

# Contractual Liability Essentials

## Core Essentials

### Understanding Contractual Liability and Insurance Clauses

It is common for commercial contracts to be used by the parties to allocate and transfer risk.

Such contracts frequently include mechanisms of allocating or altering risk, by which one party (e.g. principal) seeks to transfer all or part of their liability to another party (e.g. contractor).

The most common types of clauses include:

- clauses which impose a higher **standard of care** or a more onerous **measure of damage**
- **indemnity clauses** which require one party to pay the liabilities, costs, expenses and loss of the other party arising from the performance of the contract
- **releases** by which one party agrees to release the other party (invariably the principal) from liability

It is also common for commercial contracts to contain **insurance clauses** which require one party to arrange a specified type and level of insurance in respect of obligations connected with the contract. Often such clauses will require that the cover extends to certain obligations of the principal, head contractors, sub-contractors and others.

It is important to understand these clauses and their interaction with each other when assessing your insurance needs. You should provide copies of all relevant contracts to your insurance broker to enable them to help to ensure that cover is obtained which meets your insurance obligations and, to the extent possible, your contractual liabilities.

To the extent that cover is not available, you should be clear about the risk that you are undertaking by entering into the contract.

#### CHECKLIST

##### Contractual Liabilities

- ✓ *Have you accepted additional liability risk under the contract?*
- ✓ *Consider terms affecting:*
  - ✓ *Standard of Care*
  - ✓ *Indemnities*
  - ✓ *Releases*
  - ✓ *Liquidated damages*

*Can these be addressed through negotiation or your insurance program?*

##### Insurance Obligations

*Do you understand contractual insurance obligations?*

*Have you asked your broker to obtain insurance that complies with those obligations?*

*For legal advice contact Meridian Lawyers through the **Steadfast Contractual Liability Helpline***

## Purpose and Scope of the ‘Core Essentials’ Pack

This ‘Core Essentials’ Pack provides a foundation for you to understand:

- ✓ **Contractual obligations to insure**
- ✓ **Liability Clauses** *including Standard of Care, Indemnities and Releases*
- ✓ **Proportionate Liability**
- ✓ **Unfair Contract Terms**

This Core Essentials Pack is intended to highlight the areas of risk and potential pitfalls that are identifiable before you enter into a commercial contract, and which should be identified to help ensure appropriate insurance cover is obtained.

It is critical that these are clearly identified to:

- provide you with an opportunity to **negotiate changes to the contract**
- enable you to instruct your broker to **arrange cover for any contractual exposures** which remain after negotiation
- where cover is not reasonably available (i.e. not available at a price you are prepared to pay), **allow you to make a fully informed decision** as to the contractual risk which you are taking on.

Appropriate legal advice can play a valuable role in the above process. Meridian Lawyers can assist through the **Steadfast Contractual Liability Helpline**. You should ask your Steadfast insurance broker how you can benefit from this service.

This Core Essentials Pack aims to provide the basic knowledge and tools which you will need to navigate through and make commercial decisions to address these issues. It is not intended to be definitive given the broad and complex nature of these types of contracts and area of law. The Core Essentials Pack should be read together with other Meridian ‘Essentials’ documents which expand upon many of these issues and delve into related issues relevant to particular contract types.

## Contractual Obligations to Insure

### What is an insurance clause?

An insurance clause is an obligation under a contract where one party agrees to obtain insurance on the terms specified in the contract, which may include a requirement to obtain insurance that provides cover for another party (for example the principal, head contractors and sub-contractors). The scope of cover required to be obtained will depend on the specific wording.

Depending on the type of contract, such clauses may require a number of different types of insurance to be taken out including public liability, product liability, professional indemnity, motor vehicle, plant and equipment, transit insurance etc. It is also common for these clauses to specify requirements for sums insured and duration of cover.

Other stipulations commonly found in insurance clauses include that:

- ✓ the insurance is placed with a ‘substantial’ or ‘reputable’ insurer or an insurer of ‘good standing’
- ✓ the insurer has a specified credit rating
- ✓ certificates of insurance be provided to the other party as proof that the cover is in place
- ✓ notice be given in the event of the insurance not being renewed or being cancelled
- ✓ the party arranging the insurance not do anything which would prejudice, vitiate or render the insurance void or voidable

An example of an insurance clause is:

**Insurance**

*The Contractor must effect insurance policies that provide the following cover:*

- a) *public liability insurance with an indemnity of at least \$20,000,000 in respect of each claim;*
- b) *product liability insurance with an indemnity of at least \$20,000,000 in the aggregate for the period of cover; and*
- c) *workers’ compensation insurance in accordance with applicable legislation.*

*The Contractor must maintain the coverage required under this clause during the Contract Period.*

**Failure to arrange required insurance**

It is common for commercial contracts to require a party (for example, a contractor) to obtain insurance policies which provide cover for the loss or liability of the other party (for example, the principal) and/or others, arising out of the performance or non-performance by the contractor of its contractual obligations. Where the contractor fails to arrange such insurance, in the event that the principal suffers a loss, or a claim is made against the principal, which would have been covered by such insurance, the contractor will likely face a claim for breach of contract. The measure of damages recoverable for a breach of the obligation to insure, or adequately insure, will usually be equivalent to the amount of the indemnity which would have been payable under the policy which was required to be obtained.

**Interaction of insurance and indemnity clauses, and breach of contract claims**

In the event of a dispute as to whether a party has an obligation to obtain insurance for the benefit of another party, or is in breach of contract for failing to obtain certain insurance(s), or has agreed to indemnify another party for its liability arising from the performance of the contract, a court will closely scrutinise the obligation to insure clauses together with any indemnity clauses in the contract, to determine the nature and extent of any agreement between the parties which may transfer liability from one to another, and whether there has been any breach of contract.

**Instructing your brokers**

You should provide your insurance broker with copies of all commercial contracts, so that your broker can review any obligation to insure clauses and ensure that all required insurances have been placed. Where such insurances are not in place, or do not meet any of the other stipulated requirements, then brokers

may be able to assist you to source appropriate cover (by obtaining additional policies or arranging to have policies endorsed). However, brokers can only do so if they receive accurate instructions about all such contracts.

## Liability Clauses

The nature and effect of each of these common forms of liability clauses are set out in this table:

Clauses which impose a higher standard of care	Clauses imposing a higher measure of damages
<ul style="list-style-type: none"> <li>✓ These most often appear in contracts where a party agrees or warrants that the relevant goods or services will meet a particular standard</li> <li>✓ Raise potential problems where the agreed standard exceeds the standard of care which would otherwise be required by law</li> <li>✓ For example, a warranty to perform services to the <i>'highest professional standard'</i></li> </ul>	<p>The most common form of such clauses:</p> <ul style="list-style-type: none"> <li>✓ indemnify the other party for losses which would otherwise be regarded as unforeseeable or too remote to be recoverable by law</li> <li>✓ require the payment of liquidated damages</li> <li>✓ agree to pay legal costs on a solicitor/client or indemnity basis</li> </ul>
<p><b>Indemnities</b></p> <ul style="list-style-type: none"> <li>✓ A contractual indemnity is an obligation under a contract where one party has agreed to indemnify another party in relation to liability, loss, damage, costs and expenses in connection with the performance of the contract</li> <li>✓ Indemnity clauses can vary from reflecting the common law position, to being extremely broad and taking the form of a 'hold harmless' clause where one party agrees to indemnify the other party irrespective of fault, and in the absence with a reasonable connection with the performance of the contract</li> </ul>	<p><b>Releases</b></p> <ul style="list-style-type: none"> <li>✓ A clause by which one party agrees to release the other party (invariably the principal), and sometimes other nominated persons, from liability which such party(s) would have had to the first party by law in the absence of such contractual release</li> </ul>

The above liability clause types create the potential of uninsured risk where they:

- impose a liability which is greater than would have existed in the absence of those clauses; and
- prevent you from recovering from a third party (e.g. a principal or head contractor) where those parties would usually be liable to contribute to your liability.

## Interaction with insurance policies

The reason insurance obligations and liability clauses are problematic is that:

- most liability insurance policies will contain contractual liability exclusions which exclude liability incurred by the insured pursuant to a contract to the extent that such liability is greater than would have existed in the absence of the contract;
- most liability and property policies will exclude cover where the insured has agreed to release or otherwise waive its rights to recover its liability of loss from a third party; and
- most liability and property policies will exclude the insured’s failure to insure property.

The scope of such contractual liability exclusions varies between different types of policies and different insurers. An example of such an exclusion from a Public and Products Liability policy from a major insurer is:

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***Contractual Liability***

*Any liability assumed under a contract that requires You to effect insurance over property or to be liable for Personal Injury or Property Damage regardless of fault, except where:*

- that liability would otherwise exist at law in the absence of the contract; or*
  - the contract is an Incidental Contract and the liability does not arise by reason of an obligation to insure a leased property or an obligation to indemnify a landlord irrespective of fault.*
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Liability policies may contain limited exceptions to the operation of the contractual liability exclusion as shown in the above example. Your Steadfast broker can assist you to find a policy suitable for your needs.

Most property and liability policies will also include ‘waiver of liability’ or ‘waiver of subrogation’ exclusions which will operate to exclude liability to the insured where they have either released or limited their rights to recover loss or damage from third parties (thereby interfering with the insurer’s rights of subrogation). For example:

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***Subrogation – Preventing Our Right to Recovery***

*If You have agreed not to seek compensation from another person who is liable to compensate You for any Loss, Damage or liability which is Covered under this Policy We may not Cover You under this Policy for that Loss, Damage or liability.*

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## **Proportionate Liability**

Proportionate liability legislation applies in all states and territories of Australia and provides that, subject to some exceptions (most notably, personal injury claims), defendants are only liable for their portion of liability for the plaintiff’s loss and damage. It operates to prevent a defendant from being required to bear any liability greater than its relative share of responsibility for a plaintiff’s loss having regard to other persons who are also responsible for the same loss (referred to as ‘concurrent wrongdoers’). The practical effect of the legislation is that a defendant is not required to seek contribution from other concurrent wrongdoers and, where such other concurrent wrongdoers are impecunious, the defendant is not left to bear their share of the loss.

Some states (NSW, WA and Tasmania) allow parties to contract out of proportionate liability legislation. You should carefully consider if your contracts contain any indemnity clauses or other provisions which would have the effect of contracting out of the applicable proportionate liability legislation as this could increase your liability exposure beyond that which would otherwise apply by law and therefore give rise to the application of contractual liability exclusions.

## Unfair Contract Terms Legislation

Unfair contract terms legislation may be available to provide relief to parties from the operation of unfair contract terms contained in contracts for the supply of goods or services where:

- ✓ the contract is a ‘Standard Form’ contract (being a contract which is: drafted by the other party; not subject to negotiations between the parties; and where the party which did not prepare the contract has no real bargaining power);
- ✓ the contract is entered into by a small business, (who employs less than 20 people); and
- ✓ the ‘upfront price’ of the contract does not exceed \$300,000 per annum, or does not exceed \$1 million if the contract runs for longer than 1 year.

Where the unfair contract terms legislation applies, a party may apply to a court to have a term declared void where the term is ‘unfair’ in the sense that it:

- ✓ would cause an imbalance in the parties’ rights and obligations under the contract;
- ✓ is not reasonably necessary to protect the legitimate interests of the party benefiting from the term; and
- ✓ would cause detriment to a party if it were to be relied upon

If you fit the above criteria and find that the party with whom you are negotiating a contract is unwilling to negotiate any of the terms in the contract, then you may be protected by the ‘unfair contract terms’ legislation from onerous or one-sided clauses, depending on the nature of the businesses involved and the precise terms of the contract. Recourse to this legislation should, however, be regarded as a ‘last line of defence’.

## Managing your risk

Your Steadfast broker can advise you about your insurance requirements and assist you to obtain legal advice (at no extra cost) by using the **Steadfast Contractual Liability Helpline** operated by Meridian Lawyers.

## Legal advice

If you are uncertain about the meaning or effect of the liability or insurance provisions contained in any contract you are considering entering into, or have already entered into, you should seek legal advice. Your broker can advise you in relation to the ability of your insurance program to satisfy insurance clauses or cover the professional services provided but cannot provide you with legal advice about contractual clauses.

The Steadfast Contractual Liability Contract Review service operated by **Meridian Lawyers** provides a **one hour contract review service**, to review insurance and liability clauses. It is available exclusively to clients of Steadfast member brokers.

Please contact your Steadfast broker for information on how you can access this service.

*This information is current as at May 2020. This information has been created for educational purposes and does not take into account specific individual circumstances. The information does not constitute legal advice and does not give rise to any solicitor/client relationship between Meridian Lawyers and the reader. Professional legal advice should be sought before acting or relying upon this information.*

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