

# Vicarious liability vs Principal's liability



When undertaking any construction project Principal clients need to carefully assess whether their potential liabilities arising out of the project are adequately covered by insurance. This paper discusses the insurance options available to principals, potential uninsured exposures certain insurance options can leave and the steps principals may need to take to fill these exposure gaps.

For major projects, it is likely that the suite of insurance covers will be arranged either under an owner/principal controlled insurance programme or a contractor controlled insurance programme. However, for small to medium projects, insurance responsibilities are often shared between the parties and cover is placed by those considered best suited to arrange and manage the relevant covers. In the situation where a contractor arranges public liability insurance, principals will need to assess the level of coverage available, and to consider what exposures may still exist that are not contractually required to be covered by the contractor's policy.

In New Zealand, the most common forms of contract are NZS3910:2013 or NZS3916:2013. For large projects, where overseas contractors may be used, FIDIC or NEC4 can be utilised.

Unless the risk profile of the project dictates otherwise, most of the time the contractor would arrange public liability insurance for small to medium sized projects to cover the insured parties' legal liability to third parties, arising out of the performance of the contract works. Contractors would typically already have an annual general liability policy which can be relied upon.

Unless the risk profile of the project dictates otherwise, most small to medium projects allow the contractor to arrange public liability insurance. This typically means that the contractor will rely on their annual public liability policy and the principal can be included as an "additional insured" (for their vicarious liability only) arising out of the performance of the contract works by the contractor.

Despite having this cover in place, there are a number of other liabilities a principal could face that are not covered under the contractor's public liability policy and that the contractor is not required to provide cover to the principal for.



**There are a number of other liabilities a principal could face that are not covered under the contractor's public liability policy**

Under NZS3910:2013, the main relevant clauses relating to this subject are:

### **8.5.1 - Contractor arranged public liability insurance**

*Where the Contractor is identified in the Special Conditions as being the party responsible to effect public liability insurance, the Contractor shall, without limiting its obligations under 5.6 and 7.1, effect public liability insurance in the names of the principal and the Contractor, for an amount not less than that stated in the Special Conditions, to indemnify the Principal and the Contractor against legal liability to third parties for damage, loss, or injury caused by any act or omission of the Contractor arising out of the performance of the Contract Works.*

In other words, contractually the contractor must:

1. Effect and maintain public liability insurance.
2. Hold cover in the names of contractor and principal.

Coverage is limited to legal liability arising out of the performance of the Contract Works (vicarious liability).

There are further points to note under NZS3910:2013. The contractor is **not** liable to indemnify the principal for the following matters:

### **7.1.2**

*The Contractor's liability to indemnify the Principal shall not extend to any loss, liability or Cost in respect of:*

- (a) The permanent use of or occupation of land by the Contract Works and the right of the Principal to carry out the Contract Works on site;*
- (b) Injuries to Persons or damage to property or interference with the rights of other Persons which is the unavoidable result of carrying out or remedying of defects in the Contract Works in accordance with the Contract;*
- (c) Any act or omission of the Principal or of the Engineer, or his or her assistances, or of any other Persons for whose acts or omissions of the Principal is as between it and the Contractor responsible; or*
- (d) Any risks specifically excepted in 5.6.6.*

### **5.6.6 Excepted Risks**

Key items from 5.6.6 are:

The excepted risks are:

...

- (d) The use, occupation, or taking over of any portion of the Contract Works including but not limited to any portion in respect of which a Practical Completion Certificate has been issued.*
- (e) Any fault, defect, error, or omission in the design of the Contract Works for which the Contractor is not responsible under the Contract;*
- (h) Any act or omission of the Principal or of the Engineer or their assistants or of any other Person for whose acts or omissions the Principal is as between itself and the Contractor responsible.*

Additionally, under Clause 7.1.3 the principal is contractually required to provide the contractor with a reciprocal indemnity for the matters outlined in 7.1.2(a), (b), and (c) above.

### **Principal's own annual public liability policy**

For the most part, principals will have their own annual public liability policy structured to cover their day-to-day business operations and activities. However, it should be noted that not all policy wordings are born equal and careful consideration should be given as to whether appropriate cover is available for construction activity under the principal's existing annual public liability policy. Items to consider include the following:

1. Are construction activities included in the business description?
2. Are there any specific exclusions in the policy that may preclude cover for construction activities?
3. Can the policy be extended to include cover for construction activities? Refer example below:

Subject to the terms of this Policy, the Insurer(s) agree to indemnify the Insured for all sums that the Insured becomes legally liable to pay as Damages in respect of:

#### Contract Works

Occurrences in connection with the performance of any contract of demolition, construction, erection, alteration, decoration, installation, testing, repairs or maintenance, all at or in connection with the Insured's premises or works, are deemed to be Occurrences in connection with the Business, but only where the contract price does not exceed \$(amount). The Insured must declare any proposed demolition work that will involve the use of explosives to the Insurer prior to its commencement. Cover in respect of any such demolition work will not commence unless or until the Insurer has confirmed it in writing.

A contract price limit may vary anywhere between \$500,000 to \$5,000,000.

#### 4. What does the policy's Material Change, Material Fact or Change in Circumstances say?

In addition to points 1–3 above, insurers may rely on the Material Fact condition requiring an insured to disclose material changes to the business before being entitled to any indemnity under the policy.

### Example of argument for principals liability

Principals could face liability in the following situations:

- Allegations can be made that the principal has not selected, instructed or supervised the Contractor properly
- Where the principal has given a direct instruction to carry out works in a certain way that has caused damage to third party property
- Where the activity commissioned by the principal is inherently dangerous e.g. situations where there is withdrawal of support to adjoining land
- Due to the fact that they are the owner of the land and have a responsibility (along with the Contractor) to avoid nuisance or items escaping from site.

In conclusion, a contractor's public liability will not extend to cover the principal for all liabilities that it may face, nor will contractors be willing to extend their policy to do so. Given this, principals need to carefully consider any additional liabilities they may face and manage them accordingly, whether by modifying their existing public liability policy or by considering a project specific policy.

### For more information please contact your WTW Broker or:

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