
Is Conventional Insurance for Construction Projects Fit for Purpose?

Dr Donald E Charrett*

Insurance is a widely used risk management tool to transfer to a third party specific risks that a contracting party is liable for. In practice, insurance does not always result in payment following the occurrence of an insured event. Instead of preventing disputes as to who is liable for the financial consequences of a risk event, in many situations the insurance itself provokes or complicates disputes. This article discusses why insurance is important for construction contracts. It reviews the current insurance landscape for design and construction risks in Victorian construction projects. A number of problems that arise from the conventional approach to insurance for construction projects are identified. Different approaches to project insurance used in a large project and a civil law jurisdiction are discussed. The benefits that could flow from adopting these different approaches to make insurance more fit for the purpose for which it is intended, are outlined.

I. INTRODUCTION

Large construction projects generally involve significant complexity in their procurement – in their technical challenges, and in the interaction and interfaces between the different organisations involved in design and construction. These issues (and others) are manifest in the inherent risks of construction, which range from the physical challenges of the site and the prevailing environment, the technical and organisational challenges of each party involved in design and construction completing their work to the required quality in the specified time, to completion of the works for the specified cost. The rights and obligations between the parties involved in design and construction are regulated by contracts that assign liability if the risk events occur.

Insurance is a widely used risk management tool to transfer or offset specific risks to a third party, the Insurer, that a contracting party is liable for. Some insurance is mandated by legislation, some by contract. The aim of such insurance is to provide a third-party fund that will pay for the financial consequences arising from the occurrence of risk events to assure project completion or rectification of defects without financial detriment to the contracting parties (or owners). In an ideal world, if an insured risk event occurs, the relevant insurance company would make prompt payment, and thereby promote successful contract completion or rectification of defects and avoid disputes about financial liability.

In practice, for a variety of reasons, insurance does not always fulfil this ideal function. Instead of preventing disputes between the contracting parties as to who is liable for the financial consequences of a risk event, in many situations the insurance itself provokes or complicates disputes. This may be the consequence of, for example, different insurance policies covering different risks, debate over the cause of a risk event, or a dispute over which party is contractually responsible for the scope of particular insurance policies. Insurance companies themselves may instigate litigation to recover the costs they have paid out.

This article is in five substantive parts. Part II discusses why insurance is important for construction contracts. Part III reviews the current insurance landscape for construction projects in Victoria, with particular reference to the different types of insurance to cover design and construction risks. The following section identifies a number of problems that arise from the conventional approach to insurance for construction projects, with the consequence that it does not always respond appropriately. Part V

* BE, LLB, MConstLaw, PhD, FIEAust, FCIArb, Barrister, Arbitrator & Mediator, Expert Determination Chambers. This article was commended for the Society of Construction Law Australia Brooking Prize 2018



reviews different approaches to project insurance used in a large project and a civil law jurisdiction. Part VI outlines the benefits that could flow from adopting these different approaches to make insurance more fit for the purpose for which it is intended – to provide a fund from a source external to the contracting parties to assist successful completion of a project and rectification of defects.

Due to the breadth of this topic and space limitations, the article focuses on the Victorian position, with particular emphasis on insurance for domestic building.

II. WHY INSURANCE IS IMPORTANT FOR CONSTRUCTION CONTRACTS

Construction of major projects is an expensive business. It involves the input of considerable intellectual effort, the procurement of large quantities of materials, and the organisation and integration of the work of many skilled tradesmen of different disciplines. As has been stated by many commentators, cash flow is the lifeblood of the construction industry. That cash flow is significant for even the largest construction companies; it is vital for the commercial survival of many of the smaller organisations involved in the construction industry, such as trade subcontractors or design professionals, many of which have negligible tangible assets on their balance sheets. Thus, in many situations, insurance may be the only significant financial resource available to pay for damage or defective works.

Governments have recognised the risks arising from the potential impecuniosity of organisations involved in design and construction by mandating minimum levels of insurance in certain situations. For example, pursuant to the *Building Act 1993* (Vic), certain registered building practitioners (building surveyors, building inspectors, engineers, draftspersons and quantity surveyors) must maintain Professional Indemnity (PI) insurance of not less than \$1 million for any one claim and in the aggregate for all claims during any one period of insurance, plus \$500,000 in respect of Defence Costs.¹ Registered builders undertaking domestic building work worth more than \$16,000 are required to take out domestic building insurance that will cover costs up to \$300,000 to fix structural defects for six years, and non-structural defects for two years.²

The importance of insurance to protect the interests of contracting parties is recognised by the mandatory provisions for insurance in standard form construction contracts. For example, section 19 of the FIDIC Conditions of Contract for Plant and Design Build (2nd ed, 2017) (Yellow Book) requires the contractor who constructs the project (Contractor) to provide insurances for the contract works (Works), Goods,³ liability for breach of professional duty (PI insurance), injury to persons and damage to property (public liability), injury to employees (workers compensation) and other insurances required by laws and by local practice. Such insurance has obvious benefits for the employer who procures the project (Employer), who may pay for insurance policies itself at the expense of the Contractor if the Contractor fails to take out the contractually required insurance.

As the list of contractually required insurance under the FIDIC Yellow Book demonstrates, insurance may provide compensation for a risk event that occurs as a result of accident or natural events that were not “caused” by either contracting party, for example extreme weather events or a fire that results in property damage. Insurance may also provide compensation for a risk event “caused” by the fault of a contracting party, for example negligence in the preparation of the design of a project. The cost of rectifying the consequences of such risk events materialising may exceed the financial resources of the party which bears the contractual liability. For example, a fire which destroys a virtually completed building may entail expenditure for demolition and rebuilding that exceeds the original contract price. The financial consequences of errors in design are particularly acute for design organisations, as the construction costs are usually many multiples of the design costs. Reconstruction of defective designs may therefore cost substantially more than the fees paid for design.

¹ Victoria, *Government Gazette*, G22, 29 May 2014, 1018.

² Victoria, *Government Gazette*, G22, 29 May 2014, 1014.

³ Contractor’s Equipment, Materials, Plant and Temporary Works (all FIDIC defined terms).

Insurance therefore protects the financial interests of the party which bears the contractual liability for a risk event (typically the Contractor), whether it is accidental or fault-based, by providing compensation for an event that is not included in the contract price. Insurance also protects the interests of the Employer, by providing a fund to pay for events that will not have been allowed for in the contract price, and which may otherwise imperil the financial stability of the Contractor and its ability to complete the project or rectify defects. The existence of insurance (and the ability of an Employer to access that insurance) is all the more important in circumstances where the Contractor is insolvent.

The ability of insurance to provide compensation in any given circumstance will depend, inter alia, on the identity of the insured parties, the scope of the insurance cover, and whether the particular event comes within the scope of that cover. Each of these issues has been a fruitful source of litigation between Insurers and insureds. This highlights the importance of Contractors (and Employers) ensuring that the scope of their insurance policies provide appropriate cover for their contractual liabilities for the duration of those liabilities, as well as satisfying any legislative requirements for mandatory insurance.

III. THE INSURANCE LANDSCAPE FOR CONSTRUCTION CONTRACTS

As noted above, a Contractor or designer has a real interest in the efficacy of an insurance policy to protect its financial interests. A construction contract typically has provisions requiring the Contractor to indemnify the Employer in respect of the financial consequences of specified risks materialising, in addition to the requirement to take out insurance against specified risks. It is important to note that the obligation to effect insurance does not necessarily limit the contracting parties' obligations or responsibilities under the indemnities in the construction contract. Whether an insurance clause has the effect of satisfying the liability under an indemnity clause depends on the proper construction of the contract terms, construed as a whole. If the construction contract expressly refers to the insurance contract, the effect of both contracts taken together must be considered.⁴

The contractual provision for insurance may, properly construed, be that it limits the Contractor's liability,⁵ or it may be that it is limited to providing a fund of money to pay for damages in the event that the Contractor is unable to satisfy an obligation to pay damages.⁶ Which of these applies in a particular circumstance may have significant financial consequences in the event that the necessary insurance has not been implemented or is inadequate to meet the indemnified liabilities.

As noted above, the FIDIC Yellow Book identifies five specific types of insurance that are typically required for a design and construct contract: Works, Goods, PI, public liability and workers compensation. The focus of this article is on the insurance to protect the interests of the contracting parties, and accordingly Workers compensation insurance, insurance for the replacement value of Goods lost or destroyed and public liability insurance will not be considered further here.

Works insurance and PI insurance include features of particular importance to the contracting parties in construction contracts. In simplistic and general terms, Works insurance covers certain construction risks, and PI insurance covers certain design risks. The distinction between these two types of insurance is significant because design and construction (the implementation of the design) are usually carried out by different legal entities, even where the construction contract itself is a design and construct contract. The essential features of these two different types of insurance are as follows.

⁴ *Bovis Lend Lease v Saillard Fuller & Partners* [1984] QB 127; [1983] 3 All ER 35.

⁵ Examples of cases in which the court found that the contractual provisions for insurance satisfied the contractual provisions for liability under the indemnity clause include: *Mark Rowlands Ltd v Berni Inns Ltd* [1986] 1 QB 211; *James Archdale & Co Ltd v Comservices Ltd* [1954] 1 WLR 459; *Scottish Special Housing Association v Wimpey Construction (UK) Ltd* [1986] 1 WLR 995 (HL); *Co-op Retail Services Ltd v Taylor Young Partnership Ltd* [2002] 1 WLR 1419; [2002] UKHL 17; *Scottish & Newcastle Plc v GD Construction (St Albans) Ltd* [2003] BLR 131; [2003] EWCA Civ 16.

⁶ Examples in which the court found that the indemnity provisions were enforceable against the Contractor, notwithstanding the requirement for joint names insurance include: *Surrey Heath Borough Council v Lovell Construction Ltd* (1990) 48 BLR 108; *Dorset County Council v Southern Felt Roofing Co Ltd* (1990) 48 BLR 96; *London Borough of Barking and Dagenham v Stamford Asphalt Co Ltd* (1997) 82 BLR 25; *Casson v Ostley PJ Ltd* [2003] BLR 147; [2001] EWCA Civ 1013; *Bovis Lend Lease v Saillard Fuller & Partners* (2001) 77 ConLR 134.

PI Insurance

PI insurance (known in the USA more descriptively as Errors & Omissions or Malpractice insurance) is a contract between a professional (insured) and Insurer, in which the Insurer indemnifies the insured for claims against it by a client or person affected by the professional's activity (a third party).⁷ A contract of PI insurance entered into in Australia is subject to the relevant provisions of the *Insurance Contracts Act 1984* (Cth), which imposes a statutory overlay upon the common law.

The Insurer can provide the contracted for indemnity in the event of a claim by a third party on the insured in the following ways:

- inducing the third party to “forbear” in its claim against the insured;
- paying the third party direct; or
- recompensing the insured for the loss suffered.⁸

While a claim by a third party is the event that triggers the indemnity, any amount paid by the Insurer in response to that claim is a contractual right of the insured under the provisions of the PI policy. Although it is the third party's loss that provides the reason for any insurance payment, under common law the third party has no entitlement to any payment direct from the Insurer. Thus, even where the PI insurance appears to have been entered into so that a third party does not suffer a loss in the event of the insured event occurring, a third party has no right of payment by the Insurer, nor, in the absence of specific contractual or statutory arrangements, to any preferential entitlement to the insurance moneys.

PI insurance is relevant to construction projects in which a professional (designer) prepares the design to be implemented by the Contractor. In a construct only contract (such as the FIDIC Conditions of Contract for Construction (Red Book)), the designer is contracted to the Employer. In a design and construct contract (such as the Yellow Book), the designer is (typically) a professional firm contracted to the Contractor.

The indemnity provided by a PI insurance policy is for liability arising from breach of professional duty, including a failure to take reasonable care (negligence) and misrepresentation. In Australia, PI insurance policies usually also include liability for misleading or deceptive conduct in breach of the Australian Consumer Law. An Insurer therefore only assumes liability under a PI insurance policy where there is some “fault” or culpability on the part of the designer.

PI insurance policies in Australia generally do not provide indemnification for breach of contractual obligations in the absence of a breach of professional duty. Thus, in the absence of negligence, a typical PI insurance policy will not indemnify a designer for preparing a design that does not satisfy a contractual term that it be fit for purpose.

PI insurance is typically procured by a design firm annually for a specified limit. Coverage is usually based on a “claims made and notified” basis, that is the indemnity is confined to a claim arising from notification of the event or circumstances made during the policy year, and not when the design was prepared, or the event occurred.

In many situations, the only significant funds available to satisfy an award of damages arising from defective design are the proceeds of a PI insurance policy. The existence and cover provided by PI insurance are therefore of real interest to an Employer; it may not be financially viable to instigate litigation against a designer in the absence of insurance cover to satisfy any liability. However, in litigation against a design professional, the existence and details of the policy may not be referred to because they are not normally relevant to the issues in the case. Outside of the special conditions provided for in certain legislation,⁹ the common law position is that a third party generally has no interest in a policy of PI insurance between a professional and his/her Insurer. This means, that except in special

⁷ WIB Enright, *Professional Indemnity Insurance Law* (Sweet & Maxwell, 1996) 80.

⁸ Enright, n 7, 126.

⁹ The NT has a statute that enables a third party to enforce a charge against insurance monies that are payable in limited situations including bankrupt, insolvent, missing or dead insured defendants: *Law Reform (Miscellaneous Provisions) Act* (NT) ss 26–29.

circumstances, a plaintiff generally has no right to access the proceeds of a defendant's PI insurance policy, or to discovery of the details or even the existence of the policy.¹⁰

Works Insurance

Works insurance for construction projects is typically procured under the terms of a Contractor's All Risks (CAR) insurance policy. This type of insurance covers the risk of physical loss of or damage to the Works, and for liabilities arising in the course of the Works. Liability under such an insurance policy arises in respect of the occurrence of an insured event, and not on the basis of notification of circumstances as is the case with PI insurance. The specific cover under a particular CAR insurance policy depends on the actual wording of the insuring clause, and in particular on the exclusions and extensions to the general wording of the insuring clause. These depend on the scope of insurance offered by the relevant insurance company. CAR insurance for a project may note the Employer and subcontractors and designers are named insured, in addition to the Contractor. The entities named in the policy as insureds can generally take the benefit of the insurance.

The following example is taken from a current CAR policy provided by the City of Gold Coast Insurance Co Ltd.¹¹

The Policy Schedule provides that the following are named Insured:

- (1) Principal Council of the City of Gold Coast including subsidiary companies for their respective rights and interests.
- (2) All contractors and/or subcontractors and/or manufacturers and/or suppliers in any tier.
- (3) Professional Consultants to Insured (1) and (2) engaged solely to provide professional services for a fee.

Insuring clause: "Except as hereinafter excluded the Insurers will pay to or indemnify the INSURED under this Policy against DAMAGE to the PROPERTY INSURED howsoever caused occurring during the PERIOD OF INSURANCE." (Capitalised words are defined terms in the policy.)

Notable exclusions include the following:

- costs rendered necessary by defects of material workmanship design plan or specification;
- penalties and/or consequential pecuniary loss;
- Contractor's plant, tools and temporary buildings.

This example illustrates two heads of potential Contractor's liability that are typically not covered by a CAR insurance policy: defects due to design errors and defects of material or workmanship. The first of these may be insured under a PI policy, whereas the second is generally uninsurable under a CAR policy.

This example CAR policy provides a succinct definition of the distinction between damage and a defect as follows: "any portion of the PROPERTY INSURED shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification".¹²

In general, a CAR insurance policy provides indemnity against damage to the insured property whether as a result of accident or negligence, but not against defects in the insured property that result from culpable errors of design or faulty material or workmanship. However, domestic building insurance in Victoria is required to provide cover for faulty material or workmanship in certain circumstances. Such insurance is a particular form of Works insurance.

Domestic Building Insurance – Victoria

Pursuant to ss 135, 137A and 137D of the *Building Act 1993* (Vic), the Minister for Planning made an Order specifying the insurance that a builder is required to be covered by in order to carry out or manage or arrange the carrying out of domestic building work on a domestic building contract.¹³

¹⁰ Dr Donald E Charrett, "Professional Indemnity Insurance – Do Third Parties Have an Interest?" (2003) 14 *Insurance Law Journal* 77.

¹¹ City of Gold Coast Insurance Co Ltd, *Contractors All Risks Insurance Policy Wording* <<http://www.goldcoast.qld.gov.au/documents/bf/contract-works.pdf>>.

¹² City of Gold Coast Insurance Co Ltd, n 11, 6.

¹³ Victoria, *Government Gazette*, S98, 23 May 2003, amended by Victoria, *Government Gazette*, G22, 29 May 2014, 1014.

Insurance is required if the contract price for the domestic building work is more than \$16,000. The insurance policy must indemnify the building owner in respect of loss or damage resulting from non-completion of the domestic building work, and in respect of loss or damage resulting from any of the following events:

- domestic building work that is defective;
- a breach of any warranty implied in the domestic building contract by s 8 of the *Domestic Building Contracts Act 1995* (Vic);
- a failure to maintain a standard or quality of building work specified in the domestic building contract;
- conduct by the builder in connection with the domestic building contract that contravenes a provision of the *Australian Consumer Law*.

Importantly, the insurance policy may provide that these indemnities only apply if the builder dies, becomes insolvent or disappears. Insurance is not mandated for a limit of liability in excess of \$300,000, and the policy may limit claims for non-completion to an amount of not more than 20% of the contract price.

The requirements for such domestic building insurance are for the protection of the interests of the building owner, as the insurance cover must extend to each person who becomes entitled to the benefit of any of the warranties under the *Domestic Building Contracts Act*, and to the owner for the time being of the building or land in respect of which the domestic building work was carried out. The policy must provide the required indemnities in relation to non-structural defects in respect of loss or damage for a period of two years after the completion date of the domestic building work, and in respect of or other loss or damage for a period of six years after the completion date of the domestic building work.

Significantly however, until June 2018 a builder was exempt from the requirement to take out domestic building insurance for the construction of a multi-storey residential building.¹⁴ Considering the issues that have arisen from the installation of non-compliant cladding on multi-storey apartments (discussed further below), this is a substantial deficiency that is proving problematic for many building owners.

IV. PROBLEMS WITH THE CONVENTIONAL APPROACH TO INSURANCE

The traditional implementation of separate PI and CAR insurance for Australian construction contracts suffers from a number of problems that may result in the absence of insurance cover that was intended to protect the interests of the contracting parties. Some of these problems are illustrated in the following example arising from the use of non-compliant cladding on buildings in Victoria.

Following the fire at the Lacrosse Apartments in Melbourne in 2014 and the tragic fire at the Grenfell building in London in 2017, the Victorian Government implemented a Cladding Task Force to investigate the extent of non-compliant external wall cladding on buildings in Victoria, and to make recommendations to protect the public and restore confidence in the fire safety of buildings. In its Interim Report, the Task Force found that systems failures have led to major safety risks and widespread non-compliant use of combustible cladding in Victoria.¹⁵ The Task Force made a number of priority recommendations, including audits to determine the extent of the problem, exploration of options for low-cost financing to allow owners' corporations to fund works, and that consideration be given to introducing compulsory warranty insurance for residential multi-unit developments and insurance by commercial builders.¹⁶

These recommendations highlight the fact that the contractual arrangements for construction of residential buildings may not have provided the owners with a legal mechanism to obtain financial redress from the parties responsible for non-compliant cladding. A building owner, on becoming aware of non-compliant cladding (assumed to be within 10 years from completion of the building), would normally seek to recover rectification costs from the entity or entities that were causally responsible. Confining attention

¹⁴ *Building (Interim) Regulations 2005* (Vic) s 1808 (repealed); *Building Interim Regulations 2017* (Vic) (repealed by *Building Regulations 2018* (Vic)).

¹⁵ Victorian Cladding Task Force, *Interim Report* (November 2017) 4.

¹⁶ Victorian Cladding Task Force, n 15, 6.

to those involved in the design and construction, the causally responsible entity could be one or more of: the architect who designed the building, the fire engineer who certified that the cladding complied with the fire regulations, the Contractor who constructed the building, the subcontractor who installed the cladding, or the company that supplied the cladding material.

The relevant professionals (architect and/or fire engineer) may be able to avoid liability for many reasons, including:

- the building owner may not have a cause of action against the professional, for example, lack of privity of contract, or no contractual obligation to prepare a fit for purpose design;
- notification of the non-compliance was made after a contractual cut-off date for liability; and
- the specified design was fully compliant, and the Contractor/subcontractor installed unspecified non-compliant cladding, or the supplier supplied non-compliant material in breach of its contractual obligations.

If the owners successfully sued the architect or fire engineer, there may be insufficient funds to satisfy judgment for any of the following reasons:

- The legal entity that carried out the professional services may no longer exist years after the design was prepared, or may no longer have appropriate PI insurance.
- The professional may not have notified the Insurer of a claim or circumstances at the appropriate time or at all.
- The limit of liability under the PI insurance may be inadequate to cover the rectification costs, either because of the limited amount of insurance cover or because the professional's liability is capped under a Professional Standards Scheme.
- The professional may have insufficient financial resources to cover any shortfall not covered by insurance.

Prime facie, non-compliant cladding is a breach of the statutory implied warranties in s 8 of the *Domestic Building Contracts Act 1995* (Vic), potentially rendering the Contractor liable for rectification costs. However, there may be insufficient funds to satisfy any judgment against the Contractor for any of the following reasons:

- The Contractor may not have taken out insurance.
- The Contractor's insurance may not cover defective work arising from the use of non-compliant materials.
- The limit of any applicable insurance may be insufficient to cover the rectification costs.
- Notification of the non-compliance was made after the operative period of insurance.
- The Contractor may have insufficient financial resources to cover any shortfall not covered by insurance.

This example highlights some of the reasons why the traditional implementation of PI insurance for breaches of professional duty and CAR insurance for Contractor's risks may not be effective in providing a fund to compensate an owner for the rectification costs arising from defective work. Further, the application of proportionate liability between concurrent wrongdoers is a driver of a multiplicity of defendants and substantial litigation costs.

The issue of determining whether a defect arises from design, or the implementation of the design (construction), can lead to substantial litigation costs arising from a number of defendants, the requirement for expert evidence and technical complexities. Importantly, the issue of whether a defect derives from design or construction may be very significant in whether or not there is any insurance covering the liability.

For the reasons outlined above, from the perspective of an owner or Employer seeking to recover damages arising from defective design, PI insurance has many drawbacks. In addition, as a third party, the Employer or an owner does not have an interest in the insurance, and therefore cannot take action to recover from the insurance company directly.

The common requirements for CAR insurance to be in joint names and to satisfy specified contractual conditions, including production of the insurance policies, generally means that the Employer is

adequately informed of its rights and, properly advised, is in a position to take action when appropriate. However, CAR insurance is generally confined to damage and not defects, and accordingly does not usually cover defective work arising from poor workmanship or faulty materials.

V. DIFFERENT APPROACHES TO PROJECT INSURANCE

The following two examples illustrate how non-traditional approaches to project insurance (at least from a common law perspective) can provide benefits including greater certainty of the availability of an insurance fund for an appropriate period, and significantly reduced costs of dispute resolution.

Heathrow Terminal 5

In procuring Heathrow Terminal 5 (T5), BAA plc (now called Heathrow Airport Holdings) adopted an innovative approach to procurement, recognising that it held all the risk all the time. As part of its innovative approach, it took out an insurance program to address major or catastrophic risks on a project wide basis covering the whole supply chain. This required considerable discussion and negotiation with Insurers who were initially reluctant to adopt a new and non-traditional approach.

The project insurance included CAR, third-party liability and project PI. The PI insurance policy covered about 50% of the value of T5, with a maximum £500 million for any single item. It was the first of this kind of insurance that allowed for “collective negligence” and paid out on a no-fault basis.

In the event, following the discovery of a manufacturing fault during erection of the cabin for the new air traffic control tower, an insurance claim was made for “collective professional negligence”. The insurance company paid out on this claim without blame being apportioned for the problems, and without any legal action being taken.¹⁷

Decennial Liability Insurance

France and a number of other civil law countries¹⁸ implement “decennial liability” (garantie décennale in French): strict liability imposed by law on construction contractors and design professionals for the total or partial collapse of buildings they designed and/or built, or for the occurrence of latent structural defects which imperil the safety or stability of such buildings, for a period of 10 years after their approved completion and handover.¹⁹

The French *Civil Code* provides for decennial liability in the following terms:²⁰

Art. 1792

Any builder of a work is liable as of right, towards the building owner or purchaser, for damages, even resulting from a defect of the ground, which imperil the strength of the building or which, affecting it in one of its constituent parts or one of its elements of equipment, render it unsuitable for its purposes.

Such liability does not take place where the builder proves that the damages were occasioned by an extraneous event.

Art. 1792-1

Are deemed builders of the work:

- 1 Any architect, contractor, technician or other person bound to the building owner by a contract of hire of work;
- 2 Any person who sells, after completion, a work which he built or had built;

¹⁷ Sharon Doherty, *Heathrow's Terminal 5: History in the Making* (Wiley, 2008) 242.

¹⁸ Hök identifies 27 countries that have implemented decennial liability: Sebastian Hök, *The Civil Law Decennial (decennial) Liability* <<http://www.dr-hoek.de/EN/beitrag.asp?t=Decennial-liability-under-FIDIC>>.

¹⁹ Sebastian Hök, *The Civil Law Decennial (decennial) Liability* <<http://www.dr-hoek.de/EN/beitrag.asp?t=Decennial-liability-under-FIDIC>>.

²⁰ *Civil Code* (France) Arts 1792, 1792-1 <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=18&ved=0ahUKEwin8cjk_MfbAhWMzLwKHTSgBBIQFgiuATAR&url=https%3A%2F%2Fphalthy.files.wordpress.com%2F2006%2F11%2Fcivil-code-france.doc&usg=AOvVaw18CFeVEVSZXNgr9Zp545FT>.

- 3 Any person who, although acting in the capacity of agent for the building owner, performs duties similar to those of a hirer out of work.

France has given real force to decennial liability by mandating compulsory insurance in the French *Insurance Code*:²¹

Article L241-1

Any natural person or legal entity whose decennial responsibility may be incurred on the basis of the presumption provided for in Articles 1792 and following of the Civil Code must be covered by an insurance policy.

Upon the commencement of the building work, he/it must be able to prove that he/she has underwritten an insurance contract that covers his/its liability.

Notwithstanding any clause to the contrary, any insurance contract underwritten by virtue of this Article shall be deemed to contain a clause ensuring that the cover shall be maintained for the term of the decennial responsibility imposed on the person who is submitted to the compulsory insurance.

As can be seen, Art 1792 of the French *Civil Code* includes liability for “damages” that render a building unsuitable for its purposes. Arguably, this is sufficiently broad to include liability for the defect of non-compliant cladding that presents a fire danger to the occupants, for example. Accordingly, it is submitted that in France the owner of a building with non-compliant cladding could have access to insurance to pay for the rectification costs of making the building suitable for its purposes for a period of 10 years after acceptance of the Works.

VI. A DIFFERENT APPROACH TO INSURANCE OF PROJECTS

Some of the drawbacks of the current system of separate PI and CAR insurance to cover defective building work could be eliminated or ameliorated if decennial liability and compulsory insurance was adopted in legislation along the lines of the French model.

A single insurance policy covering both design and construction, based on strict and joint and several liability, would radically simplify the process of compensating owners or Employers for defective building work that resulted in a deficiency in strength or fitness for purpose. It could:

- avoid the time and expense of determining whether a defect was the result of design or construction;
- eliminate the uninsured gap that frequently occurs in Australia in respect of a Contractor’s breach of contract in respect of defective workmanship or material;
- provide an adequate fund to pay for rectification of defects, whether the result of design or construction;
- enable an owner or Employer to claim rectification costs directly from an insurance company, rather than instigating litigation against the designer and/or Contractor; and
- ensure that the fund was available for the 10-year period of liability.²²

In the Australian context, this is a radical proposal that is at odds with some of the developments in respect of building contract insurance in Victoria over the last 20 years, including proportionate liability and previously exempting the builders of multi-storey apartments from compulsory insurance. It would no doubt be opposed by Insurers and builders on the basis of significant cost. However, as highlighted by the non-conforming cladding fiasco, a solution needs to be found to fund the substantial costs of remediating defective buildings. As noted above, the issue of compulsory insurance for builders of multi-storey apartments is under review by the Victorian Cladding Task Force, and this could perhaps be considered alongside a revision of the liability regime.

²¹ *Insurance Code* (France) Art L241-1 <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKEwjyubvP_8fbAhWBTbwKHZVQCbQQFggnMAA&url=https%3A%2F%2Fwww.legifrance.gouv.fr%2Fcontent%2Fdownload%2F1961%2F13731%2Fversion%2F2%2Ffile%2FCode_38.pdf&usg=AOvVaw1ZI3m864VtPMI8Ftic8u-P>.

²² *Building Act 1993* (Vic) s 134.

The implementation of project PI insurance for “collective professional negligence” on the Heathrow T5 model for large projects is a less radical proposal, but would still offer significant benefits over the current annual PI insurance taken out by each professional practice. It could:

- ensure that an insurance fund was available for the duration of liability on a project;
- substantially reduce the cost of disputes by not requiring proof of “fault”; and
- enable the Employer to have direct access to insurance funds.

This proposal does not require any legislation, as it could be adopted on an ad hoc basis under the contracts for any project. It is only likely to be practical for large projects, due to the time and complexity of negotiating a non-traditional form of insurance. The biggest challenge is likely to come from the traditionally conservative insurance industry, which is not currently geared to provide this type of insurance. BAA’s experience on Heathrow T5 was that it required considerable discussion and negotiation with Insurers, however the insurance was ultimately made available on this new basis.

VII. CONCLUSION

This article considered the importance of insurance in the context of construction projects. It reviewed three types of insurance for projects that are conventionally used in Victoria: PI insurance to cover liabilities arising from breach of professional duty (generally relevant to design), CAR insurance for physical loss of or damage to the Works (but generally excluding defective workmanship or materials), and domestic building insurance that provides limited cover for defects under some circumstances (but was previously not required for multi-storey apartments where arguably it is most needed).

Some of the drawbacks of the conventional separate PI insurance and CAR insurance have been identified: increased costs in determining whether a defect was the result of design or construction, the potential for PI insurance to be unavailable when needed or inadequate in value, the inability of an owner or Employer to access the proceeds of a PI insurance policy directly, and the lack of insurance for defects in construction (except for domestic buildings in limited circumstances).

Two nonconventional approaches to insurance of projects were reviewed: the project no-fault collective PI insurance for T5, and the mandatory insurance for decennial liabilities arising under French law. It was suggested that either of these models could achieve significant benefits over the conventional insurance model, including reduced costs and more certainty that an adequate insurance fund would be available for the required period of potential liability.

As illustrated by the identified problems of funding remediation of non-compliant cladding in Victoria, the conventional approach to insurance is not always fit for the purpose of providing an adequate fund to cover the cost of rectifying defects in design and/or construction. Perhaps it is time to consider unconventional approaches that have been used elsewhere.