Risk Management Briefing

Professional Indemnity Insurance for Construction Consultants

February 2021

Introduction

Nowadays, construction consultants will invariably carry professional indemnity insurance (PII). For many disciplines it is compulsory, many clients insist on it, and for all it is desirable.

This risk management briefing explains some of the characteristics of such insurance and the issues which may arise. It is a general guide only and consultants should discuss their particular requirements with their brokers and ensure that they understand the terms of the policy.

Third party liability insurance

PII is third party liability insurance, meaning that you (the insured consultant) are covered in respect of your liability to others; you do not receive a benefit yourself. In other words, you are indemnified. Your clients are not themselves covered and this can cause misunderstanding. For example, a client may ask to be included as a joint insured. However, it is well established law that such co-insureds cannot make claims against the other for damage covered by the policy. A client may also seek to take some control over the relationship between you and your insurer, for example over your right to accept a payment from the insurer in full and final settlement of your liability under the policy. Such control over your rights is unacceptable to insurers, as their contract is with you and not your client.

What does a PII policy cover?

The cover afforded by a PII policy depends on the wording of the policy itself, including any conditions, exclusions and endorsements. A typical policy will cover you against any sum (up to an agreed limit: the limit of indemnity) which you are legally liable to pay arising from any claim made during the period of insurance by reason of negligence or breach of duty arising from the conduct of your professional business. Whether the policy only covers claims for breach of contract or negligence or is wider and covers breach of professional duty or civil liability depends on the wording. Fitness for purpose obligations or indemnities to your client or third parties are often specifically excluded, as are liquidated damages. By law, PII cannot cover criminal liabilities (e.g. fines for breach of CDM regulations 2015).

Claims made

PII policies (which are periodically renewable) are written on a claims made basis, in contrast to many other types of insurance. This means that the insurer who pays the claim is that insurer providing cover when the claim, or circumstances which might give rise to a claim, is first notified to the insurer, rather than when the work was undertaken, or the mistake made. The significance of this can be seen: the cover might be wider when a contract is entered into than when the claim under that contract is made, which may be many years later. For example, most insurers are now excluding cover for personal injury claims in relation to asbestos, whereas they offered such cover in the past. Similarly, insurers are now looking very closely at the cover available for consultants engaged in activities relating to cladding following the Grenfell disaster.

This means that you may have entered into contracts in the past which are not fully covered by your current insurance, or which you can only cover on payment of an additional premium.

When negotiating with clients, you will therefore want to avoid agreeing to potential liabilities for which you might not be able to get insurance in the future. This might mean restricting the services you provide or excluding or limiting liability.

If you take on liabilities which in the event are not covered by insurance, both you and your client are likely to suffer. You will also want to check the insurance clause in any contract, and include caveats such as ‘provided that such insurance is available at reasonable commercial rates’.

A further example of the effect of a claims made policy on a retired partner in a private partnership is that if a claim is made against such a person, there may be no insurance for that claim. On retirement therefore, you need to ensure that insurance is maintained – either under your former firm’s policy or your own run-off policy.

Who is insured?

Who is covered by the PII policy depends on who is named as the insured, and the wording of the policy and any endorsements. You should ensure that the insured is correctly described (e.g. if the practice is incorporated as an LLP, the insurer must be advised) and all those who need cover are included (e.g. past practices and partners). Employees, seconded staff, individual advisers/professional consultants and regular ‘outworkers’ are often covered, but not sub-consulting organisations, i.e. other practices and organisations (whose PII you should therefore check).

Limit of indemnity

PII policies are always subject to a limit of indemnity, that is a maximum amount that insurers will pay in respect of damages, interest and legal costs payable to the claimant. The limit can be each and every claim (sometimes expressed as any one claim or series of claims arising out of one event or series of events) or in the aggregate. Each and every claim cover means that the limit is payable in respect of each claim. Aggregate cover means that the limit is only available once, however many claims are made, in the policy period. Generally, cover is for each and every claim. However, certain types of claim may be limited to aggregate cover (e.g. pollution and contamination or asbestos). Furthermore, each and every claim cover may not be as generous as it sounds: if say the same defect, caused by a single negligent act, is found in four warehouses or 200 dwellings, all the claims brought against you in respect of the defects could constitute a single claim under your insurance policy. Such 'series of claims' issues are best dealt with through a limitation of liability clause in the contract between you and your client.

Insuring clauses

Contracts of appointment and warranties often include an insuring clause, whereby you undertake that you will maintain PII for a certain amount for a certain period of time. In an appointment, for example, you may agree to carry £1m PII for 12 years. You may currently carry £2m, but £1m may be the appropriate amount to agree for this particular job. Importantly, such a clause does not limit your liability under the appointment to £1m, just your level of insurance cover. You will remain liable for any figure successfully claimed against you in excess of your level of insurance unless you cap your liability to your level of insurance through your contract of appointment or warranty.

The excess

You will be required to pay an excess (that is, the first part of any claim). This is usually a set figure, not a percentage, and will apply to each and every claim. The excess may not apply to the costs and expenses incurred in defending a claim, which means that nothing would be payable (other than VAT on legal and other fees) if the claim was successfully defended and nothing paid to the claimant. If you were not totally successful in defending the claim the excess would apply, and you may have to pay the first part of any costs and expenses incurred in defending a claim, depending on the wording of your policy.

Insurers have become less flexible about amounts of excess, so it would be unwise to agree with your clients a limit to the amount of the excess.

Restrictions on cover

For some time, many insurers have excluded certain claims or have made them subject to an aggregate limit (and this is routinely acknowledged in contractual insuring clauses). For some time, claims resulting from war and terrorism have routinely been excluded, as may be claims in connection with asbestos as a result of bad claims experience in the US. Other common exclusions relate to liabilities arising from the transmission of viruses and other computer bugs and what is perceived to be the increased liability consultants can face from e-commerce transactions, although this last area has recently given rise to the introduction of "cyber liability" extensions under many PII policies. More recently, since the Grenfell

disaster, claims related to fire and/or cladding are routinely severely restricted or excluded by insurers. In addition, policies have always included restrictions on certain things, such as work undertaken abroad or as part of a joint venture.

How can you limit the risk of falling outside your insurance cover?

It is essential that you check your policy for any such exclusions or restrictions. Cover for certain risks may be excluded, restricted to aggregate cover only or made available only on payment of an additional premium; and the restrictions imposed can change from year to year. If your firm is unlikely to have the resources to finance uninsured or underinsured risks, you may wish to consider including a provision in your contracts excluding liability for claims for which you have no insurance at the time the claim arises (although under the Unfair Contract Terms Act 1977 ("UCTA") there are limits to the extent to which you can do this). As stated above, you could also include in your contract a cap limiting your liability to the amount available under your insurance policy, though similar issues with UCTA may apply.

In respect of joint ventures or work abroad, it would be wise to check cover for any partnering arrangement and for work undertaken overseas, and particular care needs to be given when establishing overseas offices. Fines and penalties under health and safety legislation are excluded from PII policies, but the costs of defending a prosecution may be covered (again, you should check your policy wording).

Where you appoint sub-consultants, there are particular PII considerations. You should ensure their PII is 'back-to-back' with you own, meaning that it is equivalent in terms of scope and level of cover in respect of the work they are carrying out for you. This applies to any work they perform but it is raising particular problems lately in relation to fire and/or cladding related claims where a sub-consultant's cover may now be excluded or very low. It may also be limited to an aggregate figure per project or per policy year for all their projects, meaning their annual cover may have already been exhausted by claims against them arising prior to your own. You should therefore request evidence of your sub-consultants' PII regularly and examine its level and scope in relation to your own PII and your liabilities to your client. Check also that they have not capped their contractual liability to you below their level of their PII in any event. If you can achieve it, it would be advisable to limit your own liability in your appointment with your client to that which you can recover from your sub-consultant with wording such as the following : "To the extent any claim for losses under this [Agreement/Deed] arises from errors or omissions of a sub-consultant engaged by the Consultant, the Consultant's liability for such losses shall not exceed the amount recoverable by the Consultant from the relevant sub-consultant".

Can your client take out insurance for you?

If you retire, go out of business or cannot afford to take out insurance, can your client take out PII covering your negligence – either on your behalf or in their own name? The answer is no, in relation to an annual periodically-renewable policy covering all work done. It might be possible for your client to purchase a single project policy for 10-12 years, but not many insurers offer the cover, it is likely to be expensive, and usually the scope of cover is not comprehensive. You should therefore really be taking out your own PII regardless

This Risk Management Briefing is for information only, and insurance or legal advice should be taken to cover your particular circumstances.

This briefing was prepared by the CIC Liability Panel, chaired by Professor Sarah Lupton.

It is available at www.cic.org.uk