



Contract Works and What you need to Know

1. The Need for Contract Works Insurance

The growth of large-scale construction projects has been accompanied by a demand for a new type of insurance coverage for them. Clauses written into Contract conditions have stipulated that the Contractor take out insurance on the Works. This has led to the development of Contract Works Insurance.

Effectively, all Works Contract conditions make the Contractor liable for damage to the Works, as well as for damage to third party property (other than the Works) and for bodily injury arising from the construction activities.

Under some Contract conditions, the Contractors are required to take out their own insurance. In others, the Principal takes out insurance while still holding the Contractor to indemnify the Principal:

- against damage to the Principals property
- for any claims against the Principal for injury arising out of the performance of the works

2. The Insured

Contract Works Insurance may be issued in the names of:

- the Principal
- the Project Managers
- the Contractor
- the Sub-Contractor
- the lending authorities

3. Works That Can Be Insured

3.1 Construction and Civil Engineering projects

Contract Works Insurance can be taken out for all such construction and civil engineering projects as

- residential and office buildings, hospitals, schools, theatres, factories, power plants & utilities;
- roads, rail, harbour & airport facilities;
- bridges, dams, weirs, tunnels, water supply & drainage schemes, canals, etc

3.2 Installation Projects

Projects involving the installation of mechanical and electrical items are insured in a similar manner to Construction and Civil Engineering projects. In addition, such projects can be insured during Testing and Commissioning to provide coverage for Electrical and machinery Breakdown. Sometimes such policies are known as Erection Insurance.

4. The Period of Insurance

Usually Contract Works Insurance extends through the Construction, Maintenance and Testing Periods of a project. **

(** Note: Third Party Liability extends through the Construction & Maintenance Periods)

4.1 Construction Period

During this period, insurance cover begins at the commencement date and is completed at either:

- the end date, as noted in the schedule, or
- when the Principal assumes responsibility for the project, or
- when the Certificate of Practical Completion is issued, whichever of these occurs first.

4.2 Maintenance Period

This begins at the end of the Construction Period and extends for a nominated period after this.

4.3 Testing Period

This period (within the Construction Period) is allowed for the test running or commissioning of the project's mechanical components to provide they are mechanically and electrically sound. In the insurance policy, this period is usually expressed in weeks or months.

5. Limits of Indemnity

In a Contract Works Insurance Policy, the limits of the liability of the Insuring Company are generally stated in this manner:

5.1 Works

5.1:1 Contract price materials	\$.....any one event
5.1:2 Materials supplied by the Principal	\$.....any one event
5.1:3 Escalation Allowance%
Total Contract Price	\$.....

5.2 Options available to extend the basic policy cover

5.2:1 Temporary Buildings	\$.....any one event
5.2:2 Plant and Equipment	\$.....any one event
5.2:3 Transit	\$.....any one event
5.2:4 Removal of Debris	\$.....any one event
5.2:5 Professional Fees	\$.....any one event
5.2:6 Expediting Expenses	\$.....any one event
5.2:7 Pre-Existing Structures	\$.....any one event
5.2:8 Employees Effects	\$.....any one event
Total Sum Insured	\$.....any one event
5.2:9 Third Party Limit of Liability (option)	\$.....any one event

6. What Comprises Insured Property

6.1 The Contract Price

The contract price should always include:

- establishment costs
- materials obtained or provided by the Contractor
- labour costs
- Sub-Contract work or service costs
- costs relating to the use of construction equipment
- temporary works (eg. coffer dams, access roads)
- engineering and supervision costs

- overheads and profit margins

These items need not be included:

- site investigation costs
- design costs
- cost of materials supplied by other parties not comprising the insured
- construction plant and equipment
- site hutments

6.2 Materials supplied by the Principal or other parties

In many projects for governments and some big private organisations, the Principal supplies major material items to the Contractor free of charge to the site. These can include such things as pipes and prefabricated sections.

This is because often the Principal has the plant for making such items. He may also have engineering facilities which allow him to sub-contract certain work and control a section of the Contract with his own staff.

The Principal often has much more purchasing power than the Contractor. For example, when a Council with a three-year program to renew all its existing sewerage pipes orders all the pipes it needs from a manufacturer, it can get a substantial discount.

In cases like this, the Principal may choose to supply the materials or section of the work free to the Contractor. The Principal would save on the engineering costs, overheads and profits segments of the Contract. Otherwise the basic costs of these items would have been added to the Contractor's tender price.

However, in such cases the delivered cost of the materials to the principal must be added to the Contract price. This is because in the event of a total loss this delivered cost would form part of the indemnity necessary for complete replacement of the materials.

6.3 Escalation Allowance

Provision should be made for the likely increase in the value of the Works during the term of the Contract.

Rises in labour and materials costs, as well as extra items of work performed by the Contractor, mean that inevitably the final value of the Contract is much higher than the figure estimated at the inception of the policy.

Unless an Escalation Allowance is included in the insurance policy, the project will at some stage become under-insured.

The Escalation Allowance should cover the likely increase in the tender price due to inflation. This figure is nominated by the Contractor and must be realistic. It should relate to the period of construction and be applied to the Contract tender price.

7. Options for Additional Cover

7.1 Temporary Buildings, Plant and Equipment

Equipment which a Contractor or Sub-Contractor owns and brings on-site is basically subjected to the same hazards as the Contract Works equipment.

However, only the hire rate or depreciation allowance of this equipment can be included in the contract price. If the Contractor wishes to include such equipment under the overall policy, then its new replacement cost must be declared as part of the Sum Insured.

When proposing this option, it must be made very clear just whose equipment is being insured. For example, is it only the equipment belonging to the Contractor or is it the equipment of everyone working on the site?

Consumable equipment (like formwork that cannot be re-used) is considered as part of the Works. Items that can be used on other projects such as re-useable formwork, scaffolding and shoring are considered as Plant and Equipment.

7.2 Transit Cover

The Insured may choose to insure his goods in transit to the site. In such cases, these goods are covered by insurance from the time they leave the supply depot until they are unloaded at the Contract site. A standard limit "any one carry" is usually applied as the Sum Insured for Transit.

7.3 Removal of Debris

Because a Contract Works policy is based on indemnity for total loss, the Sum Insured should include an amount sufficient to restore the project in the event of near total loss as Completion approaches.

Unless specified, the payment to the insured would not cover the expense of demolishing the damaged work and removing debris from the site. So the policy schedule should include an estimate setting an adequate limit of indemnity to cover this cost.

7.4 Professional Fees

Because the Principal has already paid fees to architects, civil, structural, mechanical and electrical engineers, surveyors and specialist consultants, these costs are not included in the Contract Price.

But should there be a major loss at or near completion of the Works, these costs may have to be paid again during rebuilding. So the value of such fees must be added to the Sum Insured.

Unless more specific or detailed information is available the value of professional fees would normally be set at approximately 10% of the project's Contract price.

There is an exception to this where the Contract is on a Design and Construct or Turnkey basis. In such instances, the Contractor undertakes all design and engineering work for the project and these fees will be included in the Contract price.

7.5 Expediting Expenses

Contracts impose penalties on Contractor for failing to complete a project within a specified period (after due allowance is made for weather and strikes)

If a Contractor has to expedite repairs to damage indemnified under the Contract Works policy, he may incur extra costs in order to meet completion date requirements. He may have to pay overtime or incur the costs of transporting damaged components between the site and the repair yard.

These extra costs are not covered by insurance, unless Expediting Expenses are insured and a specific amount of liability noted in the policy schedule.

Usually a figure of between 10% and 20% of the Contract Price would adequately cover Expediting Costs, but obviously this depends on the nature of the project.

7.6 Pre-Existing Structures

Existing buildings, facades and structures etc that are situated at the contract site and are being worked upon, but are not part of the Contract Works, may be insured in two different ways.

7.6:1

Pre-Existing structures may be considered as property held in the care, custody and control of the Contractor or Principal and thus will be required to be insured under an extension to the Material Damage Section of the Contract Works Policy. This extension of cover may be to indemnify the insured for:

- damage to the structure following the consequences of construction activities only, or
- damage to the structure following consequences of construction activities plus other perils normally insured for under an Industrial Special Risk Policy.

Claims payable under either of the above extensions would be settled on an “indemnity basis” not reinstatement and replacement.

7.6:2

Pre-Existing structures may be considered as property belonging to third parties. This means the Insurer grants indemnity according to the principles of Third Party Liability, as set out in the Liability section of the policy.

It should be noted that if Pre-Existing structures are required to be insured under the Liability section rather than the Material Damage section, it may be necessary to:

- have the liability wording specifically note that such structures being worked upon are not be considered as being property in the care, custody and control of the Insured, and/or
- have the Third Party Liability section extend cover for damage to such structure resulting from the vibration or the removal or weakening of supports.

8. Cover Provided

8.1 Material Damaged during construction

Contract Works Insurance provides indemnity during the Construction Period for accidental physical loss or damage to the Contract Works, as well as to any temporary works on the construction site. This covers every hazard which is not specifically excluded.

8.2 Inclusions

The most important causes of losses indemnifiable under Contract Works Insurance are:

- fire, lightning, explosion, crashing aircraft
- water (or other fire-fighting measures) used to extinguish a fire
- flood, heavy rain, snow
- windstorm, cyclone
- earthquake, subsidence, land or rock-slide
- theft, burglary
- impact, collapse
- malicious acts, riots, strikes

8.3 Exclusions

Not covered by a Contract Works Insurance policy are:

- the consequences of:
 - bad workmanship
 - lack of skill

- faulty materials
- error or omission in design or specifications
- nuclear risks
- consequences of war
- loss of or damage to vehicles licensed for general road use – except while used on the Contract site for the Contract Works (and as noted in the schedule)
- damage arising from a deliberate act of the Insured
- defective materials or workmanship, faulty design or specification (Note: damage resulting from these factors is covered by insurance)
- loss or damage to equipment caused by its own electrical or mechanical breakdown
- loss of Insured property only revealed by inventory check or stocktake
- loss or damage to cash or to cheques, postal or money order, stamps, deeds, coins, bills of exchange, promissory notes and securities
- consequential loss of any nature
- wasting, wearing away or gradual deterioration of and part of the works
- normal upkeep of and making good to any part of the works
- loss to or damage to waterborne vessels or aircraft
- deductibles (as detailed in 8.4)

8.4 Deductibles

Deductibles are usually quoted in the following form and comprise the self-insured amount for:

Major perils:

- loss or damage caused by water, subsidence, collapse, erosion, landslip, cyclone, storm, tempest and earthquake

Testing:

- loss or damage due to mechanical or electrical breakdown during the Testing Period

Minor Perils:

- loss or damage caused by all other perils

8.5 Material Damage caused during the Maintenance Period

Normally, after construction has been completed a Contract Works policy provides for cover during a Maintenance Period.

The Maintenance Cover may be expressed in two ways:

8.5:1 Maintenance Visits Only:

In this case, the Insurer's liability during the Maintenance Period is limited to loss or damage to the Works caused by the Insured in the course of the operations carried out for the purpose of complying with the obligations under the maintenance provisions of the Contract.

8.5:2 Extended Maintenance Cover

In addition to the protection provided under Maintenance Visits, this type of cover includes loss or damage to the Works during a Maintenance Period that originated from a cause happening in the Construction period at the Contract site. The scope of insurance cover under this is almost identical to that provided during the Construction Period.

9. Third Party

9.1 Third Party Liability (TPL)

This is an optional extension to the Contract Works Insurance Policy.

Insurance statistics on Third Party Liability for builders, engineers and others engaged in construction related activities show an unfavourable loss experience.

The Contractor operates in a new area on each project, usually with an itinerant work force. The work involves the use of bulldozers, cranes and pile drivers which can cause serious injury to people and severe damage to property.

Because the structure passes through various temporary stages before it is completed, it can collapse and cause severe damage.

Hazardous techniques such as blasting are used in construction as well as flame cutting and welding (without the reliable protective measures used in factories).

Often the vibrations from construction activity cause stresses which neighbouring properties cannot withstand.

Sometimes Contractor seek insurance cover for claims which may arise for damage caused to neighbouring buildings by vibrations or by the removal or weakening of supports. Usually Insurers grant this – but only after careful analysis and consideration of each proposal.

9.2 Insuring Clause

Under this section of the policy, the Insured is indemnified should he become legally liable for compensation for such matters as:

- bodily injury to third parties
- loss of or damage to property of third parties
- loss by third parties of the use of their property

if these occur during the Period of Insurance and arise out of the performance of the Contract and at the Contract site.

9.3 Exclusions:

The indemnity granted by this section does not apply to or include liability for:

- the deductible amount
- claims which really come within the Material Damage section of the policy
- contracts of agreement (other than the Works Contract)
- repairing or replacing defective products
- professional advice
- injury to any one party comprising of the Insured other than where the cross liability clause applies
- payment under workers compensation legislation to any party comprising the Insured
- claims arising from vibration or the weakening of supports
- liability arising out of use of or ownership of licensed vehicles, marine vessels or aircraft,
- use of or removal of asbestos products
- instances where seepage, pollution or contamination is other than sudden, unintended or unexpected.

9.4 Cross Liability

Cross Liability is almost an automatic addition to most policy wordings. Cross Liability operates between the Principal, the Project Managers, the Contractor and all Sub-Contractors (whether nominated or otherwise).

This inclusion means that any of the various parties Insured under the policy have liability cover against another party when legal liability exists between them.

Thus, should Contractor damage the Principal's Existing Property when working, claims for this loss could be made via the Cross Liability clause. Similarly, it would cover a loss caused if a Sub-Contractor's employee damages another Sub-Contractor's property.

The most common – and costly – claims arise when a Principal, a project Management Company, the Contractor, or one (or all) of the Sub-Contractors seek indemnity against a Common Law action by an injured worker.

If applicable, the direct employer of this worker must always look for protection to any Common Law extension of his Workers Compensation Policy.

Because all the other parties on the site to whom contributory negligence attaches are not the injured worker's employers, they may look for indemnity to the Third Party Liability section of the policy.

The Contractor, the Principal or Project Manager usually becomes involved because of the Building Safety Regulations in each State. These require them to provide and ensure a safe place of work; their degrees of responsibility vary.

As more specialists are now employed on projects, there are more and more separate identities on site. Obviously a Contractor with his own workforce and no cross claim liability exposure is a better liability risk than a Contractor with 20 Sub-Contractors.

Sub-Contractors now work close to each other, so Third Party exposure is no longer confined to the "man in the street" type of risk, as was the case with earlier assessments.

When assessing a Third Party Liability risk, an important factor is whether or not the main Contractor is to employ the majority of the workforce, or if there is to be extensive Sub-Contracting.

Should Sub-Contractors be employed, then it must be determined:

- what Third Party Liability policies do they themselves carry?
- who are the Insureds named in the Sub-Contractors policies?
- are such policies policed by the Contractor or the Project Manager?

If a main Contractor employs only a relatively few people but provides co-ordination and supervision over a large number of Sub-Contractors, a situation could arise in which virtually all Common Law injury claims are recoverable under the Third Party Liability section.

Such employee injury Common Law claims and the subsequent recovery actions by Workers Compensation insurers have increased Contract Works Liability premiums to new levels.