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Commercial Division**

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Guidance Note N° 2

**Insurance in Alliance Contracting:
Selling Insurable Risks**

August 2009

COMMENTS

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Selling Insurable Risks*
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1 Preamble

This guidance note was prepared to assist participants in project alliances to clarify the value proposition, or benefit, of using alliance agreements.

Governments seek to achieve a very broad range of social, environmental and economic objectives on behalf of the community. This normally results in an equally broad diversity of capital and infrastructure projects. Today, while a number of mature and emerging project delivery methodologies can cater well to this project diversity on a 'fit-for-purpose' basis, the selection needs to be based on a careful and knowledgeable analysis of project characteristics and risks.

Increasingly, governments are using alliance contracting to procure significant infrastructure. Alliancing principles are a positive innovation and are defined by collaborative relationships, in contrast to traditional positional relationships. A key value proposition of alliancing is that government entities trade off their traditional contractual rights (under a 'risk transfer' contract) in exchange for non-owner participants bringing to the project their *good faith* in acting with the highest level of *integrity* and making *best for project* decisions. This is another important alliancing value proposition.

The alliancing contracting principles of *no blame* and *collective assumption of risk* have created new challenges in finding an insurance solution. Using traditional insurance policies in alliancing contracting could potentially create significant cover gaps, duplication of coverage and expose alliance partners to greater risk.

Agencies involved in alliancing contracting need to understand different insurance solutions and make sure that the legal position and the state's commercial exposure are transparent and understood.

Like all contracting methodologies, alliancing must also make continual improvements, and this guidance note aims to identify where alliance arrangements can be improved to further demonstrate their value to the state.

2 Overview

Alliances are a major tool for delivering infrastructure projects. It is estimated that more than 217 major alliances, valued at more than \$65 billion, were undertaken in Australia and New Zealand between 1996 and 2006.¹ Ninety-five per cent of these were in the public sector.

The total insurance risk transfer costs for an alliance project (including premiums, contractor margins, brokers' fees and commissions) are likely to be a material to any alliancing project's overall cost. Depending on the project's risk profile and the covers purchased, it may range from \$4 million to \$1 million for every \$100 million of cover. Good guidance is therefore important to assist agencies manage what is likely to be a material project cost.

Insurance is a highly specialised and complex area and, to date, agencies have had little access to guidance about insurance for alliancing arrangements. However, there appears to be a strong appetite for guidance and for implementing processes that lead to better decisions.

2.1 Introduction

This guidance note provides an overview of some of the key insurance related issues for alliancing participants and comments on some related issues.

As in the many other alternative contracting methodologies for project delivery, alliancing typically involves using insurance to protect parties against various risks.

However, alliancing gives rise to specific issues regarding insurance, primarily as a result of:

- 'no fault', 'no blame', 'no dispute' alliance concepts and clauses – which make risk allocation to third parties, such as insurers, particularly important
- the allocation of various risks to 'the alliance', rather than to individual participants.

Given the increased promotion of alliancing in recent years, participants need to be aware of insurance issues, such as whether insurances will be adequate or effective in meeting the alliance project's needs or for the purposes of risk allocation between the participants.

2.2 Insurance in the alliancing context

Traditional liability insurance products hinge on findings of 'liability' and 'fault'. More specifically, the liability of the insurer under traditional insurance products and terms is not triggered without the existence of a liability of one or more relevant insured parties.

However, these concepts of liability are generally not part of the collaborative relationships established in alliancing. Alliance participants use no fault/no

¹ From the *Report on Project Alliancing Activities in Australasia 2008* produced by the Alliancing Association of Australia Ltd with the collaboration and support of RMIT University, School of Property Construction & Project Management

blame/no dispute principles and terms in their alliance agreements to endeavour to effectively block any such liability between them.

As a result, traditional insurance policy terms may not be triggered and, therefore, alliance parties may find that there is no effective insurance cover. While this typically is not problematic for project works and public liability cover, it is a significant issue for professional indemnity insurance. This issue is often overcome by purchasing first-party project-specific insurance. This, in turn, raises the issue of who controls the various insurances.

Efforts to overcome this difficulty have included special drafting, where alliance participants aim to 'carve out' from no suit terms

- those claims that insurance will cover, e.g. through professional indemnity
- specific categories of claim, such as contribution arising out of a professional negligence claim made by a third party against a participant in connection with the alliance project works. (There is more information about carve-outs in section 4.7.)

However, these approaches remain complex and it is uncertain how they will operate where the alliance agreement contains no express risk allocation terms or mechanism. They are fraught with potential issues and arguments about how the terms might operate if there is a dispute.

Even with the introduction, over time, of special insurance products for alliancing projects, there are numerous options and issues for parties to consider.

Finalising responsible, effective (and cost-effective) alliance agreement terms that take into account insurance obligations, and negotiating and procuring effective insurances, are technically demanding tasks.

Section 3 outlines some of the insurance options available to alliancing participants and highlights some relevant considerations.

Insurance in alliancing also raises the possibility of adverse risk transfer and loss of value to the state. It is possible that the insurance procurement decision will influence:

- the commercial behaviour of project participants (particularly if they feel the project has been 'de-risked' (explained in section 5.2) due to their participation in a no fault, no blame arrangement)
- the risk profile of the project or program for both the state and the non-owner participants
- each party's insurance history, insurance premium costs and the future cost of insurance
- the factoring of premiums into project costs.

The insurance procurement decision may lead to outcomes that are best for the insurance industry, best for non-owner participants, but not necessarily best for the state in either a project or whole-of-government context.

2.3 Purpose of this guidance note

The purpose of this document is to promote continuous improvement in alliances. Agencies have varying expertise in alliance insurance. This has led to a variety of experiences, indicating that guidance would be helpful.

Importantly, this guidance is prepared from the point of view of assisting government and its agencies 'sell risk' as opposed to 'buying insurance'. This is an important distinction as it is a fundamentally different approach.

'Selling risk' is considered to be a best-practice approach as it is based on the government perspective of how its risk should be managed in delivering alliance projects. 'Buying insurance' is a responsive approach to market forces, often created by the insurance market. In some cases, the approach to date has been aligned to that approach, which may not result in the best outcome for the state.

The guidance is also based on taking a cost-effective approach, seeking to achieve value for money for taxpayers and avoid the possibility of over-insuring risks. This may occur if the alliance members' view is that more insurance is better for the project and obviously incurs additional cost for the state.

There may also be cases where the public interest is best served by not insuring particular types of risks. Many of these risks may be outside the alliance's control, but will be borne by the state. Similarly much of the insurance cost will be borne by the state, either directly or indirectly. Arguably the TOC needs to capture the cost of insurable risks so that required behaviours are manifest. In particular this is relevant for developing an insurance program where the level of self-insurance (deductible) appropriately influences the behaviour of the non-owner participants. These factors would indicate that the state should have a significant role in the alliance insurance process – both in design of the process and its execution.

As a result, this guidance note is intended to provide:

- a recommended process for procuring insurances in project alliances
- assistance in identifying and articulating common insurable risks in project alliances
- assistance in identifying and recommending a range of suitable insurance options
- guidance in reviewing the adequacy and prudence of the selected insurance options.

The note is also intended to assist the state and users consider whether the products currently offered by the market meet their needs.

While there has been a level of innovation in the insurance product offering, product development to date has mainly been from the insurance industry perspective. The aim of guidance such as this document is to:

- encourage product development that carefully balances what is best for the state against the need for the private sector to create and market appropriate, attractive insurance products
- encourage public officials not to accept without challenge the way the market has shaped insurance cover, while being realistic about the ability to shape a better product offering in the short to medium term.

2.4 Commonly used terms

It is useful for those involved in alliancing projects to be familiar with some commonly used insurance terms for a basic understanding of how insurance works.

Aggregate limit: This usually refers to liability insurance and indicates the maximum amount of coverage that the insured has under the contract for a specific period of time, usually the contract period, no matter how many separate accidents might occur.

Attachment point: This is the point at which the insurance cover is in force.

Broker: An insurance professional who assists a client to obtain the insurance cover – although strictly an agent for the insured, the broker is often remunerated by way of commission from the insurer.

Brokerage: A form of Broker remuneration typically expressed as a percentage of premium.

Claim: A demand made by the insured, or the insured's beneficiary, for payment of the benefits provided by the insurance policy when the event insured under the policy has occurred. A claim, depending on its context, also means a claim against an insured by a third party for economic loss, property damage or personal injury incurred (usually referred to as the claimant) – which then triggers the insurance claim.

Claims occurrence: A policy term that provides access to indemnity as long as the insured was insured at the time an incident giving rise to a claim occurred. Should a claim – related to the period the policyholder was insured – arise years later, the policyholder can still claim.

Claims made: This term refers to liability policies covering all claims notified in the policy period, and first made against the insured in the same policy period.

Contract works: Contract works insurance provides coverage for physical loss or damage to the works. The policy provides indemnity for the insured parties which should reflect the complexities of the contract entered into. This specifically should include the contractor, the owner, subcontractors, financiers and other parties to the contract.

Compulsory third-party (CTP) insurance: Prescribed as compulsory insurance under state and territory legislation, CTP insurance covers liability for bodily injury to third parties arising out of the use of a motor vehicle.

Damage: This involves loss or injury suffered by a person, normally calculated in monetary terms.

Damages: Damages are compensation for loss suffered, which is awarded by courts and endeavours to place a person in the position where they would have been had the loss not been suffered.

Deductible: This is the amount of loss that is to be borne by the insured before being able to claim under a policy. It is sometimes called an 'excess'.

Directors' and officers' insurance: This is coverage for when a director or officer of a company commits a negligent act or omission, or mis-statement, or misleading statement, or a breach of statutory or common law duties while acting as a director or officer of the company.

Exposure: This is the measurement of the extent of a risk assumed by an insurer or indemnifier.

First party: The first party is the insured party. A first-party policy may also refer to insurance for the policyholder's own property or person. (A third party is not a party to the contract but a party who seeks to be compensated for some injury or loss caused by the insured.)

General liability insurance: This is insurance designed to protect business owners and operators from a wide variety of liability exposures. Exposures could include liability arising from accidents resulting from the insured's premises or operations, products sold by the insured, operations completed by the insured, and contractual liability. The most common form of this cover is public and products liability insurance.

Indemnity (insurance): This is the legal principle that ensures a policyholder is restored to the same financial position after a loss, as was enjoyed immediately before the loss, subject to policy terms. There are two main ways of providing an indemnity. Property can be replaced on a new for old basis; this is known as reinstatement or replacement and is a common means of settlement for personal insurance policies. Alternatively, a policy may provide for property to be assessed at its current value at time of loss, with allowances made for wear and tear, depreciation and betterment. This second approach is commonly referred to as indemnity conditions, to distinguish it from replacement conditions.

Insurance: This is a device for transferring specified risks to an insurer. The insurer agrees, for consideration (usually payment of a premium), to assume, to a specified extent, certain losses that may be suffered by the insured.

Insurance advisor: An independent person with specialist expertise in insurance, the role of the insurance advisor is to support the process of procuring appropriate insurance.

Insured: This is the party to an insurance arrangement to whom the insurer agrees to provide cover against specified losses, or to render services, subject to the terms of the insurance contract.

Insurer: This is the party to an insurance arrangement who undertakes to provide cover or to render services, when specified events happen.

Insured event: These are occurrences or circumstances causing loss and damage which are covered in the relevant policy.

Liability insurance: This is a form of general insurance that provides cover in regard to the insured's legal obligation for loss or damage to another person.

Loss adjuster: A specialist claims investigator, adjustors are usually appointed by an insurer to investigate and report on the claim and the amount validly claimed under the policy.

Non-Owner Participant (NOP): This includes any service provider such as designers, constructors, specialist consultants etc forming the Alliance, and can also include an agency or government-backed enterprise acting as a service provider rather than the owner.

Occurrence: An event that results in an insured loss; In some lines of business, such as liability, an occurrence is distinguished from accident in that the loss doesn't have to be sudden and fortuitous and can result from continuous or repeated exposure which results in bodily injury or property damage neither expected nor intended by the insured.

Personal lines: This is insurance for personal assets such as a vehicle or house. It doesn't extend to businesses, which are classified under 'commercial lines' risks.

Policy: This is the underwriting document that details the scope of the insurance cover.

Policy schedule: This document is read in conjunction with the policy to provide full details of the terms and conditions of the insurance cover.

Premium: The amount paid to the insurer for the provision of the insurance coverage is described as the premium.

Professional indemnity insurance: This provides indemnity to professionals against claims made against them resulting from legal liability to others for loss or damage arising out of professional negligence on the professional's part. 'Profession' is now accepted as the application of skill and care.

Products liability insurance: This is insurance taken out to cover liability claims arising from the manufacture, alteration, repair, modification, re-supply or distribution of products.

Public liability insurance: This insurance provides cover in the event of bodily injury or property damage that a business may negligently cause to others.

Risk advisor: Risk advisors are the individuals appointed by the owner at the time the business case is being developed to assist in identifying and managing project risks.

Sum insured: The sum insured is the maximum liability the insurer accepts under an insurance contract.

Subrogation: The statutory or legal right of an insurer to recover from a third party who is wholly or partially responsible for a loss paid by the insurer. Subrogation permits the insurer to make a claim in the name of the insured and to pursue a third party to recover part or all its losses incurred under its insurance contract with the insured.

Underwriter: An underwriter is a technical person trained to evaluate risks and premiums, and coverage terms and conditions.

Underwriting: This is the process of assessing and selecting applicants and risks for insurance and classifying them according to their degrees of insurability so that the appropriate premium may be charged. The process includes rejecting unacceptable risks.

3 Insurance – a discussion

3.1 Introduction

Insurance cover is a contract between someone who requires cover against a particular risk and the insurance company providing that cover. Insurance is used where a person does not want to accept all of the risk flowing from a particular event. Insurance allows some or all of a risk to be passed on to another party, who for a monetary amount, is prepared to accept a particular risk. Insurance is therefore an effective mechanism for transferring risk to parties who are comfortable accepting particular types of risk.

Insurance differs from other contracts in that people may not obtain cover unless they can show that they have an insurable interest. This is an interest that can be recognised by law and may exist in connection with an individual, a property or a legal liability. The interest does not have to involve ownership, but if individuals can show that they will suffer some form of damage, detriment or prejudice if the event occurs, then they would be considered to have an insurable interest.

The insurance contract is made between a party seeking insurance cover (the insured), and a party providing that cover (the insurer). The consideration paid to the insurer for accepting the risk is known as the premium. The benefit to the insured is usually the payment of a sum of money if the specific event, the subject of the insurance, occurs.

General insurance can be broadly divided into two categories – short-tail and long-tail business. These categories reflect the time between accepting the business and the possible occurrence or settlement of a claim. For short-tail business, the period is generally less than a year, and for long-tail business, it can be significantly longer. It is likely that risks to be insured by an alliancing project would be both short and long tail.

Two key concepts for the effectiveness of insurance are the duty of good faith and the duty to disclose (primarily an obligation of the insured).

The duty of good faith is an implied term in every general insurance contract in Australia, under section 13 of the *Insurance Contracts Act 1984* (Cwlth). The duty exists from the pre-insurance contract to the post-insurance contract stage with an insurance policy, including making and handling claims. This means that agencies and service providers (the insured) are required to act towards insurers with the utmost good faith. Failure to do this may result in an insurer's liability for a claim being avoided or reduced. The Insurance Contracts Act allows for damages for breaches of the duty of good faith and the right to cancel an insurance contract following a breach.

The Insurance Contracts Act also gives insured parties a duty to disclose all information relevant to an insurer's decision to accept the risk. Therefore, before a party enters into an insurance contract with an insurer they must fully disclose to the insurer every matter that is relevant to the insurer's decision to accept the risk being insured against.

3.2 Main types of insurance cover

There are as many types of insurance cover as there are risks. Essentially when consideration is paid by one party to another on transferring a risk, there is an insurance relationship. Cover can be as diverse as entertainer

performance risk to the impact of weather on farm produce. In construction projects, however, there are three main types of cover. These include contract works, public liability and professional indemnity. These are outlined below, with further detail in Appendix D.

- **Contract works insurance** provides cover for physical loss and damage, including for damage caused by natural perils such as floods or storms, to any of the work under the construction contract, and for materials and equipment that are to be used in the project but stored on or off-site. The period of cover will generally be up to and including the date of practical completion and will extend to include physical loss or damage caused by a defect during any defects liability period.
- **Public liability insurance** covers the insured's legal liability to third parties for bodily injury or property damage resulting from the negligence of the insured. Legal liability could arise in the case of consultants and non-owner participants if an injury or damage was caused to a third party on a worksite, such as an injury caused by a surveyor's pegs or a non-owner participant's equipment. In the case of non-owner participants, the liability can also arise during the maintenance/defects liability or post-completion construction period of the contract. Liability may also involve operations after construction is completed and be covered by such insurance where this is arranged.
- **Third-party professional indemnity insurance** is the typical form of cover. This type of insurance cover protects professionals, such as architects, engineers and other consultants for claims against them arising out of the professional services they provide. In basic terms, professional indemnity insurance covers the insured's legal liability for any claim for compensation made against the insured party for breach of professional duty in the conduct of business by the insured, or on their behalf.

Other insurances that typically apply to projects include:

- workers' compensation insurance (both statutory and common law)
- motor vehicle insurance
- insurance of plant and equipment
- overseas and domestic marine transit.

3.3 Insurance options

The types of insurance and the amount of cover to be taken out depend on the nature of the project and the risks associated with it.

Given the fundamental alliancing principle of no suit/no litigation, the terms and conditions of each insurance policy for the project need careful consideration.

Types of arrangements

(a) Existing insurance arrangements

Participants may seek to rely on their existing insurance policies, amended as appropriate, to cover the risks associated with the project. Since these policies are already in place, and premiums are already being paid, the costs associated with this approach may be far less than the costs associated with project-specific insurance (see (c) below).

However, as the existing policies have not been tailored specifically for the project, they may not adequately address or respond to relevant risks that may arise. Consequently, the participants need to conduct a detailed risk

analysis and review their existing insurance policies to identify gaps in coverage.

Assuming gaps do exist, the participants, in consultation with skilled advisers (and insurance brokers), need to ascertain whether they can deal with the gaps through appropriate amendments or extensions to the existing insurance policies, or by varying the cover, and what the cost will be.

Unless each policy is appropriately amended or endorsed, the no claim principle could prejudicially affect insurers' right of subrogation (the right of the insurer to step into the insured's shoes and sue another party or insurer who may be liable for or caused or contributed to the cause of the loss) and consequently an insured's rights to recover under a policy.

(b) Global insurance policies

Quite often in projects of a significant size, the contractor will be an entity established purely for the project (i.e. a special-purpose vehicle), or may be the subsidiary of an ultimate holding company.

In these circumstances, to minimise costs, the contractor may seek to rely on the ultimate parent company's policies as sufficient to satisfy its insurance obligations under the alliance agreement. (Global insurance limits are designed to be sufficient to meet future and current liabilities and insurers backing these global programs are acceptable to Australian Prudential Authorities.)

This approach may be acceptable to the principal, provided that:

- the contractor is actually covered under the global insurance policies
- the principal and participants can, where appropriate, be included in those policies as an insured (which is rare)
- relevant coverage is provided or gaps can be dealt with (see (a) above)).

(c) Project-specific insurance

Project-specific insurance, as the name suggests, involves taking out an insurance policy, or policies, specifically designed to address the risks associated with a particular project. This kind of product is tailored for the project, following a project-specific risk analysis, to provide comprehensive coverage that also takes into account the alliance agreement terms.

The advantage of project-specific insurance is that it accommodates the alliance principle of no claim between participants. However, project-specific insurance is typically more expensive. Some participants may argue that the premium can be justified, but others may consider the cost prohibitive. In practice, parties' attitudes to a higher-cost project-specific approach may be driven by the way insurance costs are dealt with under the alliancing budget and risk/reward terms. State entities should appraise the likelihood of residual risks from the project and evaluate the cost of project-specific insurance against the magnitude and propensity for these risks to eventuate.

(d) Control of insurance

In some instances, the owner participant in an alliance agreement may procure insurance for the alliance as a whole. Different considerations will arise for an owner where insurance is controlled by the owner or the non-owner participant. This includes the nature of the information non-owner participants are required to provide. Alliance participants need to understand the implications of the approach taken in connection with the specific project alliance terms. Similarly, where a committee is formed to deal with insurance issues, the parties need to be aware of the implications. For example, from an owner perspective, there may be concerns about non-owner participants controlling insurance if the cost is a project cost that will be neutral to the

risk/reward mechanisms for the non-owners. In the same way, non-owner participants may be concerned if owner-controlled insurances are put in place that may affect non-owner rights.

In some cases, the alliance can be responsible for procuring, maintaining, reviewing and administering claims. It may be that each participant is responsible for different insurance issues.

The numerous options and their implications need to be understood and considered in determining the approach that is ultimately agreed as the most appropriate for each alliance project. They should take into account the terms of the alliance agreement, the approach to insurance placement and the interests of the alliance participants.

A more detailed discussion of owner-controlled insurance versus control by non-owner participants is in section 5.3.

Use of indemnities

(a) Indemnities as a method of risk allocation

Indemnity clauses can be an effective way of allocating certain project risks between contracting parties. However, the use of indemnities is traditionally much more limited in alliancing because the risks associated with the project are generally borne by the 'alliance'. For example, alliance terms may limit indemnities to circumstances where a participant's failure to comply with insurance provisions set out in the alliance agreement causes loss or damage; indemnities can be capped to insurance proceeds.

Alternatively, if responsibility for a particular risk is not allocated, then an insurer may have more scope to deny liability, depending on the specific policy terms. The events giving rise to the claim may then need to be analysed (potentially involving costly, drawn-out litigation against the insurers) to determine which insurance company should respond. This would be time-consuming and costly.

As liability usually flows from a combination of events involving more than one party, the allocation of blame detracts from the alliance philosophy.

(b) 'Knock for knock' provisions

Quite often in insurance discussions, the concept of 'knock for knock' is raised.

This concept means that each participant retains responsibility for a particular risk or type of loss, whoever is at fault. The approach is sometimes used in relation to workers' compensation insurance, as it is seen to simplify the claims process, as everyone is responsible for their own employees and it assists in terms of the waiver of the right of subrogation.

Whether to maintain or exclude such provisions for an alliance project should be looked at on a project-specific basis.

(c) Indemnities should be secondary to insurance

As noted above, insurance is generally the participants' main method of mitigating the risks associated with a project. To ensure that the relevant insurance policies will respond before any indemnities, the insurance clauses should explicitly state that the insurances are primary and not secondary to any indemnities in an alliance agreement. Such terms then need to be integrated appropriately in the alliance agreement terms so that they do not undermine the alliance 'no suit' concept and terms – without undermining access to insurance if a relevant event occurs.

4 Some issues for consideration

4.1 Insurance cost management and allocation

One of the issues that arise where participants rely on global or parent insurance policies is how the associated costs are identified or quantified, as well as how they are dealt with under the alliance agreement. For example, a global policy may literally cover all that party's projects all over the world and the premium paid for incremental additional projects will reflect this. Clearly, it is not appropriate for the entire premium to be a cost associated with the immediate project, or allocated solely to it. Alliance participants may agree to:

- considering incorporating incremental policy costs into the corporate overhead and profit rate agreed between the participants
- taking some percentage-based or incremental cost approach as a way of allocating a proportion of costs as a direct project cost for project purposes.

Where global policies are used, parties will have the usual issues to consider regarding precise policy terms and applicable limits – in particular, whether other claims made for other projects could exhaust the limits. Parties may seek to address this issue contractually by requiring relevant participants to maintain specified levels of coverage at a 'net' agreed amount. That means the owner, or perhaps participants, need to be kept informed of other claims.

The broader issue of insurance cost in an alliance context is the way that insurance costs are allocated for the project. If insurance is a project cost, it still needs to be managed so that policies are put into effect on appropriate terms, at appropriate levels and at appropriate times, and maintained. Importantly, if insurance costs are an alliance budget cost item that has no impact on non-owner participants, then the owner participant will be adversely affected if:

- insurances are not managed effectively
- relevant claim and other information required from or in relation to non-owner participants is not available or is not forthcoming
- insurance costs are adversely affected if a poor claims history of one or more non-owner participants is revealed.

Parties can agree on project-specific arrangements to identify and manage these issues promptly in numerous ways. For example, it may be possible to identify material premium impacts attributable to one or more participants or issues, and agree project-specific arrangements to:

- deal with that differential, so that other alliance participants are not unfairly affected
- deal with relevant excesses in a particular way, depending on the circumstances of the claim.

4.2 Owner participant analysis and non-owner participant risk assessment

The approach taken to insurance can have an impact on the information non-owner participants have to provide. In various approaches to procurement, it is

accepted that owners will regularly be provided with sufficient information to consider the:

- cost for which a proposed contracting party can provide relevant insurances
- policy terms (including deductibles) on which a proposed contracting party can procure insurances
- claims history of a potential contracting party.

Owners will also rely to some extent on contracting parties having a vested interest in avoiding or minimising insurance claims – which might otherwise adversely affect the contracting party's ability to get such insurance in the future or the terms applying to future insurances. In particular, owners may value contracting parties' focus on avoiding claims. Owners may also be concerned about inappropriate attitudes to risk evolving over time if there are no commercial effects for contracting parties that maintain a positive insurance claims history.

However, in the alliancing context, the approach to insurance will determine whether or to what extent owner participants may have the visibility of or benefit from such facts and considerations. Again, careful consideration of the most appropriate approach will be required, project by project, with input from relevant advisers.

4.3 Insurance timing

Insurance arrangements should be clear about when various insurance policies must be in place, including steps to manage the confirmation of and evidence of those insurances.

Relevant insurance policies should be in place before any activity or risk that is intended to be covered by the policy arises. For example, people should not be allowed to access the site before public liability insurance is in place.

However, the position in an alliancing context can be complex. Various risks may arise at different times, or the nature and extent of relevant risks may change over time, or even be unknown until a later phase. For example, an alliance may involve developing innovative and creative technology before physical works begin. This may mean a certain amount of work and testing but not require or allow full insurances to be placed at the outset. Or, if insurances are put in place, they may provide an inappropriate level of cover or attract a higher premium than necessary. Again, project-focussed insurance strategies need to be developed and managed in the context of the particular alliance project and requirements.

4.4 Level of cover

The level of coverage for each insurance policy needed for a particular project will depend on the nature of the project and the associated risks. Most obviously, a high dollar value project that involves relatively high risks, and high impacts where risks arise, will probably warrant a higher level of cover.

However, as noted, project risk profiles can change, particularly in an alliance. For example, there may be an initial design phase that requires some insurances to be in place but not others. As a result, levels of cover deemed necessary can change. Particularly in alliancing, it is less appropriate to assume that parties can or should set a level of coverage for the duration of the project at the outset. It would be necessary to agree limits of cover at the commencement of insurance but of course these limits can be amended

during the project if deemed necessary after further risk analysis has been carried out

Although insurance cover might be considered a largely commercial issue, a responsible approach calls for project-specific analysis and guidance for the best insurance arrangements. The level of cover needs to be derived based on appreciation of the project risks. The use of an insurable risk workshop to define project risks and to articulate the plausibility of each is the basis by which the maximum requirement for insurance limits can be derived. Prudent insured clients should ensure that the policy limit sufficiently addresses the Maximum Foreseeable Loss. Selecting a lower limit may be suitable provided this risk profiling exercise has been done.

4.5 Deductibles

Generally, deductibles payable under insurance policies are payable on a 'claim by claim' basis. This means that for every claim under the particular insurance policy, a deductible is also paid, whether the claim is the first during the insurance period or a subsequent claim. If the deductible is payable on a claim-by-claim basis, the amount of the deductible may be treated as a direct cost that is specific to the project.

Care needs to be taken where a deductible applying to a particular insurance policy is not paid on a claim-by-claim basis, but instead paid on a one-off basis for the year following the first claim for that year (which is more common in global policies). For example, some insurance policies provide that in any insurance period, the deductible is only payable on the first claim and no deductible is paid for all subsequent claims regarding that insurance year. Policies of this nature generally have large deductibles and it would seem inappropriate for a single project to bear the cost of that deductible – providing, in effect, deductible free insurance for subsequent claims on other projects. Special terms are required to deal with such issues. For example, participants may agree that if the first claim under such a policy is made in connection with the current project, then only a certain percentage of the deductible will be considered a direct project cost, with the remainder of the deductible being a cost borne by the non-owner participant outside the alliance.

The owner participant has options for dealing with not just insurance costs but also deductibles – in particular, whether, or to what extent, such costs should be considered an alliance cost or should have some impact on particular participants in terms of risk/reward provisions. The owner participant should consult with the insurance advisor and consider the amount of the deductible as well as the circumstances and processes for allocation of the deductible amongst non owner participants.

4.6 Right to subrogate

The relatively standard insurance policy condition that the insurer retains the right to subrogate is particularly significant for alliancing projects.

Clearly, in connection with alliance participants the rights of subrogation (as noted, the right of the insurer to step into the insured's shoes and sue another party or insurer) is in tension with the concept and terms for no suit/no litigation. Accordingly, in endeavouring to support the no suit concept, waivers of the right of subrogation need to be obtained from the various insurers and endorsed on the relevant insurance policies, where possible.

However, principals should be aware that the right to subrogate will not always be waived by an insurer. For example, the right to subrogate may not be waived for individual (as opposed to project-specific) professional indemnity

insurance policies, motor vehicle insurance policies and workers' compensation insurance policies. During the course of negotiating insurance provisions for a project, parties should consider and consult with relevant advisers about various relevant policies and available terms and issues from time to time, so that they understand the circumstances when insurers will or will not waive rights to subrogate and the impacts and options for project insurance arrangements. Sometimes principals' extensions can be negotiated.

Some issues that may be relevant to consider include:

- (a) whether parties can be named as additional insureds on any existing insurance policies that might provide cover (with or without amendment), and the relative cost
- (b) whether the particular insurance policies provide that the interests of any insured will not be invalidated by any action or inaction of any other insured
- (c) the procedure for cancelling the insurance policy or altering the terms and conditions
- (d) the credit worthiness and financial backing of the particular insurance providers, including considering Standard & Poors and other ratings reports or information available regarding insurers
- (e) whether the particular insurance policies contain a 'double insurance clause'. This is a clause in an insurance policy stating that, if a particular risk is covered under another insurance policy held by an insured, then the insurance policy does not have to respond. However, it should be noted that in Australia the *Insurance Contracts Act 1984* (Cth) prohibits the use of these clauses in relation to insurance policies covered by that Act. While the Act covers basically all insurance policies, it does not cover marine insurance policies.

4.7 Exceptions to no suit clauses

Alliance agreements typically contain exceptions to the provisions ('carve-outs'). These attempt to provide for the no suit/no litigation concept.

In particular, participants may agree that the no suit provisions do not extend to third-party claims (which may be dealt with according to specific provisions) or to claims for loss or damage arising from specific events or circumstances, such as:

- a wilful default (basically a deliberate and calculated default)
- a default and termination of the alliance agreement
- breaches of provisions identified as fundamental to the alliance arrangement (for example, insurance and confidentiality provisions).

Importantly, the precise terminology used in the alliance agreement needs to be carefully considered to determine whether it will operate as intended by the parties, and whether its meaning is certain.

A participant's liability for loss arising in relation to such events may or may not be limited in a number of ways. For example, it may be limited to:

- (a) the amount that can be recovered under insurances
- (b) a pre-agreed dollar amount
- (c) the amount of security provided
- (d) direct losses only (and not consequential, special or indirect losses)
- (e) a combination of the methods above.

On the other hand, it may be agreed that limits do not apply, or that limits will not apply in particular circumstances (e.g. where a participant has failed to comply with its insurance obligations).

These provisions and their scope and operation need to be clearly understood in the context of effecting relevant insurances for an alliance project, whether or not such insurances are intended to be owner or non-owner participant controlled.

4.8 Ongoing review

The types of insurance policies and the terms, conditions and levels of coverage applying to those insurance policies cannot always be adequately and accurately identified at the start of an alliance project. Therefore, it is particularly important to consider mechanisms for the systematic and periodic review of cover. This should be provided for in the relevant alliancing documents.

During an alliance project, there may well be points at which it becomes clear or was predicted that insurances should be reviewed to consider changes, including changes to the level of coverage as well as the scope of the cover.

Insurance policies effected and maintained by the participants are a major risk-mitigating device for the project and regular review and refining may well be essential. Participants should therefore consider implementing an insurance risk management plan setting out, as a minimum, the policies, procedures and guidelines the participants need to adopt to comply with the insurance requirements specified in an alliance agreement and the individual insurance policies.

4.9 General observation

Insurance is complex at the best of times. It often involves various stakeholders who will have an interest in the insurance provisions, as well as their insurance advisers, brokers, lawyers, internal and external risk management specialists and the underwriters themselves.

While recent project-specific insurance products have aimed to overcome some core issues that traditional insurance products pose for alliancing agreements, alliance participants still face many complex and difficult insurance issues. Participants (particularly owner participants and their specialist advisors) need to understand and consider these factors so that their project has effective insurance protection on appropriate terms, both at the outset and on an ongoing basis as the alliance activities progress.

Given the complexities and cost of insurance, it is desirable to address insurance issues as early as possible in the project negotiations.

5 Insurance in project alliancing

5.1 Introduction

Governments are undertaking large infrastructure projects using alliancing procurement methodologies. Each project and each alliance is different, with a different risk profile and risk treatment. Alliancing results in an unusual risk profile for the state when compared to other, contractually more straightforward, forms of delivery. Alliancing is most often used for projects that are considered to be high risk. This makes the role of insurance particularly complex.

More insurance is not necessarily better insurance, and value-for-money considerations are not straightforward. The true effectiveness of insurance is tested when a claim is made. For instance to date, first-party professional indemnity insurance for Australian alliance projects does not have a history of claims experience to use as a basis for testing the effectiveness of the insurance. While this can be seen as positive for alliancing as a delivery approach, it does raise the question of the effectiveness of the cover obtained. If there have been no claims, and a substantial number of projects have been delivered, then what risks are being effectively insured?

5.2 Risk analysis

Project alliancing involves delivering a project with a degree of predictability; however, unanticipated consequences or substantive risk events can be expected to arise during the project alliance. Risk analysis involves identifying, quantifying and modelling the probabilities and consequences for each of the unanticipated consequences or substantive risk events. The risk profiles are used during the risk mitigation planning stage to:

- identify which events contribute most to the overall risk of the project
- provide input into the target outcome costs
- focus potential treatment actions on the higher risk
- design strategies to avoid or to allocate the risks.

Insurance for project alliancing is a potential treatment for risks, but it is not available, or desirable, for all risks. In alliancing, insurance should be purchased where it is considered best for the state and only where sufficient controls are in place so that alliance insurance does not de-risk projects and lead to negative non-owner participant behaviour. These are two key concepts, which, although difficult to define, are described below:

- *Best for state*: This context considers the optimal position for the state rather than the project. (It is similar to taking a portfolio-wide rather than a project-specific view.) Regarding insurance, this may mean that less project insurance is best for state – either because it is comfortable assuming certain risks, or because it already carries the risk. This is different to a ‘best for project’ approach, which would generally require that all identifiable project risks are insured at the project level.
- *Project de-risking*: The alliance framework for project delivery incorporates collective sharing of (nearly) all project risks, and agreement of no fault, no blame and no dispute regime between

alliance participants. While alliancing is usually used for more technically complex projects, it does result in a lower risk profile for non-owner participants compared with a design and construct approach. It is possible that a non-owner participant may consider that the project has been de-risked for them when insurance is added to this framework for delivery.

As shown in Figure 1, the project alliance risks that are ultimately insured may only be a small part of the overall investment or enterprise risk.

Figure 1: Alliance risk versus overall investment/enterprise risk



5.3 Insurance arranged by owner versus non-owner participants

As part of preliminary work, the owner must decide whether to obtain alliance insurance under an owner-arranged or a non-owner participant arranged framework.² It could also be alliance-arranged (by the alliance participants). Often alliances use a hybrid approach consistent with obtaining a best-for-project result and benefiting from the insurer relationships that owners and non-owner participants have with the insurance market.

Option A: Owner-arranged insurance

Owner-arranged insurance (OAI) covers the owner, non-owner participants and sometime includes subcontractors and other service providers, together with other parties at risk.

Option B: Non-owner participant-arranged insurance

Under a non-owner participant arranged insurance (NOPAI) framework, the owner specifies the policy coverage and level of cover required and the non-owner participant arranges the insurance. This is subject to the owner's approval, which should not be unreasonably withheld. The owner is able to appoint a third-party review and interpret the policy to ensure it is adequate and that the coverage and conditions remain current during the course of a contract.

² *Insurance for Government Construction Projects Guidelines*, NSW , October 2004, DC report no. 04080 (Note - In NSW this is referred to as a principal-arranged insurance (PAI) or contractor-arranged insurance (CAI) framework.)

The non-owner participant is required to meet all excesses and other costs not covered by the insurer with each occurrence and claim. Policies must be in the non-owner participant's name with the owner an additional named insured. Policies must cover the non-owner participant, owner and on some occasions all subcontractors to the non-owner participant. They must include cross-liability and waiver of subrogation clauses, where the insurer agrees to waive all rights of subrogation against all the insured.

Option C: Alliance-arranged insurance

Under this option, the owner, non-owner participants and other insureds are named insureds, each has ownership of the insurance policy, and all the insureds have the same right to claim under the policy.

Choice between owner-arranged and non-owner participant-arranged insurance

There are a number of implications, often be characterised as advantages and disadvantages, for both owner and non-owner participant frameworks, including those listed in

Table 1.

Table 1: Implications of owner arranged versus non-owner participant-arranged insurance

	Owner-arranged	Non-owner participant-arranged
Premium cost	<p>The owner has the advantage of bulk purchasing leading to lower insurance premiums.</p> <p>The owner assumes responsibility for considerable work, both in placing insurance and in administering it.</p>	<p>The premium cost for each non-owner participant in aggregate will be higher than the cost for owner-arranged insurance; however, the impact of this cost depends on the amount of the premium cost allocated to the target outturn cost (TOC).</p>
<p>Certainty of cover for the owner</p> <ul style="list-style-type: none"> • Coverage in place • The scope of coverage • Gaps in cover 	<p>This framework provides more certainty for the owner as well as the non-owner participants, although most medium to large contractors have reasonable-sized policies in place that would provide automatic cover up to agreed limits for contract works. (Most insurers would not grant automatic extension of cover to an alliance. Alliances or joint ventures are typically excluded in professional indemnity wordings.)</p> <p>The framework provides more control over the insurance because the owner appoints the insurance advisor and the broker, and directly funds the insurance. It reduces the possibility of gaps in separate covers purchased by the non-owner participants and future covers purchased by the owner for the operational phase.</p>	<p>It is possible that the insurance coverage under this framework is broader than that obtained by the alliance. However, if the non-owner participant insurance coverage is narrower in scope, a concern will arise as to whether that participant is responsible for damage or loss suffered by the alliance in the absence of insurance coverage.</p>
Level playing field for small and medium-sized contractors	<p>This framework introduces a level playing field where small, medium and large contractors have no relative commercial advantage or disadvantage because of the cost of insurance or potential difficulties in obtaining insurance because of their claim history (which could be adverse)</p>	<p>Under this framework, a natural barrier of entry may arise (by size of the enterprise or by adverse claim history) which has implications for the owner, as well as the larger contractors. Exposure of claim history is a useful indicator to the owner of contractors' track record in project delivery, and an adverse history will disadvantage a tenderer.</p>
The owner-arranged framework has the potential to prevent disputes.	<p>Under this framework, there is only one insurance program. Non-owner frameworks may have multiple programs.</p> <p>However, in the case of gaps in cover or disputes, the owner could be liable and will be involved in those disputes.</p>	<p>Under this framework, the potential for disputes can be minimised by understanding and structuring the approach to and process for insurance claims in the alliance agreement. The difficult arises in allocating liability within the alliance, an important step in proceeding with a claim.</p>

Allowing non-owner participants to choose between owner-arranged, non-owner participant-arranged or alliance-arranged insurance is not recommended. The decision should be the sole responsibility of the owner. This decision should be considered at the same time as the insurance requirements (see section 6.5).

5.4 Insurance to be effected by each alliance participant

During the life of the alliance agreement, each alliance member, including the owner and each non-owner participant must put in place and maintain for itself certain insurances. (Non-owner participants must ensure their sub-contractors do the same.) The insurances are:

- *workers compensation insurance* to cover liability arising out of death or injury to those employed by the alliance member, including liability by statute or at common law (unless project-specific workers compensation cover is available)
- *a policy to cover the replacement value of plant and equipment* belonging to, leased, hired or otherwise in the care, custody or control of an alliance participant or their employees, agents or subcontractors – whether on the site or at other places where work under the alliance agreement is carried out
- *comprehensive motor vehicle insurance*, including insurance for third-party liability, for all motor vehicles used by the non-owner participant at any time in connection with the work under the agreement, including for third-party property damage and personal injury in line with relevant laws
- *all other insurances required by relevant laws.*

5.5 Other insurance to be considered by an alliance

It may be appropriate for the alliance to procure other insurance. This should be determined after the risk analysis and advice from appropriate advisors. Such insurance may include:

- *product liability* – insurance in relation to damage such as injury, damage or suffering, caused by the use of a particular product
- *marine hull, cargo and professional and indemnity* – insurance for vessels or goods lost or damage during transport, including marine liability exposures
- *delayed start-up or advanced business interruption* – protects a business owner against losses resulting from project completion delays
- *contractor environmental liability.*

6 Recommended alliance insurance process

This section outlines (in summary form) a recommended process for procuring alliance insurance. There is additional material in the appendices.

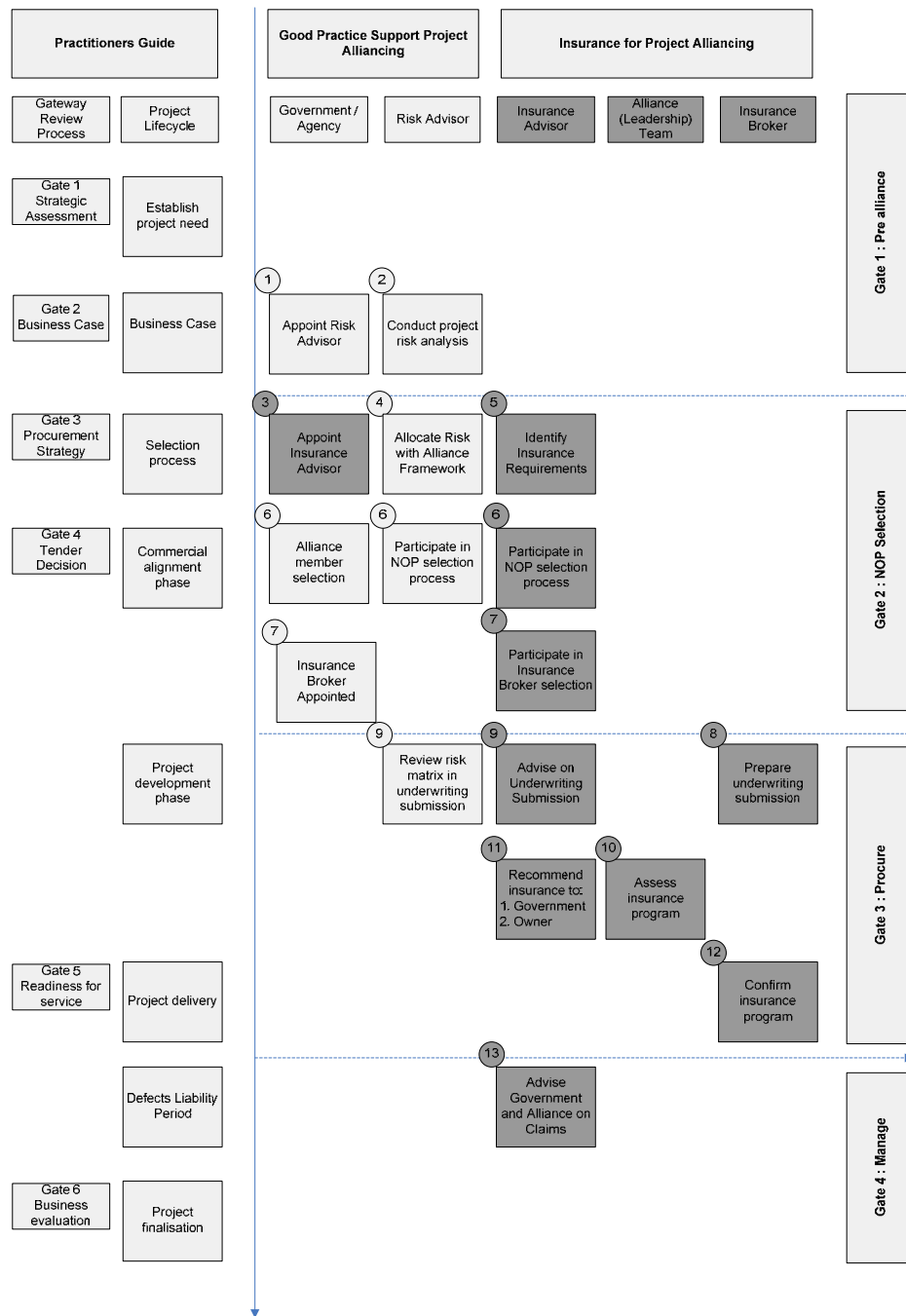
Figure 2 shows the process recommended for insuring project alliances. The steps that relate to insuring project alliance risks are in the darker shade. It should be noted that these insurance steps complement existing processes.

Thirteen process steps are described in this section:

- Step 1: Appoint risk advisor
- Step 2: Conduct initial risk analysis workshop
- Step 3: Appoint insurance advisor
- Step 4: Allocate risk within the alliance framework
- Step 5: Identify the insurance requirements
- Step 6: Alliance member selection
- Step 7: Insurance broker appointment
- Step 8: Insurance broker prepares underwriting submission
- Step 9: Insurance advisor and/or risk advisor review the underwriting submission
- Step 10: Assess the insurance program
- Step 11: Recommend insurance
- Step 12: Confirm the insurance program
- Step 13: Advise government and the alliance on claims.

The most important steps are the appointment and role of the insurance advisor, as well as the advisor's interaction with the owner, the risk advisor, the alliance leadership team and the insurance broker.

Figure 2: Recommended process for insuring alliance projects



Legend

- Existing process step
- Insurance-specific process steps (some new, others already taking place but not necessarily recognised as part of formal insurance procurement process)

6.1 Step 1: Appoint risk advisor

The appointment of the risk advisor (a role that may be led by an individual with a broader role or title such as a commercial advisor), should be considered on all procurements that use the project alliancing method. The appointment does not arise solely in the process of insuring a project alliance.

The advisor should be appointed when the business case is being developed and before the procurement decision.

The risk advisor role can be filled by either an appropriately qualified and experienced internal officer or an external advisor – selected from a pre-approved panel or through a competitive tender process. Appendix G shows a suggested process for appointing third parties.

The risk advisor should be an experienced person or organisation familiar with the risks encountered in similar projects and more generally in project alliancing. The main tasks of the risk advisor are to carry out the risk analysis tasks outlined in Appendix A. In summary, the tasks are to:

- conduct a project risk analysis
- allocate the risks within the alliance framework
- participate in selecting the non-owner participant selection
- review the risk matrix in the underwriting submission (more information in Step 6.8).

The appointment of the risk advisor should be for the period from the development of the business case until at least the time the insurance program is placed.

The risk advisor should be remunerated on a fee-for-service basis.

6.2 Step 2: Conduct initial risk analysis workshop

The risk analysis workshop conducted early in the project's life (during project business case development) is not about identifying insurable risks. At this stage, the main objective is to capture all significant projects risks and develop a risk management strategy. However, one of the mitigation strategies for some of the risks may be insurance.

Participants in the risk analysis workshop should be the owner (and their stakeholders) and the risk advisor. The objective of the risk analysis workshop is to support the project procurement decision. After careful consideration of the characteristics of the project (including the risk profile), the decision may be to select alliancing as the method, where it is demonstrably provides better value for money than other delivery methods.

A complete description of the risk analysis tasks during the risk analysis workshop and subsequent process steps is outside the scope of this guidance note. Appendix A discusses project risk from a project alliance perspective. In summary, the tasks include:

- establishing the risk context of the project
- identifying, evaluating and allocating
- developing a risk management plan.

After the appointment of the non-owner participants, a final risk assessment workshop with all participants and their insurance brokers is often held to finalise the insurance arrangements. The final regime is the end result of a co-operative process, making for better ongoing behaviours.

6.3 Step 3: Appoint insurance advisor

The appointment of the insurance advisor is recommended on all projects procured using project alliancing. This is due to the likely high value of the project and the complexity of obtaining appropriate insurance.

The role of the insurance advisor is to support the process of putting appropriate insurance in place – including overseeing the process of selling the alliance’s risks. It is important for the insurance advisor to be appointed after the procurement decision but before drafting the alliance request for proposal (RFP), so that:

- insurance is considered early in the project, helping alliances avoid making insurance decisions ‘on the run’ later in the process
- a best-for-state approach can be taken in the request for tender (which can also help in guiding subsequent commercial negotiations).

The objective of selling risk by obtaining insurance is the result of a deliberate judgement made on how to treat certain risks. Buying insurance is simply one of many different risk mitigation strategies that the alliance may adopt. When considering the insurance options available, it is important for the alliance to understand that insurance products are custom-made in nature, and that there are substantial differences between products.

The effectiveness of an insurance product should be considered by comparing the underlying insurable risks and the scope of insurance coverage. Leaving aside considerations such as cost, the most effective insurance coverage is one that responds to the insurable risks, and this depends first on the ability of the alliance (and its insurance advisor) to adequately present its insurable risks. Second, it depends on the competency and expertise of the insurance broker to effectively ‘sell’ the insurable risks to the insurance market.

In assisting the owner to ‘sell risk’ rather than buy an insurance product, the advisor’s role recognises that insurance is not a product that can simply be bought off the shelf, but that the advisor can influence the insurance obtained for a project. The objectives of the insurance advisor would therefore be expected to include:

- assisting the state achieve an optimal insurance arrangement for the state and the project
- assisting in managing and, where appropriate, driving down the costs of premiums by capturing and accurately presenting the risks of the project (‘selling risk’)
- assisting in obtaining the best scope of cover for the risks and the insured at a favourable premium.

The insurance advisor is also in a position to support the state in the alliance member selection process. There may be valid reasons related to insurance that could influence the selection process. This may include factors such as claims history or views on the responsibility of insurance procurement (i.e. member-procured or project-procured).

The insurance advisor can be appointed either by selection from a pre-approved panel, or via a competitive tender process in line with that outlined for the appointment of third parties in Appendix G.

The advisor should be a person or organisation capable of performing the tasks outlined below. They should be familiar with the local and international insurance markets that underwrite project alliance risks. The advisor should be a member a relevant professional association such as the:

- Risk Management Institution of Australasia Limited
- Australian and New Zealand Institute of Insurance and Finance
- Institute of Chartered Accountants, Australia
- Institute of Actuaries of Australia.

(A government may have established an authority to act as its insurance manager. Agencies may consider appointing the state authority, if this possible, as the insurance advisor on a fee-for-service basis. See Appendix I.)

The owner should appoint the insurance advisor, and initially the duties and obligations should be to the owner. During the later steps in this process (such as steps 10 and 11, assessment and recommendation of the insurance program), the insurance advisor may also have duties and obligations to the alliance. The main tasks of the insurance advisor are to:

- identify the insurance requirements.
- **assist** in the non-owner participant selection process
- **assist** in selecting the insurance broker
- advise on the underwriting submission
- recommend insurance to the government and the alliance
- advise the government and the alliance on claims.

The appointment of the insurance advisor should be for the period starting from the procurement decision and continuing possibly during the defect warranty stage of the project.

The insurance advisor should be remunerated on a fee-for-service basis.

6.4 Step 4: Allocate risk within the alliance framework

Following the decision to proceed with procurement by alliancing, it is critical to revisit the general project risk analysis and make further decisions on the allocation and treatment of risk. This step allows the risks identified in Step 2 to be allocated between the potential alliance member participants, with the assistance of the insurance advisor appointed in Step 3.

There are only four parties to whom the risk can be allocated:

- the owner – risks retained by the government
- the non-owner participant – risks allocated to or retained by that party (e.g. workers compensation)
- the alliance – risks shared by the members of the alliance (effectively the owner and the non-owner participants)
- the insurer – risks transferred to the insurance company.

It is important to be clear on the ownership of risk as part of identifying the alliance risks that need to be insured, and making sure there are no gaps between the alliance insurance and the non-owner participant insurance. Any overlap of insurance (sometimes referred to as double insurance) also needs to be minimised because this naturally leads to unnecessary costs.

In determining the allocation of risk it is important to achieve the right balance between:

- the 'collective assumption of risk' principle that exists in project alliancing, on the one hand
- the fundamental principle of undertaking project alliancing on the basis of what is 'best for state'.

The allocation of risks is relatively straightforward for some risks such as workers compensation, which is likely to be a risk owned by the non-owner participants, and some less certain risks, depending on the nature of the project.

Being transparent and explicit about risk ownership while allocating risk will help achieve the right balance between the 'collective assumption of risk' principle and the 'best for state' principle.

With regard to the treatment of risk, the options are to either insure or to self-manage it. Where self management is chosen, the owner develops a mitigation strategy. The risk manager should consider a range of strategies including:

- developing the risk management policy and mitigation strategy
- establishing accountability and authority
- customising the risk management processes
- if necessary, re-designing elements of the project.

6.5 Step 5: Identify the insurance requirements

Step 5 is a key step in the insurance procurement process. It progresses the risk analysis and allocation and identifies the risks to be considered for insurance.

The allocation of risk that will be taken to the insurance market should take account of insurance options, specifically the insurance products available for the project risks to be insured. Given the specialist knowledge required for this step, an insurance advisor is likely to provide significant support and advice. Their role in this step is to consider the risks that the alliance would like to insure, and then consider the:

- most suitable insurance product for the risk
- likely availability of the product
- likely cost of the insurance product.

6.6 Step 6: Alliance member selection

The owner will select the non-owner participants against formal tender evaluation criteria.

It is recommended that the risk advisor and the insurance advisor also contribute in the alliance member selection process where appropriate in the commercial evaluation of tenders. This can provide an owner with appropriate specialist advice about a potential non-owner participant's approach to risk and insurance.

6.7 Step 7: Insurance broker appointment

An insurance broker should be appointed on projects undertaken by a project alliance. The broker's role can be described as 'packaging and sale' of the project risks to the insurance market.

Following the risks that are to be insured are identified, the broker takes those risks to market for insurance cover, an important step in the procurement process.

The insurance advisor should participate in broker selection, particularly where the selection is undertaken by a competitive tender process. The insurance advisor should:

- prepare the tender document (if appropriate), including specifying the broker requirements, developing the competency framework, specifying the performance measures
- manage the tender process
- advise the owner on selection
- advise the owner on the broker contract.

The insurance broker can be appointed either by selection from a pre-approved panel, or via a competitive tender process. The key considerations for appointing the insurance broker are described in more detail in Appendix C and include:

- their experience
- the term of the appointment
- remuneration
- duties and obligations of the broker.

Subject to the obligations and role played by state-owned insurers, it is considered unlikely that the insurance advisor could also operate in the broker role. The requirements of these roles need a degree of independence from each other.

6.8 Step 8: Insurance broker prepares underwriting submission

The insurance broker is a specialist in insurance risks and the insurance market. The way in which an insurance broker 'sells' the projects risks is through the preparation of an underwriting submission. This is essentially a sales document that explains the nature of the risks that are to be insured and the basis on which the insurance is requested. (The term 'underwriting' is derived from the original Lloyds of London insurance syndicates where individuals signed their names at the bottom of the documents describing risks to indicate that they had accepted the risk and in so doing 'underwrote' the risks described above their name.)

It is normal practice to prepare underwriting submissions for placing insurance, regardless of the nature of the risk and the identity of the insured. In this regard, preparing the underwriting submission is no different for a project alliance than for any other construction contract.

The underwriting submission not only outlines the project risks but also contains information about the likely terms and conditions of the insurance cover, including the anticipated cost.

6.9 Step 9: Insurance advisor and/or risk advisor review the underwriting submission

The ability to obtain the most suitable insurance for a project alliance largely depends on the skill and experience of the insurance broker. However, it is also very important that stakeholders with a detailed understanding of the project and the associated risks assist the broker in preparing the underwriting document. The insurance advisor and/or the risk advisor may be required to continue to work with the broker to refine the underwriting submission in circumstances where the:

- insurance quotes obtained appear uncompetitive
- insurance terms are not likely to be beneficial
- insurance sought is unavailable.

6.10 Step 10: Assess the insurance program

The alliance leadership team should assess the insurance quotes obtained by the insurance broker. The assessment of the insurance quotes should be conducted in line with the assessment criteria outlined in Appendix E, Assessment of Insurance Cover. The key issues in assessing the insurance cover include the:

- cost
- scope
- limits
- term
- security.

The alliance leadership team may have recourse to the risk advisor and/or the insurance advisor in assessing the insurance quotes.

6.11 Step 11: Recommend insurance

After the insurance program assessment, the insurance advisor should be in a position to advise the owner and the alliance on whether to accept the insurance quotes obtained by the insurance broker.

If this is not the case, it is recommended that the insurance advisor goes back to the step where the recommendation process encountered a difficulty, and starts again from that point. It is likely that the broker would be able to provide the insurance advisor with this information.

6.12 Step 12: Confirm the insurance program

Confirmation of the insurance coverage is critical for good governance and probity. The confirmation of coverage should be provided in line with the documentation in Appendix F. The insurance program that has been agreed must be documented. Documentation should include, at a minimum, the:

- name of parties to the insurance contract
- scope of the cover
- period of the cover
- limits of the cover
- jurisdiction and territorial limitations of the cover.

As well as documenting the detailed terms and conditions of the insurance program, it is important to keep the documents in a secure location so that there is adequate proof of a policy being in place if a claim needs to be made.

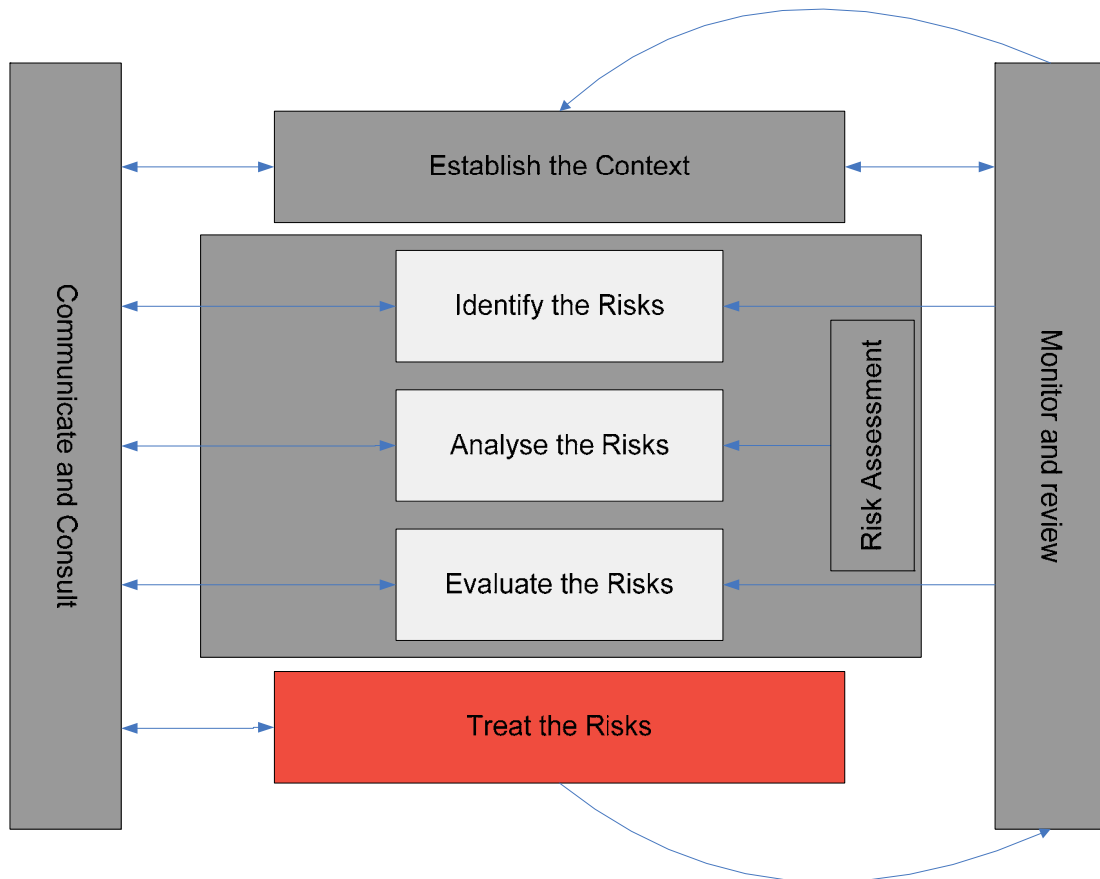
6.13 Step 13: Advise government and the alliance on claims

In the normal course of events, any claims made by the alliance should be handed by the insurance broker. However, due to the complexity of alliance risks and the nature of the possible events and causes that may lead to a claim by an alliance, complications may be expected to arise during the claim process. Where this is the case, the insurance advisor may be retained to advise the alliance and owner, as required, in pursuing their claims.

Appendix A: Confirm risk analysis (post alliance decision)

This appendix outlines a risk analysis process that can be used after the decision to use alliancing as the procurement method.

Figure A1: Alliance risk analysis – broad process



A.1 Establishing the risk context of the project alliance

The context of the risk faced by a project alliance must be established. The context includes the alliance's external and internal environment and the purpose of risk management activities. It also includes considering how the external and internal environments relate to one another.

1. Establish the external context of the project alliance

This step defines the external environment in which the project alliance operates and defines the relationship between the alliance members. This may include, for example:

- the business, social, regulatory, cultural, competitive, financial and political environment
- the organisation's strengths, weaknesses and opportunities, and threats it faces
- external stakeholders
- key business drivers.

It is particularly important to take into account the external context regarding the alliance because of the extent of the externally-generated risks that alliance must manage.

2. Establish the internal context of the alliance

Before starting any risk analysis, it is necessary to understand the alliance members, including the:

- culture of members
- alliance stakeholders
- alliance structure
- capabilities (resources such as people, systems, processes and capital)
- goals and objectives, and the strategies in place to achieve them.

3. Establish the risk management context

The goals, objectives, strategies, scope and parameters of the project alliance should be established. The process considers the need to balance costs, benefits and opportunities. Setting the scope and boundaries for applying risk management to the project alliance involves:

- defining the alliance, process, project or activity and establishing its goals and objectives
- specifying the nature of the decisions that have to be made
- defining the extent of the project activity or function (the time and location)
- identifying any scoping or framing studies needed and their objectives and the resources required
- defining the depth and breadth of the risk management activities to be carried out, including specific inclusions and exclusions
- considering the roles and responsibilities of various parts of the alliance participating in the risk management process
- considering the relationships between the project or activity and other projects or parts of the organisation.

4. Develop risk criteria

This step involves deciding the criteria against which risk is to be evaluated and considering whether risk treatment is required based on operational, technical, financial, legal, social, environmental, humanitarian or other criteria.

5. Define the structure for the rest of the process

This involves subdividing the activity, process, project or change into a set of elements or steps – to provide a logical framework that helps ensure significant risks are not overlooked. The structure chosen depends on the nature of the risks and the scope of the project, process or activity.

A.2 Identify risks

Risk identification using a well-structured systematic process is critical, because a risk not identified at this step is likely to be excluded from further (timely) analysis and treatment. Identification should include risks that are not under the control of the organisation, as well as those that are.

What can happen, where and when?

The aim is to generate a comprehensive list of sources of risks and events that might have an impact on achieving each of the objectives identified in the business case. These events might prevent, degrade, delay or enhance the achievement of those objectives. These risks are then considered in more detail to identify what can happen.

Tools and techniques

After identifying what might happen, possible causes and scenarios need to be considered. There are many ways an event can occur. It is important that no significant causes are omitted. Approaches used to identify risks and their causes include:

- checklists
- judgements based on experience and records
- flowcharts
- brainstorming
- systems analysis
- scenario analysis and systems engineering techniques.

A.3 Analyse the alliance risk

Analysis of alliance risk is about developing an understanding of the risk. This provides an input to decisions about whether and how risks need to be treated, and the most appropriate and cost-effective risk treatment strategies.

Importantly, it leads to the decision on the party to whom the risk should be allocated and whether the risk should be insured.

Evaluate existing controls

It is unlikely that alliances will have existing controls in place to manage the identified risks, but regard should be given to this possibility.

Consequences and likelihood

The effectiveness of existing strategies and controls are taken into account when assessing the magnitude of the consequences of an event, should it occur, and the likelihood of the event and its associated consequences occurring. An event may have multiple consequences and affect different objectives.

Consequences and likelihood are combined to quantify the risk. These two factors can be estimated using statistical analysis and calculations. In the case of alliances, there will typically be no reliable or relevant past data available. Therefore the most relevant information sources and techniques should be used regarding alliances. These may include:

- the past claims record of the alliance members
- practice and relevant experience in wording in design and construct arrangements, as well as alliances
- relevant published literature and market research on alliance members
- the results of consultation with alliance members
- economic, engineering or other models
- specialist and expert judgements.

Types of analysis

Risk analysis regarding an alliance may be more or less detailed, depending on the risk, the purpose of the analysis, and the information, data and resources available. Analysis may be qualitative, semi-quantitative, quantitative or a combination of these, depending on the circumstances.

Some alliance risk estimates are imprecise and a sensitivity analysis should be carried out to test the effect of uncertainty in the assumptions and data. Sensitivity analysis is also a way of testing the appropriateness and effectiveness of potential controls and risk treatment options.

A.4 Evaluate risks

The purpose of risk evaluation is to make decisions (based on the outcomes of risk analysis) about which risks need treatment and the treatment priorities. Risk evaluation involves comparing the level of risk found during the analysis process with risk criteria established when the context was considered. Decisions should take account of the wider context of the risk and include consideration of the risk tolerance of the parties, which in turn should lead to the allocation of the risk.

A.5 Allocation of the risk

There are only four parties to whom the risk can be allocated:

- the owner – risks retained by the government
- The non-owner participant – risks allocated to or retained by that party (e.g. workers compensation)
- the alliance – risks shared by the members of the alliance (effectively the owner and the non-owner participants)
- the insurer – risks transferred to the insurance company.

It is important to be clear on the ownership of risk as part of identifying the alliance risks that need to be insured, and making sure there are no gaps between the alliance insurance and the non-owner participant insurance. Any overlap of insurance (sometimes referred to as double insurance) also needs to be minimised because this naturally leads to unnecessary costs.

In determining the allocation of risk it is important to achieve the right balance between:

- the 'collective assumption of risk' principle that exists in project alliancing, on the one hand
- the fundamental principle of undertaking project alliancing on the basis of what is 'best for state'.

The allocation of risks is relatively straightforward for some risks, such as workers compensation, which is likely to be a risk owned by the non-owner participants, and some less certain risks, depending on the nature of the project.

Being transparent and explicit about risk ownership while allocating risk will help achieve the right balance between the 'collective assumption of risk' principle and the 'best for state' principle.

A.6 Treat risks

Risk treatment involves identifying the range of options for treating risks, assessing these options and preparing and implementing treatment plans. For

project alliancing, the treatment options may be classed as either sell or retain the risk.

The *sell* option is to buy insurance to cover the risk. This can be achieved if either the owner, the non-owner participant, or the alliance sells the risk in the insurance markets. The process for considering the insured risks is described in Appendix B of this guidance note.

The *retain* option is to manage the risk. For project alliancing, this requires:

- risk management policy and planning
- project design and possibly redesign
- establishing accountability and authority
- customising the risk management processes
- ensuring there are adequate resources.

Appendix B: Identification of insurable and non-insurable risk

B.1 Background

'Project alliancing should generally only be considered in the delivery of complex and high-risk infrastructure projects, where risks are unpredictable and best managed collectively. The decision to use project alliancing must be based on a robust understanding of the project risk, including risks that cannot yet be determined or scoped. Organisations must also ensure they have the understanding and resources required to deliver projects through project alliancing.'³

A comprehensive risk assessment must take place before a procurement decision is made. Once the procurement decision is finalised and approved, this risk assessment should be re-visited in light of potential implications given the risk positions taken by respective procurement methodologies.

This appendix provides guidance once the risk assessment is confirmed for delivery of the project by alliancing. The many unique characteristics of an alliance create distinct challenges for risk assessment and insurance procurement. The notion of 'no blame' is fundamental to the concept of a project alliance and this must be properly reflected in the risk assessment.

This appendix proposes that the insurance advisor leads a review of the confirmed risk assessment for an identification of insurable and non-insurable risks.

B.2 Risk assessment for project alliances

Following confirmation of the risk assessment for the alliance project, the risk advisor should work with the insurance advisor to discuss the nature and extent all key risks. The process and outcomes of this assessment should form the basis for determining the alliance's insurance program.

Legal and contractual considerations in risk assessment

Concerns have been raised that the drafting of 'no blame' or 'no litigation' provisions in some alliance agreements may be void. This is because breaches of these aspects are claimed not to be under the court's jurisdiction, apart from those involving wilful default. Other concerns have been raised regarding the extent of exposures or risks that are believed to be covered, or may unintentionally be covered, by the 'no blame' provisions.

In addition to the services of an insurance advisor, specialist legal advice may need to be obtained to identify and manage these risks and ensure that certain risks should not be borne by the alliance, but retained by the individual alliance participants (refer to B4 below).

The intent and effectiveness of the alliance agreement must be fully understood before completing the detailed risk assessment of insurable and non-insurable risks.

B.3 Identification of insurable risk

The insurance advisor needs to lead a discussion of which risks should be insured. Insurable and other risks can be categorised as:

³ *Project Alliancing Practitioners' Guide* (page 3), Department of Treasury and Finance, Victoria, April 2006

- those to be covered by insurance required by legislation, such as workers compensation insurance, that is to be taken out by the state and participants to cover their employees
- risks that are fundamental to the alliance project, which should be considered on a 'no blame' basis
- professional indemnity risks (These require special consideration, as the 'no blame' provisions of an alliance agreement preclude liability arising between the alliance participants (except in cases of wilful default) and so must be covered by project specific 'first-party' professional indemnity insurance.)
- risks that should be fully retained by the state
- risks that are transferred or allocated directly to participants under the contract, which the participants may in turn insure against – where insurance is available and they are insurable, considering market conditions
- those risks where the level and/or nature of the risk is such that the state accepts the risk, which may or may not be covered by insurance and/or be insurable, considering market conditions
- those risks where it is prudent for the state to arrange insurance on behalf of the state and/or participants or to 'top up' the participants' insurance.

In deciding whether the alliance should be required to insure against the risk, and the extent of insurance, it is recommended that owner, as well as alliance participants once appointed, consider the:

- commercial availability of the insurance, including limitations on policy wording regarding exclusions and limits
- cost of insurance premiums and excesses.

B.4 Identification of risks not shared with the alliance

Although the underlying principle of an alliance is that project risks are shared, it is appropriate that some risks are fully retained by one participant where that participant has either the legislative responsibility for the risk (e.g. health and safety or federal taxation) or full control of the risk without any input from the alliance. For example, risks the owner may retain fully (particularly where full control of risk management is also desirable) are native title, cultural heritage and material procurement with long lead times.

Certain professional indemnity risks should also be fully retained by the participants and not passed on to the alliance. Such risks include responsibilities under the alliance agreement and other contractual representations made during the alliance participant selection process.

However, allocated risks should be kept to the absolute minimum – to reinforce the collective responsibility of the participants for delivering the project.

Appendix C: Broker appointment

The key terms in this section are to be included in the appointment of a broker for an alliance project.

C.1 Selection of the broker

The owner selects the broker for an alliance project using the following selection criteria:

- previous experience in placing alliance risks
- a demonstrable understanding of the alliance project risks
- international presence or strong international alliances to assist in placing risk in overseas insurance markets
- an explicit commitment to maintaining consistency with the client service team.

While initially each participant may be advised by its own broker, once a decision is made on who will be the principal, the principal should appoint the broker to supply the services to the principal. For example:

- If the insurance is to be non-owner participant-controlled, then the non-owner participant should be entitled to appoint its broker of choice (i.e. the non-owner participant arranged (NOPA) framework).
- The alliance should probably appoint a placing broker if it is collectively controlled (i.e. the alliance-arranged framework).
- The owner appoints the broker to supply the services to the owner (i.e. the owner-arranged (OA) framework).

C.2 Appointment and term of the broker

The principal will formally appoint the broker under a Broker Services Agreement. The term of the appointment will be for the duration of the alliance project, plus the insurance coverage period.

C.3 Broker remuneration

The service fee should not be subject to adjustment.

Only in exceptional circumstances should broker remuneration consist of brokerage. An example of an exceptional circumstance might include:

- where there is an extremely limited market for type of cover being placed by the broker
- where it is necessary to use a broker network consisting (for example) of a retail broker and a placing broker. In this example, the placing broker would have no contractual remuneration arrangement with the alliance.

Any form of broker commission should be discouraged. It is a requirement of the Broker Services Agreement that any form of broker commission paid or due to the broker is fully disclosed to the principal, and that the broker warrants that all broker commissions (if any) are fully disclosed.

C.4 Duties and obligations of the broker

In providing the services under the contract, the broker must:

- undertake a risk analysis
- provide, at their own expense, all materials, equipment and tools necessary to perform the services in line with the contract
- not interfere with, disrupt or hinder any of the principal's activities
- keep proper records of the time taken in supplying the services and give the principal copies of those records when asked
- use or copy the contract material and the principal's material only for providing the services and no other purpose
- use the principal's material only in line with conditions attaching to the that material's use – of which the principal or the principal's representative informs the broker
- keep the principal fully informed of all aspects of its performance of the services (including its safety and health performance), and when asked, discuss with the principal and the principal's representative the performance of the broker's obligations under the contract or the services
- if requested by the principal or the principal's representative, attend meetings arranged by the principal or the principal's representative to review the progress of, and any other matters related to, the services; and submit reports on the progress of the services at the frequency required, and in the format requested by the principal
- be responsible for the safekeeping and maintenance of all the principal's confidential information and intellectual property rights (except where confidential information and information on intellectual property rights has to be disclosed by the principal to insurers to comply with its statutory and common law duties of disclosure. In this case, disclosure is at the risk of the principal. However, the broker will require insurers to sign a confidentiality agreement in favour of the principal if the principal requires this.)
- take all steps necessary to protect the safety and health of people, and property at or in the vicinity of the site.

C.5 Appointment of service team

The broker must ensure that all services are at all times executed by, and under the supervision of, competent, available, appropriately qualified, trained, experienced and skilled personnel.

If asked by the principal, the broker must provide the principal with a detailed organisation chart showing key personnel's positions, job descriptions and reporting relationships and any other information the principal requires regarding the key personnel.

The broker will use their reasonable endeavours to supply and retain the key personnel, promptly inform the principal if any of them leave the broker's employment, or give notice of an intention to leave.

The broker may enter into subcontracts for performing any part (but not the whole) of the services – with the prior written approval of the principal (which must not be unreasonably withheld).

Appendix D: Types of insurance cover

D.1 Contract works insurance cover

A contract works insurance policy typically **include** cover for the following risks:

- damage to materials, goods, equipment and supplies forming a permanent part of the works
- damage to temporary work required to construct the works, including props and slipforms
- removal of debris
- consultants' fees in rectifying damage
- government charges associated with rebuilding and rectification
- preparing plans, files, records and specifications relating to the works rectification, including computer software
- damage to buildings used for construction purposes.

A contract works insurance policy typically **excludes** cover for the following risks:

- damage to plant and equipment owned by a contractor, unless declared
- damage to leased equipment if not required to be insured by the lessee
- damage to vehicles on site
- damage to water borne craft exceeding 8 metres in length
- personal injury
- breaches of professional duty
- workers compensation.

Some risks may also be included in the insurance for the payment of an additional premium includes the following:

- high-risk civil engineering works
- levee bank and coffer dam construction
- goods in transit and stored off-site.

D.2 Public liability

A public liability insurance policy typically covers the following risks:

- indemnity for the insured for all amounts for which the insured becomes liable regarding, or arising out of:
 - personal injury
 - property damage
 - advertising liability
- costs and expenses incurred by the insured in connection with or incidental to:

- providing medical aid to any person
- protecting property
- mitigating, containing or suppressing actual or possible loss
- all costs associated or connected with or incidental to the investigation, settlement or negotiation of a claim
- all costs recoverable from the insured by a claimant
- all costs and expenses connected with or incidental to the investigation, defence, negotiation or settlement of the insured by any official investigation or examination.

A public liability policy typically excludes cover for the following risks:

- property damage or bodily injury caused by a motor vehicle where the motor vehicle is insured. (Bodily injury in this case is covered by compulsory motor vehicle third party (CTP) insurance.)
- injury to the insured's employees, which is to be covered by workers compensation insurance
- loss arising from the professional services provided by the insured
- risks associated with asbestos
- product liability; however, product liability and public liability insurance are often sold together
- liability arising out of aircraft, watercraft or vessels (if they exceed agreed specifications).

D.3 Professional indemnity

The scope of cover in a professional indemnity policy varies significantly depending on the nature of the alliance project and the underlying risks, as well as whether the policy offers first-party and third-party cover. Typically, the scope of cover for a professional indemnity policy includes:

- breach of professional duty
- negligence
- bodily injury and property damage arising from negligence
- fraud or dishonesty, other than a company director's dishonesty
- infringement of intellectual property
- breach of duty or confidentiality
- defamation
- loss of documents
- legal costs.

The main difference between third-party and first-party cover is the trigger event. A third-party contract is typically triggered by a claim of one party against another. A first-party insurance policy is triggered where the alliance makes a claim in its own right, independent of any third-party claim.

Appendix E: Assessment of insurance cover

E.1 Introduction and overview

The assessment of the insurance cover should not be driven by the cost of insurance. However, the cost of the insurance is an important consideration because it directly affects the project outturn costs. The insurance cover cost is driven by many factors:

- The capital supply in the insurance markets for the type of cover sought will be a factor.
- The insurable risks identified during the risk analysis will largely determine the scope of coverage of the insurance procured.
- The scope of coverage of the insurance, and in the case of professional indemnity, the trigger for calling on the coverage, will have a direct impact on the cost of the insurance.
- The limits of cover and timing of the insurance cover will directly affect the cost of the insurance cover.
- The security of the insurer from whom cover is purchased.

The primary test to be applied when assessing the appropriateness of the insurance cover is whether the insurance is 'best for state'. A secondary test should also be undertaken by adopting the balanced decision criteria.

E.2 Balanced decision criteria

Cost of insurance

When considering the cost of the insurance, the main question is whether the insurance represents value for money. This is a difficult and highly subjective concept, for the reasons stated above. A number of objective tests may be undertaken, including:

- Ask the broker to provide quotes of other insurance markets not accepted, and compare reasons for the price differences.
- Benchmark pricing with comparable projects using a normalised metric, for example, rates on line (premium/limit of cover) or rates by asset value having regard to differing cover scope and deductible levels.
- Undertake a sensitivity analysis by modifying the insured risks and assessing the impact.

Scope of cover

The starting premise for the scope of the cover is that all reasonable insurable risks identified in the risk analysis should be insured. That is, there has been a considered assessment leading to the preferred coverage that has included certain potentially insurable risks not being covered on the basis of a cost/benefit judgement. Regard should also be had to the participants own insurances. (In some cases some of the participants might have umbrella policies which does not make it cost effective to take out policies to additionally cover all reasonable insured risks.)

The scope of cover offered to project alliances is typically a point of differentiation of brokers. In placing the insurance for a project alliance, the skill of the broker is very important in identifying right insurance markets and

presenting the alliance risks. In assessing the scope of coverage the onus should be placed on the broker to demonstrate that:

- the appropriate insurance markets have been approached
- the risks have been appropriately packaged and presented so that the underwriters fully understand the risks being presented
- the scope of coverage is comparable to leading practice.

It is fundamentally understood, particularly in relation to professional indemnity, that the alliance will only provide cover for alliance risks. The professional indemnity risks retained by alliance members is identified in the risk analysis process.

Limit(s) of cover and attachment point

The limits of cover purchased vary according to the identified risks and the class of insurance. As a starting point, the limits of cover to be purchased are:

Contract works: The limit of cover purchased should be equivalent to the value of the contract, but may also include a contingency, depending on the project.

Public and product liability: The limit of public and product indemnity insurance is wholly connected to the scope of coverage. Factors to be considered include the nature of the site work, the contract value and size, the risks of the activity to others, and the number and type of contractors. Generally speaking, the amount of \$50 million for public and product liability cover would be considered typical.

Professional indemnity: The limit of professional indemnity insurance is also wholly connected with the scope of coverage. Assistance with evaluating the level of cover required, including through a project risk assessment approach, is available in the Australian Procurement and Construction Council Incorporated (APCC) Professional Indemnity Insurance Guidelines in the Building and Construction Industry (the APCC Guidelines). Available at www.apcc.gov.au, this document outlines two main approaches to establishing the level of cover:

1. The first is a simplified method that applies for conventional consultancies not related to construction. The simple approach is to base the level of cover on the fee to be paid. The minimum level of cover recommended with this approach is whichever is the greater – \$1 million, or 10 times the fee amount. Generally speaking though, the amount of \$1 million for professional indemnity cover would be considered insufficient and \$20 million of professional indemnity cover would be typical.
2. The more comprehensive approach is the risk assessment-based method, which addresses the particular risks associated with the type and nature of the professional service involved. Tables in the APCC Guidelines can assist in the initial evaluation of the project risk and the service risk.

Term: The term of the cover purchased will vary according to the identified risks and the class of insurance. At a minimum, the term of the cover should be the period of construction and defect warranty period. Consideration should be given to the requirement for a retroactive start date where certain activities such as design and construct begin before the date that insurance is sought.

A typical period for project-specific first or third-party alliance insurance is from seven to ten years from project commencement.

E.3 Security

The alliance should determine and prescribe the minimum security rating of insurers on long and short-tail alliance risks based on advice from the insurance broker. Generally speaking, insurers should have a Standards & Poors rating of no less than A-. Where possible the selection of insurers should be limited to APRA regulated insurers or insurers that are subject to a comparable regulatory regime.

Appendix F: Documentation

F.1 Form of documentation

Unless there are valid reasons for an insurance policy to be kept confidential, the owner is entitled to a copy of the policy and its schedules at least 10 business days before inception or renewal. Evidence should be sought by obtaining a certificate of currency; however, as policies can be changed and even cancelled at any stage, it is prudent for service providers to confirm the currency of a policy at various stages during the course of a contract or contracts.

F.2 Description of insurance coverage

In general terms a certificate of currency should specify the:

- name(s) of the insured/alliance members
- policy number
- scope of cover – a description of acts and events that are covered
- coverage period, including reporting period if appropriate
- name of the insurer(s)
- limits of cover, including sub-limits and aggregate cover
- summary of the cover provided, important exclusions, excesses and similar items
- jurisdiction and territorial limits.

This list is very generic and is not intended to be exhaustive. Other policy details for the specific type of insurance should also be included, as required.

F.3 Role of the insurance broker and the alliance

It is the responsibility of the insurance broker to prepare the certificate(s) of currency for the alliance. This is to be within a reasonable time of the insurance coverage being bound, but no later than five days after acceptance by underwriters. It is the alliance's responsibility to ensure that the certificate(s) of currency are complete and accurate.

Appendix G: Process for the appointment of third parties

G.1 Preliminary considerations – third-party appointments

A third-party appointment helps with good governance and provides a framework under which good commercial decisions can be made and tested. These appointments need to follow normal procurement policies, guidelines and best practices

The scope of third-party appointments in project alliancing includes the:

- risk advisor
- insurance advisor, including, if appropriate, the government specialist authority (e.g. in Victoria, the Victorian Managed Insurance Authority)
- the insurance broker (which may be an external party or the government's insurance authority).

A third-party appointment does not include subcontractors, agents and representatives.

G.2 Risk advisor appointment

The risk advisor selected should be a person or organisation familiar with the risks encountered in project alliancing and, where appropriate, should be a member of a relevant professional association such as the:

- Risk Management Institution of Australasia Limited
- Australian and New Zealand Institute of Insurance and Finance
- Institute of Chartered Accountants, Australia.

The risk advisor should be appointed by the owner, and the duties and obligations of the risk advisor are to the owner.

The risk advisor is appointed by the owner at the time the business case is being developed. The main tasks of the risk advisor are to perform the risk analysis tasks outlined in Appendix C:

- conduct a project risk analysis
- allocate the risks within the alliance framework
- participate in the non-owner participant selection process
- review the risk matrix in the underwriting submission.

The appointment of the risk advisor should be for the period starting from the development of the business case until the time that the insurance program is placed. The risk advisor should be remunerated on a fee-for-service basis.

G.3 Insurance advisor appointment

The insurance advisor selected should be a person or organisation capable of performing the specific tasks outlined below, and should be familiar with the local and international insurance markets that underwrite the risks of project

alliances. The insurance advisor should be a member a relevant professional association such as the:

- Risk Management Institution of Australasia Limited
- Australian and New Zealand Institute of Insurance and Finance
- Institute of Chartered Accountants, Australia
- Institute of Actuaries of Australia.

The owner should appoint the insurance advisor, and initially the duties and obligations should be to the owner. During the later steps in the process (such as steps 10 and 11, assessment and recommendation of the insurance program) (refer to section 6.10 and 6.11 of the guidance notes), the insurance advisor may also have duties and obligations to the alliance.

The main tasks of the insurance advisor are to:

- identify the insurance requirements.
- participate in the non-owner participant selection process
- participate in selecting the insurance broker
- advise on the underwriting submission
- recommend insurance to the government and the alliance
- advise the government and the alliance on claims.

The appointment of the insurance advisor should be for the period starting from the procurement decision and continuing possibly during the defect warranty stage

The insurance advisor should be remunerated on a fee-for-service basis.

G.4 Insurance broker appointment

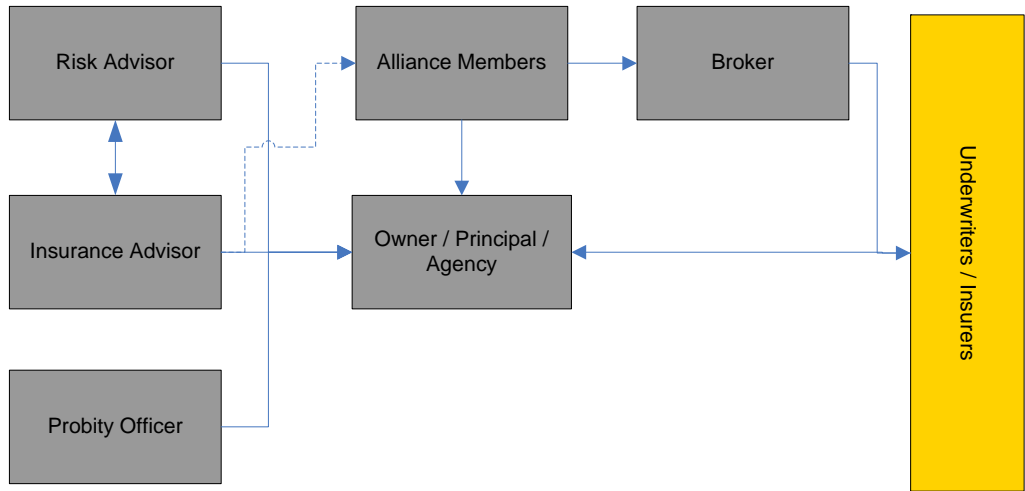
The appointment of the insurance broker is critical in achieving the objectives of the alliance and the owner. The broker should be appointed by the owner, although the duties and obligations of the broker should be for the benefit of the owner and the alliance. This form of appointment is known as principal-arranged insurance.

Appendix C has a summary of the key terms to be negotiated with the insurance broker.

G.5 Governance structure

An optimal governance structure must be set up. Figure G1 shows such a structure.

Figure G1: Alliance governance structure



Appendix H: Compensation framework for alliances

The compensation framework of a project alliance is a key mechanism for aligning the objectives with the project objectives. Under a project alliance, the owner and the non-owner participants develop and scope the project jointly and agree a target cost and performance targets. The alliance participants then take collective responsibility for delivering the project and achieving the agreed targets, sharing in financial pain or gain, depending on how actual outcomes compare with the agreed targets.

Once the target costs and performance targets have been agreed, the non-owner participant compensation is determined according to the following three-limb model:

- Limb 1 includes the expenditure on the work under the alliance (including mistakes, re-work and wasted effort) – project-specific overheads related to the work under the alliance are reimbursed at actual cost, subject to audit.
- Limb 2 comprises a fee to cover normal profit and a contribution towards recovery of non-project-specific overheads.
- Limb 3 comprises an equitable pre-agreed share of the pain or gain, depending on how actual outcomes compare with pre-agreed targets.

Note

Care should be taken in assessing Limb 1 and Limb 2 that insurance costs are not inherently included, or that insurance recoveries do not positively impact on Limb 3.

Each non-owner participant is reimbursed for their actual costs incurred on the project, including costs associated with mistakes and re-work. Limb 1 must not include contributions to corporate overhead or profit. There should be no contributions to administrative or support functions not directly involved in performing the work under the alliance agreement.

Under Limb 2, each non-owner participant should be paid a fee that reflects their normal business margin for corporate overheads and profit margin. There are two approaches: the fixed-fee and the floating fee approach. There are no rules for determining which approach to adopt, although it is common in infrastructure projects to adopt a mixture of the two approaches; here the non-owner participant's Limb 2 fee is fixed, and the designer's Limb 2 is paid as a percentage of actual costs.

Care needs to be undertaken in understanding whether the cost of insurance is included, explicitly or implicitly, in calculating Limb 1. The use of insurance claim proceeds also needs to be made clear. There are some important consequences arising from these issues:

- If insurance costs are included in Limb 1, insurance costs will effectively be double-counted where an explicit cost of insurance is allocated to the alliance.
- If insurance costs are included in Limb 1, then they will also be included in Limb 2 where it is calculated as a percentage of Limb 1.
- Assuming that:
 - Limb 1 includes (for example) rework, and
 - if rework is an insurable event, and
 - if an insurance claim is made and the proceeds are for the benefit of the alliance, then non-owner participants may be unintentionally benefiting under Limb 3.

During the development phase of the project alliance, the owner and the non-owner participants develop and agree on various performance targets that form the basis of the three-limb pain/gain arrangement. Notably, the owner and the non-owner participants agree the target outturn cost (TOC) and the target cost estimate (TCE).

it is recommended that the cost of risk should be included in the TOC, but the cost of insurance should not be included in either Limb 1 or Limb 2 of the non-owner participant compensation. The cost of insurance should be included in the TCE and TOC, but as a direct cost to the alliance, rather than a cost of the non-owner participants.

APPENDIX I: State Insurance Authorities

Each state has self insurance arrangements usually administered via a statutory insurance authority providing advisory services and insurance for their nominated public sector clients. This Appendix provides information on the respective state authorities.

I.1 Victoria

The Victorian Managed Insurance Authority is a statutory authority established under the Victorian Managed Insurance Authority Act 1996 (VMIA Act). The authority acts as insurer for Victorian government departments and *participating bodies*⁴ and has a broader charter allowing it to provide insurance and risk management services to all Victorian government agencies.

The VMIA has a mandated role to provide risk management advice to the State⁵. When VMIA provides agencies with such advice, it does so on the basis of a *best for state* approach. This means that VMIA provides such advice in consideration of the State's capacity to retain risks as distinct from merely the requirement to transfer such risks to the commercial insurance market. This approach means that any insurance program may not necessarily need to be the sole means by which risks can be transferred. This approach is underpinned by the need to ensure that the procurement of insurance for the Alliance achieves value for money for the State by not passing on those risks where the State would be better able to retain the risk.

The scope of the VMIA services

Broadly:

- For government departments and participating bodies (“clients”)
 - act as an Insurance Adviser in Alliance projects (at the choice of the client);
 - provide insurance products where the client is the sole insured covered or where the client has obligated itself pursuant to a Project Alliance Agreement (‘PAA’) to insure all parties within an Alliance (clients are mandated by the VMIA Act to use VMIA); and
 - in defined circumstances, as would be set out in Ministerial Directions that may be issued from time to time pursuant to section 25A of the VMIA Act, may provide Alliance professional indemnity insurance to bodies (State and private) within a project alliance.
- For Victorian agencies not departments and not participating bodies (“non-client”)
 - act as an Insurance Adviser in Alliance projects (at the choice of the “non-client”); and

⁴ As defined in Part 1, 3 Definitions of the Victorian Managed Insurance Act 1996

⁵ As per Part 2, Section 6 (e) of the Victorian Managed Insurance Act 1996

- it an advisory role it can ensure the project's Broker has acquired the most suitable insurance cover for the Alliance but it cannot insure nor become involved in insurance placements if the entity is not a client (VMIA Act S.4 or S.25A).

VMIA in the role of Insurance Adviser

The VMIA is able to undertake the role of Insurance Adviser to the Alliance and can provide support to the Risk Adviser where required (including input into the Project Risk Analysis Workshop). The VMIA can be retained by all Victorian government agencies on a fee for service basis in the role of Insurance Adviser.

The key activities of the VMIA as Insurance Adviser to defined VMIA clients are as follows:

- Assist with Project Risk Analysis
- Inform the allocation of risks within the Alliance Framework
- Articulate a best for state approach to insurances in the Alliance expression of interest and RFP
- Assist the project owner to articulate the approach to Owner Arranged Insurance versus Non Owner Participant Arranged Insurance
- Develop the Underwriting Submission for placement either with VMIA or the commercial insurance market
- Review insurances of Non Owner Participants
- Finalise and confirm agreed insurance arrangements for the Alliance
- Provide ongoing support to the Alliance in relation to claims, premium adjustments and policy changes

Where the VMIA is providing assistance as Insurance Adviser to non VMIA clients, in addition to the above the VMIA would also:

- Advise on the selection of the Insurance Broker
- Provide an independent assessment of the Insurance Program for the Alliance and Non Owner Participants
- Review insurance documentation for the Alliance and Non Owner Participants including policy wordings and schedules
- Advise the Government and the Alliance on claims handling protocols and on the resolution of any claims

The VMIA has an important role in providing impartial and independent advice to State Government clients involved in Alliances. The VMIA recognises the inevitable tension that exists between an insurance program that maximises the good faith behaviour of Non Owner Participants and optimises the transfer of potentially insurable risks by the Alliance. By providing expert insurance and risk advisory services to State Government clients, the VMIA will be working to increase the transparency of decision making in relation to insurance procurement and aiding the skills of government personnel in alliance related insurance matters.

VMIA providing insurance products

Should the VMIA provide insurance products to the VMIA client, in its capacity as the State's insurer, the VMIA would charge appropriate premiums in relation to those required policies commensurate with the risk being transferred.

In relation to non clients, the VMIA can offer an independent advisory service to ensure that the Alliance selects an insurance program that achieves

outcomes of best for State and value for money. The VMIA would advise on the suitability of the insurance program including the individual policy terms and conditions.

The VMIA would not be able to provide insurances to non-clients and any request to do so would need to be actioned in accordance with the provisions of the VMIA Act.

I.2 Western Australia

The Government of Western Australia adopted a Managed Fund approach to administer all insurable risks of its public authorities who are RiskCover Fund members (agencies) on a self-insurance basis. The RiskCover Fund is underwritten by the Crown and is managed by the Insurance Commission of Western Australia (RiskCover Division) on behalf of the Government of Western Australia and its participating state government agencies.

The Insurance Commission of Western Australia Act 1986 authorises the Insurance Commission (RiskCover Division) to:

- manage and administer insurance and risk management arrangements on behalf of Western Australian public authorities;
- provide services, facilities and advice to public authorities in respect of the management of claims against them or against funds maintained or administered by them under any written law; and
- provide advice to Government on matters relating to insurance and risk management.

Up to this point, RiskCover participating agencies have had limited involvement in alliance contracting and consequently there has been little call on RiskCover to provide services in relation to such arrangements. RiskCover's enabling legislation does not allow it to issue policies of insurance covering alliance projects, or any insurance covering non government entities.

The services RiskCover is able to offer in relation to alliance contracting are thus limited to providing insurance and risk management advice to participating state government agencies, which would include assistance:

- by way of the facilitation of a risk analysis of contracting options (i.e. alliance, design and construct, PPP etc);
- with project risk analysis, the development of risk management strategies and the implementation of a risk management framework;
- with determining the best insurance options for the State including participating agencies' consideration of Owner Arranged Insurance versus Non Owner Participant Arranged Insurance and Alliance Arranged Insurance options;
- with the review of insurances of Non Owner Participants for the participating agency;
- with the review of insurance documentation for the Alliance for the participating agency; and
- with the selection of an insurance broker if required.

I.3 New South Wales

The NSW Self Insurance Corporation (NSW SICorp) is the statutory authority established by the *NSW Self Insurance Corporation Act 2004* to manage the Government's self insurance scheme know as the NSW Treasury Managed

Fund. NSW SICorp operates as a branch of NSW Treasury and is responsible to the NSW Treasurer.

NSW SICorp utilises a wholly outsourced provider model. The current model has five claims management contracts, and separate actuarial, reinsurance and risk management contracts.

Main functions

SICorp's main functions are:

- the administration of the Treasury Managed Fund (TMF), which provides cover for all insurance exposures faced by general government sector budget dependent agencies in New South Wales (other than compulsory third party insurance); and provides cover for all insurance exposures faced by other public sector agencies who choose to join the TMF;
- the management of liabilities from a number of closed schemes. The closed schemes are the Governmental Workers' Compensation Account, the Transport Accidents Compensation Fund, the Pre-managed Fund Reserve and the Rail Infrastructure Corporation;
- the collection and analysis of data provided by TMF claims managers; systems management of the TMF data warehouse; provision of reporting functions to member agencies and monitoring of claims providers; and provision of financial statements and budget estimates;
- provide insurance policy advice to all stakeholders on behalf of the NSW Government; and
- advise member agencies and claims managers on scope of coverage available.

Scope of cover

The Contract of Coverage dictates the New South Wales government's response to the TMF agencies when loss or damage is suffered. The TMF provides unlimited cover worldwide in respect of:

- Workers' Compensation as per NSW statute;
- liability, including, but not limited to, public liability, products liability, professional indemnity, directors/officers liability and medical negligence;
- property (full replacement, new for old, and consequential loss);
- motor vehicle; and
- miscellaneous losses, notably, due to employee dishonesty, personal accident and protection for overseas travel.

The extent of cover provided under the TMF's Contract of Coverage is unique to TMF agencies. Exposures not included are:

- illegal activities;
- wear and tear, and inherent vice; and
- pollution (not being sudden and accidental pollution).

The TMF is protected from catastrophic losses by a wide-ranging reinsurance program.

Risk Management

The TMF scheme is designed to financially reward agencies that manage risk and to penalise those that do not. This principle provides a fundamental

incentive for agencies to seek to understand and manage the organisational systems and processes that lead to the wide range of unwanted outcomes which, in this environment, become evident in the form of claims against the Fund. The TMF has a range of risk management resources to support agencies.

Insurance Advisor

The SICorp Insurance Advisor role encompasses:

- to advise and support TMF agencies participating in Alliance Contracting;
- SICorp personnel and contracted service providers are available to assist and advise with regard to contractual requirements, indemnity wordings and risk assessments;
- provide agencies with advice on recommended deductibles, insurable risk limits and indemnities;
- SICorp's risk services provider can where required refer agencies to third party providers;
- SICorp as a branch of Treasury is able to weigh the potential insurable and financial risk against the need for contract delivery and Alliance outcomes;
- assist agencies to ensure that contract deliverables do not adversely impact the State; and
- SICorp's reinsurance broker can access the international reinsurance market and niche market providers.

I.4 Queensland

The Queensland Government Insurance Fund (QGIF) is a managed insurance fund located within Queensland Treasury. The operation of QGIF focuses on assisting insured agencies to manage their property and liability risks more effectively.

QGIF's Role

QGIF's primary role is that of the insurer of Queensland Government departments and selected statutory bodies. The QGIF operation is based on an insurance company model, which means that insurance risk is underwritten to ensure that sufficient funds are available to meet the cost of claims. QGIF is responsible for the setting of insurance premiums and terms, the management of claims and the provision of insurance advice to insured agencies.

QGIF offers eight classes of insurance to departments and eligible statutory bodies. Departments and eligible statutory bodies have a responsibility to insure risk exposures that they have with QGIF, provided that the risk exposure is one that can be insured under one of the eight classes of insurance that are available. Government-owned corporations are not eligible to insure with QGIF and nor does QGIF provide insurance to any other non-State Government entities.

In its role as an insurer, QGIF underwrites risk exposure, issues insurance policies, invoices its insured agencies for premium and provides advice on insurance risk exposures. QGIF also manages claims that are made by the insured agencies seeking indemnity under their QGIF insurance policy for:

- cost of claims against them by third parties for damages or compensation;
- loss of or damage to insured property; and
- additional cost resulting from loss or damage to insured property, and personal accident and illness benefits for specified persons.

The management of a claim continues until it is resolved, all payments made, recoveries effected and the file closed. QGIF, as the claim manager, has the objective of managing claims so that the best outcomes available are achieved for the State of Queensland.

QGIF has an insurance advisory role across the whole of Government and a risk management support role for its insured agencies.

Insurance Policy

The insurance policy issued by QGIF covers 8 insurance classes from which an insured agency can select the insurance cover it requires. The policy provides insured agencies with cover for claims involving:

- property loss or damage;
- business interruption;
- general liability;
- professional indemnity;
- health litigation;
- personal accident for volunteers and Board members;
- aviation; and
- marine.

Not all types of insurance are available from QGIF. QGIF does not provide Motor Vehicle, Travel or Construction insurances nor compulsory insurances such as Compulsory Third Party (CTP) and Workers Compensation.

Participation

QGIF is in effect a self-insurance scheme of Government departments and eligible statutory authorities. It is not available to either Government-owned corporations or entities outside of the Queensland Government.

It is compulsory for all Government departments to participate in QGIF. Participation by statutory authorities is optional, however their participation is subject to Queensland Treasury approval.

QGIF was established to cover the assets and liabilities of the State of Queensland but it is important to note that the policy cannot be extended to cover any non-State Government entities. In circumstances where an insured agency participates as a joint venture/alliance partner with a non-State Government entity then QGIF will be unable to offer any insurance coverage to the joint venture/alliance.

QGIF's role is to provide advice to the Queensland Government on its insurance needs but QGIF does not act in an advisory capacity to Alliances or Joint Ventures. QGIF does not operate on a fee for service basis.