



Traps for Contractors and their Brokers

David Pryce

The importance of choice

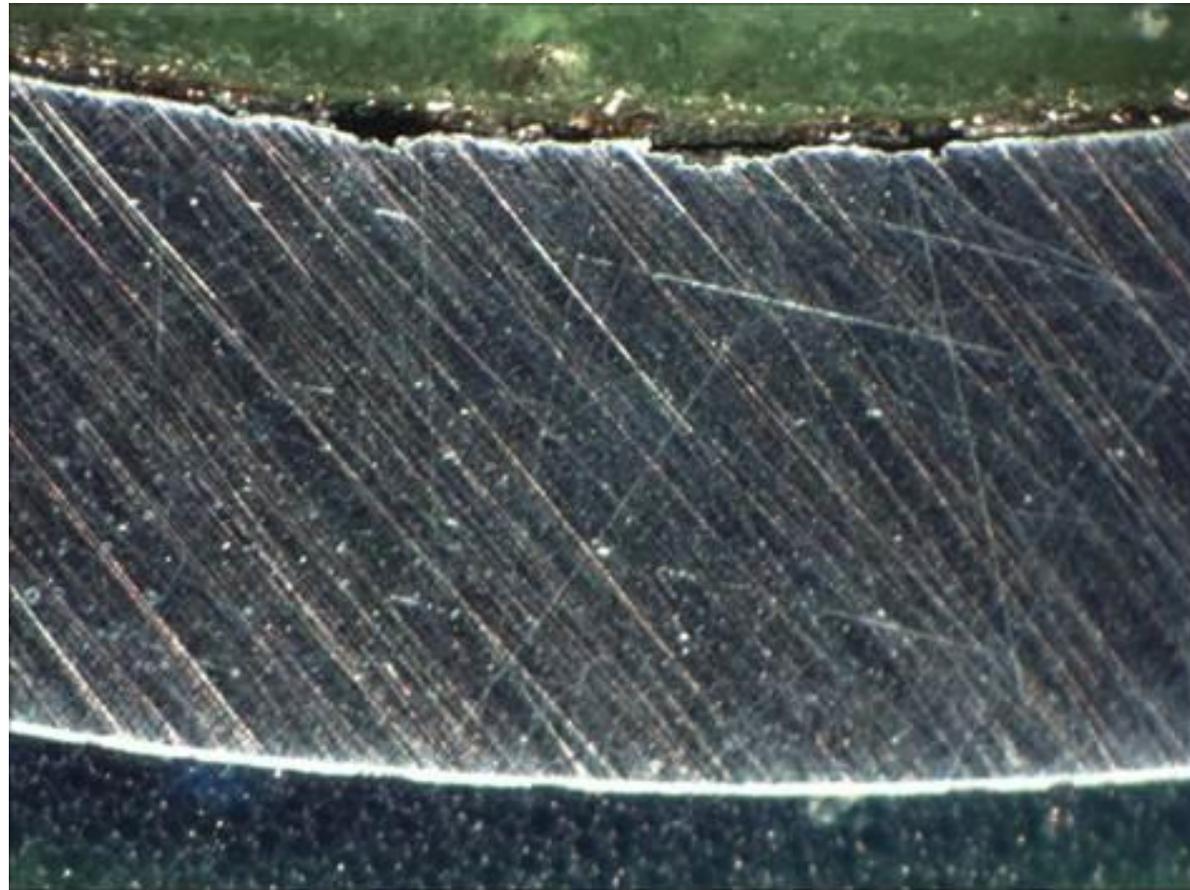


McLaughlin & Harvey Limited v Lockton Companies International Limited [2017] NI Master 2

CAR Trap #1 “DE” Exclusions



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CAR Trap #1 “DE” Exclusions

DE3 (1995): Limited defective condition exclusion

“This policy excludes loss of or damage to and the cost necessary to replace repair or rectify

- (i) Property insured which is in a defective condition due to a defect in design plan specification materials or workmanship of such property insured or any part thereof;
- (ii) Property insured lost or damaged to enable the replacement repair or rectification of Property insured excluded by (i) above.

Exclusion (i) above shall not apply to other Property insured which is free of the defective condition but is damaged in consequence thereof.

For the purpose of the Policy and not merely this Exclusion of the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property insured or any part thereof.”

CAR Trap #1 “DE” Exclusions

DE4 (1995): Defective part exclusion

“This policy excludes loss of or damage to and the cost necessary to replace, repair or rectify:

- (i) Any component part or individual item of the Property insured which is defective in design plan specification materials or workmanship;
- (ii) Property insured lost or damaged to enable the replacement repair or rectification of Property insured excluded by (i) above.

Exclusion (i) above shall not apply to other parts or items of Property insured which are free from defect but are damaged in consequence thereof.

For the purpose of the Policy and not merely this Exclusion the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property insured or any part thereof.”

CAR Trap #1 “DE” Exclusions

DE5 (1995): Design improvement exclusion

“This policy excludes:

- (i) The cost necessary to replace, repair or rectify any Property insured which is defective in design plan specification materials or workmanship;
- (ii) Loss or damage to the Property insured caused to enable replacement, repair or rectification of such defective Property insured.

But should damage to the Property insured (other than damage as defined in (ii) above) result from such a defect, the Exclusion shall be limited to the costs of additional work resulting from and the additional costs of improvement to the original design plan specification materials or workmanship.

For the purpose of the Policy and not merely this Exclusion the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property insured or any part thereof.”

CAR Trap #1 “DE” Exclusions

Takeaways

- Significant difference in cover between DE3, DE4, and DE5
- The wider the cover the higher the likely price
- Some wordings provide for a choice between DE3 and DE5 at the point of bringing the claim, subject to a difference excess being applicable
- It should always be a commercial decision for the client, balancing the cost and the risk.

CAR Trap #2: Project Insurance Coverage



- Policies typically cover named employer and main contractor + other unspecified sub's and consultants
- Subrogation - general rule that insurers should not be able to pursue claim for recovery of insured loss against co-insured under CAR policy
- Based on implied term of underlying contract, **UNLESS** overridden by express terms

CAR Trap #2: Project Insurance Coverage



- *GardMarine and Energy Ltd v China National Chartering Company Ltd [2017] UKSC 35.*
- Insurance placed for the benefit of both parties to a venture - usually cannot claim against each other in respect of insured loss.
- 3:2 majority decided liability excluded rather than satisfied - implications re: third party claims, insurer delay/insolvency, or underinsurance.

CAR Trap #2: Project Insurance Coverage



- *Haberdashers' Aske's Federation Trust Ltd v Lakehouse Contracts Ltd and others [2018] EWHC 558*
- Contract term requiring a sub-contractor to maintain separate insurance prevented it from claiming cover under a project insurance policy

CAR Trap #2: Project Insurance Coverage



- Carefully review insurance requirements in construction contracts to ensure appropriate risk allocation and limits of indemnity.
- Contractors expressly agreeing to obtain separate liability insurance may be exposed to subrogation claims from project insurers.
- Parties intending to create an insurance fund as the sole avenue for making good the relevant loss should say so clearly in the contract.

CAR Trap #3: “Actual Damage”



- The legal test for “*damage*” has three limbs:
 - Change in physical condition;
 - That is unwanted;
 - That impairs value or usefulness.
- The trigger for CAR policies is not uniform:
 - Some are triggered by “*Damage*”;
 - Some are triggered by “*Physical Damage*” or “*Actual Damage*” (which, in this context, can be considered to be interchangeable).
- Those two triggers look the same, but they aren’t. Two cases illustrate the difference.

CAR Trap #3: “Actual Damage”

Transfield v GIO Australia [1997] 9 anz Cas
61-336



Ranicar v Frigmobile [1983] Tas R 113



CAR Trap #3: “Actual Damage”



Transfield v GIO Australia [1997] 9
anz Cas 61-336

Policy triggered by “physical loss or damage including destruction” (my emphasis).

Requires a permanent and irreversible change in physical condition.

Ranicar v Frigmobile [1983] Tas R
113

Policy triggered by “all risks of loss or damage”.

The change in physical condition can be transient and reversible.

CAR Trap #3: “Actual Damage”



Takeaways

- If the insurer proposes an “*Actual Damage*” or a “*Physical Damage*” trigger, ask them to amend it to a plain “*Damage*” trigger.
- The insurer may do so without turning their mind to the significance.
- If the insurer refuses, or agrees but at a higher price, the issue should be referred to the client for a decision, balancing the cost and the risk.

Professional Indemnity Trap #1: Workmanship exclusions



- D&C Contractors are retained to do two things:
 - Take complete or partial responsibility for design; and
 - To take responsibility for the construction work.
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- The general principle of professional indemnity insurance for D&C Contractors is that it:
 - Covers design liabilities; but
 - Does not cover liabilities arising from workmanship.
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- There is a common misconception that there is a neat dividing line between design and workmanship.

Professional Indemnity Trap #1: Workmanship exclusions



Covered

Excluded

Design

Workmanship

Professional Indemnity Trap #1: Workmanship exclusions



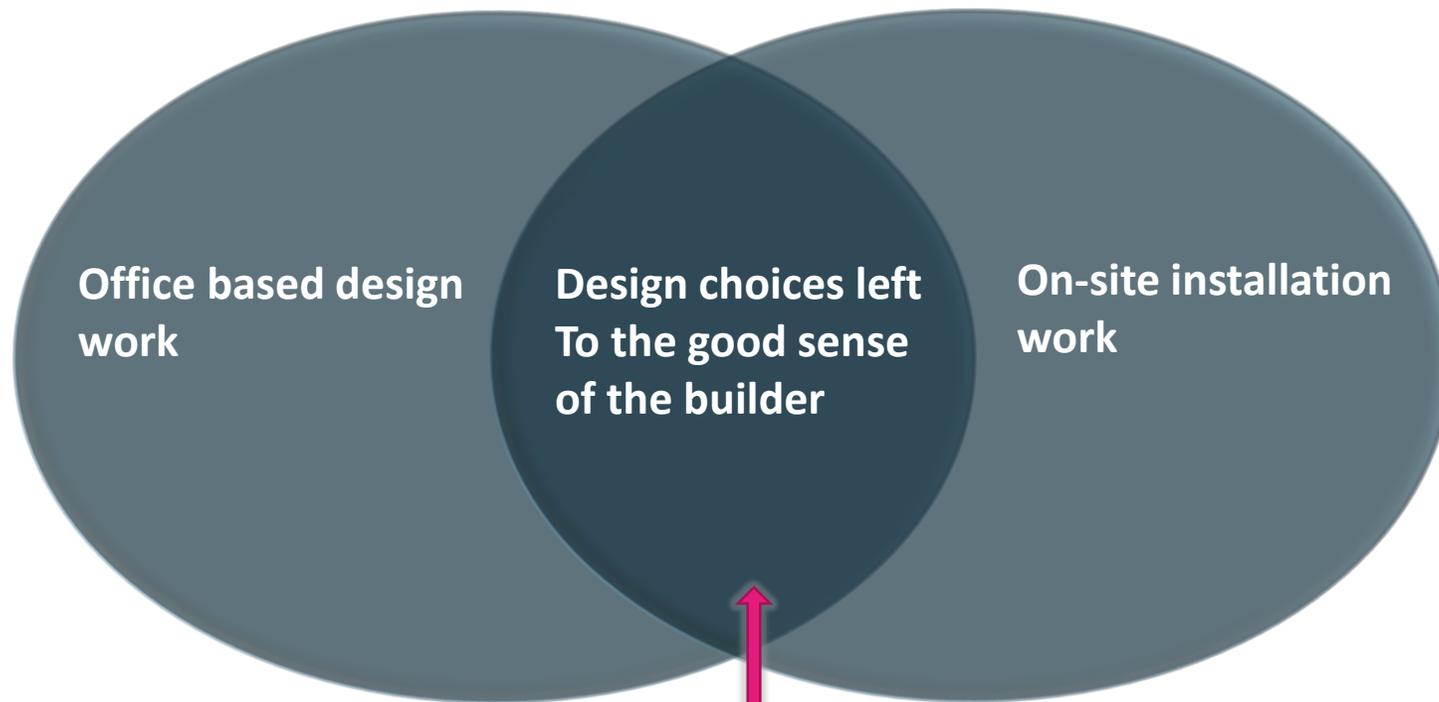
The better view is that there is an overlap.

Professional Indemnity Trap #1: Workmanship exclusions



Covered

Excluded



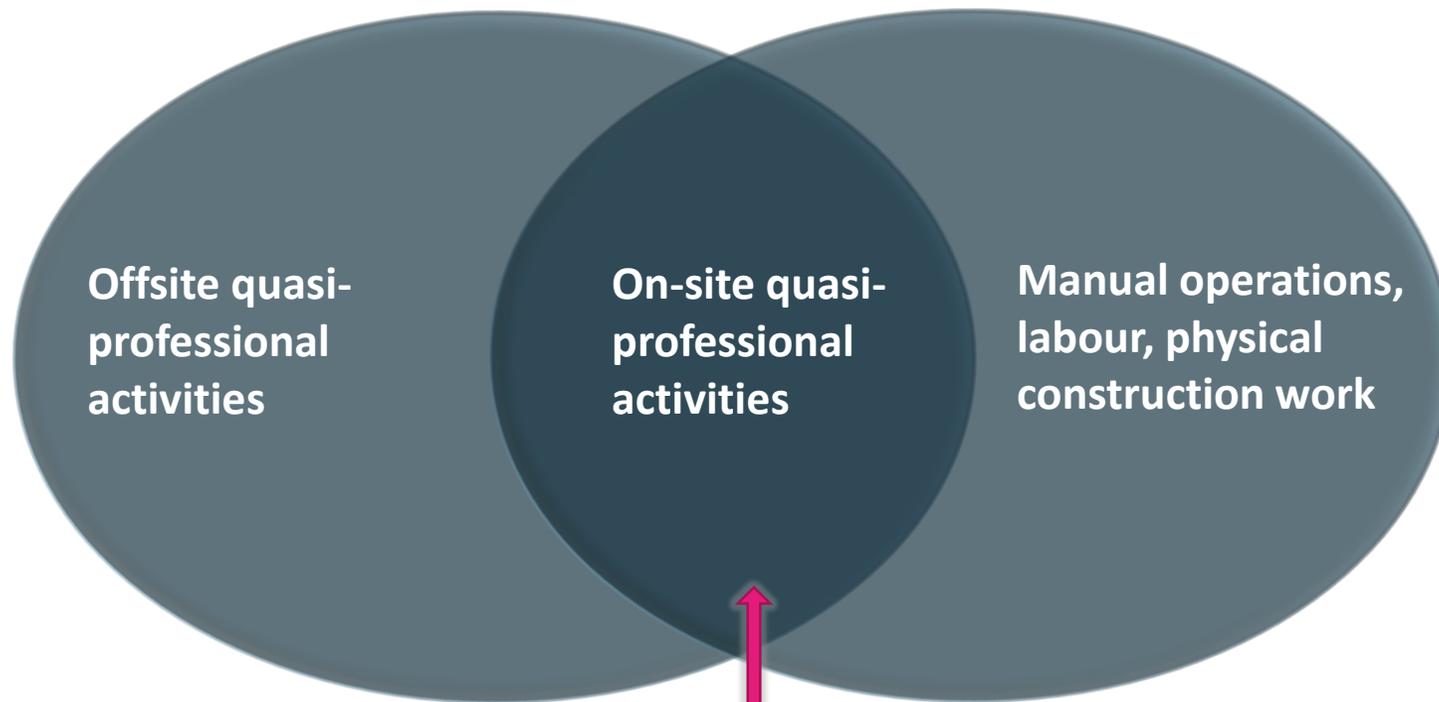
Potentially covered > Depends on who

Professional Indemnity Trap #1: Workmanship exclusions



Covered

Excluded



Potentially covered > Depends on who

Professional Indemnity Trap #1: Workmanship exclusions



- Manual Labour & Physical Construction Work will always be excluded.
- Professional / quasi-professional activities undertaken off-site will always be covered (usually subject to minimum levels of qualification or relevant experience).
- Design choices left to the good sense of the builder / on site quasi-professional activities, which constitute both design and workmanship will:
 - Sometimes be excluded and sometimes insured, according to the wording of the policy.

Professional Indemnity Trap #1: Workmanship exclusions



- Limited workmanship exclusion (activities which constitute both design and workmanship are insured, subject to the person who made the mistake having the necessary qualifications / experience):
 - *“Arising from defective workmanship or defective materials but only to the extent that such claim does not arise in consequence of the exercise and conduct of the Assured’s Activities and Duties”.*
- Full workmanship exclusion (activities which constitute both design and workmanship are excluded):
 - *“Any claim arising out of defective workmanship or defective materials or the failure to supervise or inspect work carried out”.*

Professional Indemnity Trap #1: Workmanship exclusions



Takeaways

- There is a significant difference in the scope of cover under a D&C professional indemnity policy depending on whether the workmanship exclusion is a limited one, or a full one.
- If the insurer proposes a full workmanship exclusion, the client needs to understand the implications, so that it can make an informed decision about whether to insure on that basis.

Professional Indemnity Trap #2: Accepting uninsurable obligations



- PII policies respond to negligence claims - alleged failure to exercise reasonable skill and care
- Strict obligations imposing higher standards expose contractors/designers to potential uninsured loss
- Fitness for purpose warranty or guarantee

Professional Indemnity Trap #2: Accepting uninsurable obligations



- Clearly defined roles and responsibilities of “designer” and “contractor” increasingly blurred
- Dual role of design & build contractor under modern procurement - liability and insurance implications
- JCT and ICE contracts usually contain express provisions excluding fitness for purpose; NEC3 and FIDIC silver book impose more onerous contractor design obligations

Professional Indemnity Trap #2: Accepting uninsurable obligations



- MT Højgaard v Eon [2017] UKSC
- Robin Rigg windfarm - inaccurate international standard J101
- Breach of fitness for purpose “20 years design life” requirement, despite reasonable skill and care
- Inconsistency in performance obligations - courts likely to uphold more onerous requirements

Professional Indemnity Trap #2: Accepting uninsurable obligations



- Carefully review performance obligations in construction contracts for consistency and to limit potential liabilities
- Avoid strict obligations imposing onerous requirements
- Construction contracts often incorporate numerous technical schedules and specifications - include provisions confirming which documents take priority in the event of any conflict or discrepancy

Products Liability

Trap #1: Creation of a defective final product



- Like CAR policies, Public Liability policies are triggered by “*Damage*”.
- As we know, that requires a change in physical condition.
- The *Bacardi* case highlighted a particular problem for policyholders in the mixing and blending industry.

Products Liability

Trap #1: Creation of a defective final product



*Bacardi Martini Beverages Ltd v Thomas Hardy
Packaging Ltd [2002] EWCA Civ 549*



Products Liability

Trap #1: Creation of a defective final product



Mixing & Blending endorsement (which does not address the issue highlighted by *Bacardi*):

- *“Underwriters shall indemnify the Insured against all sums that the Insured shall become legally liable to pay as damages...in respect of any Claim arising solely by reason of Property Damage to third party products provided that the Property Damage arises directly from the mixing, binding, blending, bonding or compounding of the Product(s) with a third party product(s)”.*

Products Liability

Trap #1: Creation of a defective final product



Alternative approach:

- *“In respect of claims arising directly from the mixing, binding, blending, bonding or compounding of the Product(s) with a third party product(s) the definition of Property Damage shall be extended to include the creation of a defective finished product”.*

Products Liability

Trap #1: Creation of a defective final product



Takeaways

- For any clients whose business involves mixing & blending and / or providing products for incorporation into finished final products, the insurer should be asked to amend the definition of Property Damage in the Products Liability policy.
- If the insurer refuses, or agrees but at a higher price, the issue should be referred to the client for a decision, balancing the cost and the risk.

QUESTIONS?



David.pryce@fenchurchlaw.co.uk



+44 (0)203 058 3072