

Insured interest

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How can businesses ensure they are sufficiently insured when things go wrong, asks Chris Green?

Consultant and contractor quantity surveyors are expected to have a good working knowledge of the types of business insurance needed to provide cover for occasions when things go wrong. This feature will focus on 3 key types of policy that offer protection for clients, contractors and advisers in the construction and infrastructure industries.

Common types of insurance include:

- **professional indemnity insurance (PII)**: for negligence or breach of contract committed as a professional adviser;
- **contractors? all-risks insurance**: this covers damage to the permanent and temporary works, materials, property, plant, tools, equipment and personal effects of employees;
- **third-party or public-liability insurance**: for injury to third parties or damage to their property;
- **employers? liability insurance**: for injury to employees;
- **directors? and officers? liability insurance**: for damages arising from any act, error or omission made while acting in the capacity of a director or an officer of a company;
- **environmental insurance**: for historical conditions that manifest as a result of, or are exacerbated by, construction activities; and
- **latent defects insurance**: for physical damage to buildings that result from inherent defects in the structural parts of those buildings.

Professional indemnity cover

PII insures against claims for negligence or breach of contract by a professional advisor. This may be, for instance, a consultant quantity surveyor or a contractor who has accepted a level of design responsibility under the building contract. PII can be purchased for varying levels of cover and uninsured excess, and it is advisable to examine the excess in particular because it may be impossible for a client to recover this amount from the policy holder in the event of the latter?s insolvency.

For instance, if a client makes a claim for professional negligence against a professional adviser, the adviser?s PII policy will pay out the amount insured less the uninsured excess; however, they will still owe the outstanding amount, and if they become insolvent they may not have the funds to pay it. The danger is that consultants can buy a cheaper PII policy because they have very high uninsured excesses, and this poses a risk to both client and consultant.

The consultant quantity surveyor requires PII to protect themselves. RICS publishes guidelines on appropriate amounts for given expected fee incomes, specifically listed in regulation document [Professional Indemnity Insurance version 3, effective from 1 November 2015](#) .

However, it is more important that the amount of insurance is sufficient to cover the aggregate liability accepted by the consultant in their various appointments.

Therefore, if the consultant carries a PII policy for ?1m, it would be unwise for them to accept any appointment with a higher aggregate liability or they will be exposed to uninsured losses.

Policies should be arranged on an 'each and every claim' basis, meaning that they will pay out up to the insured amount for each claim presented, without limit to the number of claims. This assures clients that insurance will be available to meet their claims regardless of the number made in each policy year. Insurers often refer to these policies as 'any one claim' (AOC) policies.

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PII may not respond, however, to claims for consequential loss, and it is therefore important that consultants do not accept any appointments that would make them liable for this. Neither will PII respond to claims made for a failure to honour the duty of care to ensure a project?s 'fitness for purpose'.

Consultants are usually required to use 'reasonable skill and care' in performance of their duties, but occasionally a client may require the consultant to ensure that the project will be fit for the purpose required; however, it may fail to do so even though the consultant has used all reasonable skill and care. In this case, the client will not have to demonstrate that the consultant has been negligent but simply to show that the works are not fit for purpose. Thus the PII may not provide cover, leaving the consultant, and hence the client, uninsured.

Care needs to be taken when reviewing appointments for this higher, uninsurable duty of care. The wording may not always make this apparent, as the appointment documents may only refer to an obligation to meet the particular requirements of the specification. This is effectively a 'fitness for purpose' requirement, which may be uninsurable. It is advisable to obtain a legal review of appointment documents before accepting them.

PII is also referred to as insurance on a claims-made basis. The consequence of negligence or breach of contract may not materialise for several years after work has been completed, and the PII policy that applies is the one in force when the claim is made rather than that which was in place at the time of the negligent act or breach of contract.

Contractors now commonly take out PII so they can accept some or all design liability for construction works undertaken or temporary works design. Again, it is important to obtain sufficient insurance to cover the contractual liabilities accepted under the building contracts.

A contractor?s liability is often expressed as a percentage of the contract sum. On large infrastructure projects this can be in excess of insurance readily available in the market. In such instances, it is advisable for the contractor to agree an inner cap, meaning that within the overall liability cap, no claim greater than that inner cap can be brought, which equates to the insurance being carried.

For example, on a ?1bn infrastructure project, the total aggregate cap may be 15% of the contract price, that is, ?150m; yet the contractor may only carry a maximum of ?50m PII cover. It would therefore be advisable to agree an inner cap of ?50m per claim within the total liability of ?150m for all claims, to be certain that all liabilities are properly insured for the benefit of both contractor and client.

Contractor's all-risk cover

All-risks insurance policies provide protection for damage to the works from specified causes or from the performance of the works. While the policies are generally known as 'all risks', there are many specific exclusions that must be understood on a per-policy basis.

It is important to take out sufficient cover for the value of projects undertaken. This may not be the full reinstatement value of the works, but should be representative of the likely cost of damage to them.

For large-value projects, it may be advisable for the client to arrange project-specific insurance so the works are effectively covered during construction and the potential duplication of premium costs incurred by parties working on the project ? in addition to their usual annual premiums ? is avoided.

Where the client provides works insurance, the policy is often referred to as an owner-controlled insurance policy (OCIP). Contractors need to examine the detail of the policy as it may not cover all elements of the works being undertaken. In such an event, the contractor will have to take out an additional policy to cover the shortfall, often referred to as difference in conditions insurance (DIC).

If the contractor provides defective materials or the quality of work is poor, then the cost of rectification will not be covered by the policy. Subsequent damage to the works may be recoverable under third-party or public-liability insurance. In a simple example, if a pavement sub-base is laid defectively, the costs of rectifying it may not be recoverable, but the cost of replacing the paving above may be.

Third parties and public liability

Third-party and public-liability policies provide insurance for injury to persons other than employees of the contractor and damage to property other than the works themselves. As outlined above, this may be useful in recovering some of the costs arising from defective materials or poor quality of work.

Completed works become third-party property and are thus covered by third-party insurance. The policy may also respond to non-negligence claims, where the contractor has not been negligent in carrying out the works but damage to third-party property has still arisen.

Opportunities to recover losses incurred on contracts due to the damage caused by defective materials and poor quality of work are often missed due to limited understanding of the cover provided by third-party insurance.

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Further information

- Further advice can be found in the [RICS Construction insurance guidance note, first edition, July 2009](#) (archived).
- Related competencies include [Business planning](#) , [Contract administration](#) , [Contract practice](#) , [Procurement and tendering](#) , [Project administration](#) .
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