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# WHY PROJECT ALLIANCES NEED NEW INSURANCE PRODUCTS

By *Rehana Box*

Alliance contracting is becoming increasingly popular, particularly in the public sector. Rehana Box explores the suitability of traditional liability covers to adequately protect alliance partners and finds them sadly lacking.

## Alliance Contracting Defined

In most large private sector projects and, increasingly, in public sector projects consideration is given by the parties at the outset to what is termed 'relationship contracting'. This term refers to a spectrum of mechanisms and contracts whereby the parties seek to establish and manage the relationship between them with a view to removing traditional barriers and encouraging maximum contribution by each party to allow the parties to achieve success.<sup>i</sup> These mechanisms and contracts can range from co-operative contracting and partnering to project alliances. It is this latter form of contracting with which this article is concerned.

Project alliance contracting developed in the oil and gas and construction industries during the 1990s but is now being more widely adopted in both the public and private sectors. Indeed, Australia now leads the world in public sector project alliancing.

A project alliance is a legally enforceable relationship entered into by all the participants in the project (typically the project owner, the designer and the constructor) for the purposes of maximising the chances of outstanding project delivery.



Fundamental to true project alliancing is the deliberate contractual alignment of the interests of the parties (shared gain and shared pain) and a 'no blame' culture.

## 'No Blame' Culture

It is this 'no blame' culture which raises issues of the value of traditional liability insurance in the circumstances of a project alliance.

Essentially, under a 'no blame' culture none of the parties will be liable to any other party for any act of default or negligence, other than possibly a wilful default. The 'wilful default' exception, if included, is usually defined to mean a wanton, reckless act or omission involving a wilful and utter disregard for its harmful and avoidable consequences. It usually does not extend to include errors of professional judgement, mistakes or acts or omissions made in good faith, even if they involve gross negligence. The rationale behind the 'no blame' culture is to allow the parties freedom to consider alternative methods of design and

construction without the usual liability concerns. In the event that something does go wrong, it allows the parties to focus on joint solutions rather than arguments as to liability.<sup>ii</sup>

From a legal perspective a project alliance leads to each participant assuming a share of certain risks that it would never have to bear under a conventional contract, while diluting those risks which it would usually bear. This contractual approach presents significant risk management issues, particularly in relation to the use of insurance as a way of transferring risk from the alliance partners.

## Professional Indemnity Insurance

One of the key areas of risk in any construction project (particularly design and construct projects) is in relation to professional negligence. This risk is traditionally insured under a professional indemnity policy effected by each individual contracting party who is providing professional advice or jointly by the parties to the construction contract in the form of a project specific professional indemnity policy covering contractors, sub-contractors and consultants.

However a conventional professional indemnity policy will only respond where the insured has incurred a liability to another party in respect of its negligence. Under the 'no blame' regime of alliance contracting, the negligent party has no liability to the other alliance partners. Yet, in most cases professional liabilities arise between the project participants. So, for example, if the alliance partners include the designer, building contractor and the project owner then in the event that the designer is professionally negligent causing substantial

redesign and additional works to be necessary, under a project alliance contract the alliance partners would work jointly towards agreeing and effecting the necessary remedial action and the costs of doing so would be an 'alliance cost' (i.e. a cost which the alliance partners would share equally). The alliance as a whole has suffered a loss (the designer who was negligent may in fact be better off than the others through payment of its margin on the additional works required). Importantly, there is no liability of the designer to the other alliance participants, and so no trigger of the designer's professional indemnity insurance (whether effected individually or jointly).

### Public Liability Insurance

Expanding on the above example, assume there is a loss incurred by third party as a result of the negligent design, for example where the negligently designed construction damaged an adjoining property. In these circumstances the 'no blame' principle would not bind the third party as it is not privy to the project alliance contract. However, the 'no blame' principle will prevent cross-claims between the alliance partners, in the event that they are jointly or individually sued. Assume the building contractor, not the designer is sued by the third party. If the alliance partners have effected a project specific public liability policy jointly and that policy includes a waiver of the insurer's rights of subrogation in respect of named insureds, and the insurer agrees to cover liabilities assumed under the project contract the policy will probably respond. However, if the policy is not in these terms or the partners are relying on their own public liability policies the result may be very different. The cost of the claim may be uninsured and will be borne jointly by the alliance partners as an alliance cost.

### Considerations

For these reasons the project alliance contracting situation requires careful consideration to be given to whether alliance partners should retain their own liability insurances or insure together under a project specific policy and, particularly in the case of professional indemnity policies, what the real value of the policy is.

While a project specific professional indemnity policy covering all parties, which includes a waiver of subrogation by the insurer against named insureds and a term to the effect that the insurer accepts the liabilities of each insured as assumed under the alliance contract, should adequately respond to claims by third parties on alliance partners for professional negligence, how likely are such claims? Further, in my experience, extensions to professional indemnity policies to include contractually assumed risks are difficult to obtain.

The value of traditional professional indemnity policies in the context of project alliancing is questionable. In most cases the liability for professional negligence will be from either the contractor or designer to the project owner. Situations where a third party has a claim will be the exception. Accordingly, a traditional policy, even if written in the terms discussed above, may not be of significant value to the alliance partners.

Another issue which arises with respect to indemnity policies, in the event that they do respond, is responsibility for the excess. By reason of the 'no blame' principle it may be that the project partner who has made the claim is not the partner 'responsible' for the claim. The 'no blame' principle will prevent the innocent partner seeking reimbursement of the excess from the responsible partner. Whether this should be dealt with in the project alliance contract, for example by making it an 'alliance cost', should be considered. In the event that joint policies are effected on behalf of the alliance partners, there is all the more reason for the excess to be classified as an 'alliance cost' in the event of a claim.

### Challenge for the Industry

The insurance industry needs to respond to this new and increasingly popular form of contracting with a policy that protects the alliance from increased alliance costs as a result of the negligent acts or omissions of one alliance partner.

Essentially, if written carefully, the risk should be no greater for insurers than under a traditional construction contract where the

parties to the contract effect a joint professional indemnity policy.

There have been attempts by Australian brokers and insurers to develop new wordings to meet the specific requirements of a project alliance. However at the time of writing, I understand that there is no insurer offering a product to meet the needs of alliance partners.

Issues will include whether insurers are prepared to offer professional indemnity insurance for the whole range of professionals involved in the construction project (including engineers and designers) and the length of time these policies will be required. In relation to the latter point, policies will be required for the construction time (which can be many years in large projects, particularly public sector projects) and an additional seven years run-off (to cover claims brought within the six year limitation period). An alternative would be to write an occurrence wording in the policy.

### Interim Solutions

If and, until the insurance industry develops new products for project alliances, alliance partners will be forced to retain alliance losses caused by the negligence of one alliance partner, or to write back the 'no blame' principle, at least in part – for

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example, by amending the 'no blame' principle so that it applies only to losses not indemnified under either the project specific liability policies effected on behalf of all the alliance partners or individual liability policies effected by the alliance partners individually.

Another alternative would be to exclude design from the 'no blame' principle altogether.

### Conclusion

Project alliances pose yet another challenge to the insurance industry. Until the industry rises to the challenge, those selling or promoting traditional policies to alliance partners must be careful to ensure that alliance partners fully understand their limits.

- i *Jim Ross, Project Control International Pty Ltd, 'Introduction to Project Alliancing (on Engineering & Construction Projects)' presented to the Defence Partnering and Alliances Conference, Canberra, November 2001, p.1 quoting Australian Constructors Association, 'Relationship contracting - Optimising Project Outcomes', February 1999.*
- ii *Doug Jones, 'A questions of babies or bathwater', 17 October 2001, Infolink Architecture and Building <http://www.infolink.com.au/articles/c1/0c0026c1.asp>*



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