

# TOP 10 RISK CLAUSES IN CONSTRUCTION CONTRACTS

If you work in the building and construction industry, understanding how key clauses in your contract allocate risk is critical to protecting your business. This guide outlines the top 10 risk clauses commonly found in construction contracts, explaining:

- what each clause does
- how it can shift liability between parties; and
- the commercial implications for both contractors and principals.

## CLAUSE 1 – LIABILITY CAPS



In a construction contract, a contractor will typically limit their liability to a specific amount or a percentage of the contract sum. Sometimes, a principal may also have a cap on their liability. A liability cap limits a party's liability under the contract (so far as the law permits). Although it is market-standard and reasonable for a contractor to cap their liability, a principal will often request “carve outs” (or exclusions) from the liability cap, which may include:

- insurance proceeds recovered by the contractor;
- claims for personal injury or death;
- infringement of intellectual property rights; and
- fraud, criminal misconduct, wilful default and gross negligence.

### Contractor Position: Capping Liability

Contractors generally aim to cap their liability to manage financial risk. A liability cap establishes a clear ceiling on the contractor's exposure to liability, providing a predictable risk framework. This is crucial given the complex, multi-party nature of construction projects, where disputes can arise across various stakeholders.

Without a liability cap, contractors could be exposed to significant claims that may exceed their financial capacity, which can be particularly damaging for smaller parties.

### Principal Position: Exclusions from the Liability Cap

Principals often seek to exclude certain types of loss from the liability cap to ensure broader protection. This means that where a loss is “excluded” or “carved out” from the liability cap, the contractor's liability for that loss will be unlimited. The rationale is that some risks, like fraud or personal injury, are seen as too significant to be limited, or cannot be limited at law. By negotiating these carve outs, principals aim to ensure that critical risks are not capped, allowing full recovery where necessary.

Other common exclusions include:

- breach of a statutory duty;
- fines or penalties made against the principal by any authorities;
- liability to pay liquidated damages; and
- any loss or claim that cannot be limited at law.

## CLAUSE 2 – INDEMNITIES



An indemnity makes one party responsible for compensating the other party for any loss suffered or incurred by that party.

Construction contracts often include indemnities for:

- death or personal injury;
- property loss or damage;
- infringement of intellectual property rights; and
- breaches of law (including Work Health and Safety and Security of Payment laws).

Indemnities often increase liability beyond what is required by the law. This can be problematic for the party giving the indemnity, as it may result in uninsured losses. Indemnities are frequently the focus of negotiations and can be tricky. If you have an indemnity that is not market-standard, you should request that it be deleted.

### Contractor Position: Managing Indemnity Risk

Contractors typically seek to limit the scope of indemnities to manage liability exposure. Since indemnities can significantly extend a contractor's risk beyond legal obligations, they often aim to ensure these clauses are market-standard and tied to specific, insurable events. Non-standard indemnities are a red flag as they may result in uninsured losses.

To avoid taking on unintended liability, contractors should:

- carefully review proposed indemnities;
- negotiate deletions or amendments where necessary; and
- consult their insurers to confirm what types of losses are covered by their insurance.

### Principal Position: Broad Indemnity Coverage

Principals typically seek broader indemnity coverage in construction contracts to ensure maximum protection against potential risks. They view indemnities as a means to secure compensation for significant losses, particularly those that may have serious operational or financial implications, such as personal injury or legal breaches.

Principals often push to retain non-standard indemnities if they provide greater assurance of risk coverage, even if it means more intense negotiations with contractors.

## CONTACT US

visit our website | [legalvision.com.au](https://legalvision.com.au)  
email us | [info@legalvision.com.au](mailto:info@legalvision.com.au)  
call us | 1300 544 755

## CLAUSE 3 – PROPORTIONATE LIABILITY



Proportionate liability legislation (PLL) is a legal framework in Australia that seeks to apportion liability between concurrent wrongdoers in claims involving economic loss or property damage. The legislation aims to ensure that each wrongdoer is only liable for the proportion of the loss or damage they caused, rather than being jointly and severally liable for the entire loss.

This means that a claimant will only be able to claim a portion of the total loss from each wrongdoer.

### **Contractor Position: No Exclusion of Proportionate Liability**

Contractors and consultants generally want the PLL to apply to their contractual arrangements and resist clauses that contract out of the scheme. The legislation is seen as an important protection against being disproportionately liable for a plaintiff's losses, especially as construction is an industry where multi-party disputes are common.

The rationale is that proportionate liability limits a contractor's risk exposure to their assessed share of responsibility. Without it, a contractor faces the risk of being liable for 100% of the loss, even if they are only partially at fault. This is particularly concerning for smaller contractors who may not have the financial resources to bear such liability.

Contracting out of proportionate liability is permitted in:

- New South Wales;
- Tasmania; and
- Western Australia.

Queensland expressly bars contracting out. Every other jurisdiction is silent on the issue.

### **Principal Position: Exclusion of Proportionate Liability**

Principals prefer to contract out of proportionate liability and revert to joint and several liability. They argue that proportionate liability can leave them short-changed if one of the wrongdoers has insufficient funds or is insolvent.

Under joint and several liability, the principal can recover 100% of its losses from any solvent defendant, regardless of their share of fault. The burden and risk of recovery then fall on the defendants to pursue each other for contribution.

## CLAUSE 4 – DESIGN OBLIGATIONS



Construction contracts often include various design clauses that outline the responsibilities and obligations of the parties with respect to the design of the works. These clauses can take different forms, such as overall design obligations. Where the contractor is responsible for the design of a project, there may be more specific clauses that operate as warranties, such as fitness for purpose clauses.

Fitness for purpose warranties require the contractor to ensure that the design and construction of the project are suitable for the intended use, even if this exceeds the standard of care typically expected. These clauses can provide additional protection for the principal, but they also increase the contractor's exposure to risk.

### **Contractor Position: Construct Only, Express Fitness for Purpose**

Contractors may prefer a 'construct only' approach, where their responsibility is limited to constructing the project according to the principal's design. This position minimises the contractor's exposure to design-related risks and allows them to focus on the core construction elements.

Contractors typically seek to amend any design warranties so that they are expressly linked to the requirements of the contract. For example, the design will be "fit for the purposes expressly stated in the contract". An express warranty clearly defines the scope of the contractor's design obligations and the purposes the design must satisfy. This is preferable to an implied, open-ended fitness for purpose obligation, which leaves room for interpretation.

### **Principal Position: Broad Indemnity Coverage**

Principals may want the contractor to finalise a "preliminary design" developed by the principal or its consultants, to completion. Under this arrangement, the principal will seek to engage the contractor on a "design and construct" basis, which requires the contractor to assume full design responsibility.

The principal will typically include provisions that state that the principal does not warrant the suitability or fitness of any preliminary design or other information provided to the contractor for the purposes of developing the design, and that the contractor warrants that it has made all investigations as to the suitability of any preliminary design. Contractors may attempt to remove or limit the effect of such implied warranties to reduce risk exposure.

## CLAUSE 5 – DEFECTS LIABILITY PERIOD



The Defects Liability Period (DLP) is a provision in construction contracts that allows the principal to identify and report defects, which the contractor must rectify at their own expense, typically lasting 6 to 12 months after practical completion. This period serves as a safeguard for the principal, ensuring the work meets specified standards.

### Contractor Position: Temporary DLP

Contractors generally prefer a finite DLP with a clear end date. They resist 'evergreen' DLPs, which continue and reset each time a defect is identified and rectified and could extend indefinitely as new defects are discovered. The ideal position for a contractor is that once the initial DLP expires, their contractual obligations should cease, barring breaches of statutory warranties.

### Principal Position: Evergreen DLP

Conversely, principals often seek more extensive protection. An evergreen DLP allows a Principal to continually report defects, with the contractor obligated to rectify them regardless of when they're discovered. This approach guarantees quality workmanship and protects the principal's long-term investment. The tension between these positions often leads to the negotiation of a middle ground. A common compromise might involve a fixed initial DLP, followed by an additional period for newly discovered defects with a defined limit, balancing the interests of both parties.

## CLAUSE 6 – LIQUIDATED DAMAGES



Liquidated damages are payable by a contractor to a principal to compensate the principal for a failure to complete the construction works on time. Liquidated damages are quantified in the contract as an amount or a rate per day or week. They are determined at the time the contract is entered into. Liquidated damages need to be a genuine pre-estimate of the principal's likely losses, otherwise, they may be voided by a court.

### Contractor Position: Limiting Liquidated Damages

Contractors often seek to limit their exposure to liquidated damages, usually by negotiating a cap on the total amount payable (e.g. x amount of liquidated damages per day, until 10% of the contract sum). This approach helps manage financial risk, as uncapped liquidated damages can lead to substantial liability, especially in large-scale projects.

Contractors should ensure that the agreed rate reflects a reasonable estimate of potential losses to avoid disputes over enforceability. When negotiating, contractors should aim for realistic and clearly defined terms to mitigate risks of excessive or punitive damages.

### Principal Position: Securing Adequate Compensation

Principals generally favour liquidated damages as they provide a clear, predetermined means of compensation for delays, reducing the need for lengthy legal proceedings to recover losses. Principals should ensure the damages are set at an appropriate level that genuinely reflects potential losses from project delays. They often resist caps on liquidated damages, arguing that it could limit their recovery in cases of significant delay. For principals, the focus is on achieving enforceable, adequate compensation that protects their interests in timely project delivery.

## CLAUSE 7 – VARIATIONS



Variations are changes to the original scope of work. These can involve additions to or deductions from the agreed works, often impacting the project's cost and timeline. Variations typically include adjustments for profit and overheads for the changed work.

### Contractor Position: Unrestricted Variations Clause

Contractors generally prefer no restrictions on variation claims, allowing them to recover costs for any changes to the original scope. They seek mutual agreement on variations, ensuring fair compensation for additional work or alterations. This approach provides flexibility to address unforeseen circumstances or client requests without financial risk.

### Principal Position: Limited Variation Claims

Principals aim to limit variation claims to control costs. They may seek to include clauses that bar certain types of claims or restrict the contractor's right to direct variations or additional costs. This position shifts the risk of unexpected changes onto the contractor.

The variation clause is crucial in balancing these opposing interests. It typically outlines the process for proposing, approving, and valuing variations. A well-drafted clause provides clarity on:

- who can initiate variations;
- the approval process;
- methods for valuing variations;
- timeframes for claiming and responding to requests; and
- dispute resolution mechanisms for disagreements.

**Note:** Under the expanded Unfair Contract Terms regime, unreasonable time bars preventing variation claims from being made, or unilateral variation powers, may be seen as "unfair".

## CLAUSE 8 – QUALIFYING CAUSES OF DELAY AND EXTENSIONS OF TIME



Extension of time (EOT) clauses allow parties to extend the completion date without incurring financial penalties when delays occur due to factors beyond their control. This results in a “time only” entitlement for contractors. Common causes of delay include site issues or material delivery delays, variations in work scope, force majeure events or legislative changes. EOTs are commonly available for principal-caused delays, under the ‘prevention principle’ in construction law.

### Contractor Position: Detailed EOT Provisions

From a contractor’s perspective, having a clear and well-defined EOT clause is essential for managing delays and ensuring they are not financially penalised for uncontrollable factors. To claim an EOT, contractors must adhere to the contract’s specific provisions, including notice requirements and time bars. However, some contracts allow superintendents discretion to grant EOTs even if the contractor has not formally claimed one.

### Principal Position: Minimising EOT Claims

Principals tend to adopt a more limited stance when it comes to EOT claims. They often seek contracts that restrict the types of delays claimable. This approach helps control project timeframes and minimises potential frivolous claims made by contractors.

However, principals must also recognise that certain delays, particularly those caused by their own acts or omissions, may warrant an EOT under the ‘prevention principle’, which frees the contractor from the obligation to meet the original completion date.

## CLAUSE 9 – SECURITY



Security in construction contracts serves as financial protection for the principal against a contractor default or non-performance. Common types of security include:

- **Cash Retention:** The principle withholds a percentage of each progress claim, until 5% of the contract sum is reached.
- **Bank Guarantees:** Unconditional promises by a financial institution to pay on demand. Principals usually require two bank guarantees, each for 2.5% of the contract sum.
- **Insurance Bonds:** Function similar to bank guarantees, but are issued by insurers.
- **Security for Advanced Payment of Unfixed Plant and Materials:** Typically equal to the value of the unfixed materials.

Security is usually released as 2.5% upon practical completion, and the remaining 2.5% on expiry of the DLP.

### Contractor Position: Minimum Security

Contractors prefer minimal security requirements, favouring cash retention. They seek limited recourse rights for the principal, aiming to restrict when and how security can be called upon.

### Principal Position: Unlimited Security

Principals generally prefer for security by way of bank guarantees without expiry dates. This provides ongoing protection even after the DLP, guarding against latent defects or contractor insolvency.

**Note:** Unrestricted access to security may be deemed “unfair” under the new Unfair Contract Terms regime, so principals should carefully consider what circumstances entitle them to call on the security.

## CLAUSE 10 – COMPENSABLE CAUSES OF DELAY



Compensable causes of delay are events or circumstances that occur during a construction project and entitle the contractor to an extension of time and additional monetary compensation. These delays can arise from:

- changes in the scope of work;
- unforeseen site conditions; or
- actions (or inactions) by the principal or their representatives.

Properly identifying and managing compensable causes of delay are crucial for both contractors and principals to ensure the timely and cost-effective completion of construction projects.

### Contractor Position: No Cap on Delay Costs

From the contractor’s perspective, a wide recognition of causes is preferable. Common forms often claimed include:

- acts, omissions or defaults by the principal;
- delays due to material shortages;
- necessary design alterations; or
- unforeseen regulatory changes.

Contractors generally advocate for contracts to include no cap on delay costs, allowing them to claim full compensation for all overheads and increased costs directly linked to the delay.

### Principal Position: Limited Entitlement to Delay Costs

Principals tend to prefer a conservative approach. They often push for contracts that limit entitlement to delay costs, accompanied by a capped daily limit. This stance is aimed at controlling budget overruns and encouraging efficiency, ensuring that the project remains financially manageable.