the cost of fighting fires from a responsible party, whether they had been negligent or not; this strict liability meant that public liability insurance would not always respond. It became standard practice for an F&RFA extension to be added to public liability insurance to respond to the strict liability. However, as part of the restructure of the Fire Service into Fire and Emergency New Zealand (FENZ) the F&RFA was repealed on 01 July 2017, and the power to recover costs was not carried over into the new act.

It is therefore not appropriate to simply replace the reference to the F&RFA with the FENZ Act. Liability under the FENZ Act does not require special insurance – it is either covered under the general limit of indemnity of a public liability policy, or under a Statutory Liability policy, or is not insurable due to its’ criminal nature. Accordingly, the sub-limit should be deleted, or the limit amount stated as “Not Applicable”.

## CLAUSE 8.6

### CONTRACTOR ARRANGED PROFESSIONAL INDEMNITY

#### CLAIMS MADE VS OCCURRENCE

Like many conditions of contract, the 2013 NZS suite requires that contractors maintain professional indemnity insurance for a minimum of 6 years after practical completion. This requirement stems from professional indemnity being a claims made policy as opposed to the occurrence based policies normally used for public liability. The difference between claims made and occurrence policies is that a claim is made against the policy that was in force at the time that the loss occurred for occurrence policies, but against the policy that is in force at the time that the loss is discovered / made for claims made policies.

#### SUBCONTRACTOR PROFESSIONAL INDEMNITY INSURANCE

The original intent of clause 8.6.2 was to allow a more nuanced approach to limits of indemnity – the idea was that low consequence activities (i.e. those activities where the cost to rectify would be small) could have a lower limit of indemnity specified than a high consequence activity. Instead, the Schedule 1 wording refers to a sub-limit for work by subcontractors. It is not standard for professional indemnity policies to have a sub-limit for work done by subcontractors or subconsultants – the policy either insures the liability arising out of the work of subcontractors or consultants, or it doesn't. This means that 8.6.2 serves no purpose.

Another item to consider is the extent to which a subcontractor's professional indemnity insurance has relevance to a principal; unless it is built into the contractual arrangements, the subcontractor will typically not owe a duty to a principal, rather the subcontractor owes a duty to the head contractor. The principal's contractual arrangement is with the contractor so they would not usually need to seek recovery from the subcontractor directly, and in the absence of the subcontractor owing a duty to the principal, there would not be any benefit to the principal taking action against the subcontractor. If the head contractor does not maintain professional indemnity insurance and wants to rely on the subcontractor / consultant's cover then the head contract and the subcontract both need to be amended to reflect the intent that the subcontractor is to owe a duty to the principal or the head contractor's vicarious liability is to be covered by the subcontractor's policy.

#### NZS3916 CONTRACTS

The professional indemnity requirements under NZS3916 differ from NZS3910 and NZS3917 contracts; under NZS3916:2013, the general conditions of contract offer two options in respect of professional indemnity insurance:

- (a) Annually renewable professional indemnity policies can be used up to Final Completion, followed by a single period run-off policy for a further five years; or
- (b) A single professional indemnity policy for the full duration of the project (from commencement of design through to five years after Final Completion)

Several issues arise with option (a), especially for projects of significant size or duration. Not all insurers are willing to provide a run-off policy as prescribed by the general conditions even if they already provide the annual professional indemnity insurance that will be used up to Final Completion. Even where an insurer is willing to offer a run-off policy at the time of tender, the length of time between tender submission and the commencement of the policy (which in the case of larger projects will be several years) introduces a substantial pricing and coverage risk for several reasons. This includes the potential for a claim or notification to occur before the policy is bound, possible changes in reinsurance availability or pricing and the potential for a change in the annual professional indemnity insurer during the construction period.

If the annual professional indemnity insurer were to change during the construction period, even if the new insurer was also willing to provide a run-off policy on Final Completion, as insurers would need to underwrite the whole project (including what has happened during construction) to determine their terms, it is possible that the new insurer would not be willing to provide the appropriate retroactive date.

Consequently, our recommendation is that either annual policies be used for the entire duration that insurance is required to be maintained, or a project policy be arranged from the commencement of the project. The use of annual professional indemnity policies would work best where the level of design risk and cover required is relatively low while a project policy works best for higher risk projects with higher limit requirements.

The use of project professional indemnity policies will have a significant impact on the cost of the project due to the duration that cover is required to be maintained for, especially if significant limits of indemnity are required.

#### PRODUCT GUARANTEE

Professional indemnity insurance covers financial loss arising from an act error or omission in the provision of professional services or advice; this does not equal a guarantee that the works will meet a particular specification. Unless the failure to meet specification is the result of an error in professional services or advice then professional indemnity insurance does not cover this exposure.

# CLAUSE 8.8

## PRINCIPAL ARRANGED CONSTRUCTION INSURANCE

### POLICY WORDING USED

Part 8.8 of the First Schedule requires that the wording title for the principal arranged construction insurance be provided, along with details of any extraordinary exclusions, conditions, warranties or endorsements; the intent of this requirement is for the principal or their insurance adviser to identify the base cover provided by reference to the policy form being used (preferably the specific form where known rather than just “insurer contract works policy”) to enable the contractor or their insurance adviser to quickly identify what cover is being provided, and whether there are any alterations to cover that are specific to this project; ideally the full wording of any extraordinary exclusion, condition, warranty or endorsement should be provided as part of the tender documentation.

### WAIVER

Clause 8.8.1 requires that the construction insurance be effected in the names of the principal, the contractor and subcontractor for the Contract Works. Clause 8.8.2 requires that in certain circumstances the principal is also to effect insurance under 8.8.1 for the replacement values nominated in the Special Conditions, and the construction of the two clauses implies (but does not explicitly state) that the insurance of the existing structures is also to be in the names of the principal, the contractor and subcontractor.

However, just adding the contractor or subcontractor as an insured is not necessarily sufficient to eliminate the existing structures insurer’s ability to recover from a contractor or subcontractor as this action is not sufficient on its own to create an insurable interest in the existing structures, especially those elements of the structures that are not in the contractor’s control. The extent of the indemnity that the contractor provides the principal under section 7 of the General Conditions argues that the contractor’s exposure is founded in negligence rather than an absolute responsibility for damage.

The contractor and subcontractor’s exposure (and therefore their interest) in respect of existing structures is the risk that they could be legally liable for the damage, and while damage is covered by contract works and material damage policies, liability is not, meaning that the contractor or subcontractor’s interest would potentially not trigger the policy, so they could still be exposed to a recovery action from the insurer.

Where existing structures are added to construction insurance, the usual approach is for the construction insurance only to provide “performance damage”, i.e. damage arising from the performance of the works. This does not provide cover where the contractor or subcontractor causes damage in a manner unrelated to the works.

Clause 8.8.2 requires that where applicable the principal arranged insurance “... shall include cover for the replacement values nominated in the Special Conditions in respect of: ...”; if the Special Conditions are amended to refer to performance damage cover subject to an event limit, then there is no need for a waiver to be granted by the principal’s existing structures insurer as the performance damage extension of the contract works policy will satisfy the requirement of the general conditions, and contract works policies contain a waiver in respect of the parties who are insured under the contract works policy.

There is nothing in the general conditions that requires that a waiver of subrogation be provided, and it is a commercial decision between the parties as to whether a waiver should be provided. Additionally, depending on the nature of the works involved, insurers may require an additional premium to reflect the increased risk they take in granting a waiver; this additional cost would need to be factored into any negotiations.

This waiver premium can be in addition to any aggravation of risk premium the existing structures insurer requires for the works. The use of performance damage cover under the contract works policy can eliminate the need for an aggravation premium, but care needs to be taken in the specification of the performance damage cover under the contract works policy to avoid incurring excessive FENZ levies.

### PROCEEDS OF PRINCIPAL ARRANGED CONSTRUCTION INSURANCE

While it is reasonable for the insurance funds to be channelled through the principal where the principal has arranged the contract works insurance, there needs to be an obligation for the insurance funds to be passed on to the contractor to align with the contractor’s care of works obligations; the contractor has an obligation to make good damage to the works at their own expense and the only recourse for these costs that the contractor has is the insurance proceeds unless the damage is caused by an excepted risk where the contractor is entitled to a variation.

It is reasonable to have the Engineer provide quality control oversight to ensure that any reinstatement works are done in accordance with the contract, however there are some elements of cover under a contract works policy that do not solely relate to repair costs, and these costs should be claimable from the insurer directly by the contractor as they are incurred.

Examples of where the contract works policy includes cover for various expenses incurred by an insured in addition to the reinstatement of the works include:

- Demolition, debris removal and other costs: some of the costs covered (such as dumping fees for debris) would be incurred by the contractor as part of their preparation to commence reinstatement

- Prolongation costs: a contractor incurring additional hire charges to keep plant on site in consequence of damage delaying the completion of the works would not normally require certification by the Engineer
- Contract works policies can also include extensions for additional costs of working / extra expenses to maintain normal operations or to minimise delay
- Protection costs to prevent or minimise damage

Another factor to consider when channelling payment via the principal and using payment claims to reimburse the contractor is the implications of the Construction Contracts Act. Using this approach can present cash-flow issues, especially where there are multiple insurers involved – the contractor may present a valid payment claim for repairs before the insurer has agreed to make payment under the policy leaving the principal to fund the settlement until the insurer reimburses the principal.

## CLAUSE 8.9

### PRINCIPAL ARRANGED PUBLIC LIABILITY INSURANCE

The common approach to arranging public liability insurance for construction projects is for the contractor to arrange public liability insurance; however principals still need to ensure that their own public liability insurance will respond to claims arising from an act of the principal.

As noted above, where a contractor is required to provide public liability insurance for a project under clause 8.5, the contractor's policy will only cover the principal for the principal's vicarious liability arising from the contractor's performance of the works; there is no cover for a principal for the principal's own acts or omissions in respect of the works.

Additionally, under clauses 5.6 and 7, a contractor is not liable to the principal for loss, liability, or cost arising from:

- The permanent use of or occupation of land by the works and the right of the principal to carry out the works on the site;
- Injuries to persons or damage to property or interference with the rights of others which is the unavoidable result of carrying out the works in accordance with the contract; or
- Any act or omission of the principal or other parties engaged by principal that the principal is responsible to the contractor for (such as a principal's designer).

Where the contractor suffers a loss as a result of these items, the principal indemnifies the contractor for that loss. Of particular note is that the third point above includes liability arising from defective design – where a principal has provided

a design and an error in the design causes damage or injury to a third party (i.e. someone that is not the principal or the contractor), then this exposure is a principal's risk.

Because a contractor is only required to insure the principal for their vicarious liability under the contractor's policy (and does not have to insure for liability that the contractor is not responsible for), there are areas that are insurable that the principal will not be covered for without their own public liability policy in place, and it is for this reason that a principal needs to ensure that their own public liability insurance will respond.

Unless construction activities are part of the principal's normal ongoing activities, their public liability policy will not necessarily automatically cover this exposure. However it should be possible to extend a public liability policy to cover the principal for liability arising from a construction project, although depending on the project there may be some cost involved to do so.

Contractors are not generally willing to provide full cover for principals under their annual public liability policy, and amending the contract conditions to require this will usually result in a project specific public liability policy being offered at an additional cost – in some cases this may be the best insurance solution for the project.

A project specific public liability policy provides many benefits over the use of individual annual policies including:

- The policy is dedicated to the project so claims for other projects do not affect the project;
- The policy insures all parties as full insureds while being able to make claims against each other, and provides certainty that all parties involved in the project are insured;
- The extent to which the individual parties to a contract caused the third party loss does not need to be proved – if a claimant can prove that their loss results from the negligence of that parties performing the works then the project specific policy will respond enabling claims to be settled quicker than relying on each individual's policies; and
- There is reduced administration required as you do not need to periodically check that the contractors and subcontractors have renewed their annual insurances.

To sum up, even when contractors are required to provide public liability insurance, the contractor's public liability policy cannot fully protect a principal which is why it is recommended that principals have their own cover as well, or a project specific policy fully insuring all parties should be arranged.

# CLAUSE 11.1

## DEFECTS NOTIFICATION PERIOD

Typically the defects notification period will range from 3 to 12 months, but longer periods can sometimes be specified. The duration of the defects notification period has implications for the length of time that insurance needs to be arranged for:

- Contract Works policies need to have cover for the contractor returning to the site to fulfil their obligations under the contract such as rectifying defects
- Public Liability and motor vehicle liability policies also need to be in place until the end of the defects notification period
- For NZS3916 contracts, professional indemnity insurance needs to be maintained for 5 years after the end of the defects notification period.

Contract works insurers will generally be willing to provide defects notification periods up to 24 months, and in some cases will be willing to extend this to 36 months, however it is not possible to extend defects liability period cover beyond this.

Where a contract specifies a duration for defects notification period longer than 36 months, the duration in excess of 36 months will need to be uninsured.

## ABOUT MARSH

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