Liability Briefing

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Professional indemnity insurance for construction consultants

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 note explains some of the characteristics of such insurance and the issues which may arise.

It is a general guide only and you should discuss your particular requirements with your broker and ensure that you understand the terms of your 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 co-insureds can not 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 insurers, for example over your right to accept a payment from insurers in full and final settlement of your liability under the policy. This is equally unacceptable to insurers, as their contract is with you not your client.

What does a PII policy cover?

The cover afforded by a PII policy depends on the wording of the policy itself, any endorsements etc. A typical policy will cover you against any sum (up to 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 negligence (in contract or tort) or is wider and covers breach of professional duty or civil liability depends on the wording. Fitness for purpose obligations or indemnities are often specifically excluded, as are liquidated damages.

Claims made

PII policies (which are annually renewable) are written on a *claims made basis*, in contrast to many other types of insurance. This means that the insurers who pay the claim are those providing cover when the claim, or circumstances which might give rise to a claim, is first notified to insurers, 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 a claim is made. For example, some insurers are now excluding cover for personal injury claims in relation to asbestos, whereas they offered such cover in the past.

Indeed, 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 therefore, you will 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 is that if a claim is made against a retired professional who is no longer covered by a current insurance policy, there will 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 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 (eg if the practice has incorporated as an LLP, insurers must be advised) and all those who need cover are included (eg past practices and partners). Employees, secondees and consultants are usually covered, but not subconsultants (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 *any one occurrence or series of occurrences arising out of one event*) 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, but certain types of claim may be limited to aggregate cover (eg pollution and contamination or asbestos). (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.)

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 10 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.

The excess

You will be required to pay an excess (that is, the first part of any claim) likely to be around 1% of your gross income. This 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 if the claim was successfully defended and nothing paid to the claimant. Alternatively the excess may apply, and you would have to pay the first part of any costs and expenses incurred in defending a claim. Insurers have become less flexible about excesses, 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 claims resulting from pollution or contamination or have made them subject to an aggregate limit (and this is routinely acknowledged in contractual insuring clauses). Date recognition claims may, even now, be similarly subject to an aggregate limit. Claims resulting from war and terrorism are now routinely excluded, as may be claims in connection with asbestos and toxic mould (the fungus exclusion) 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. You will want to check your policy, particularly the exclusions and any endorsements, to be sure what is covered and what is not.

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 there are limits to the extent to which you can do this). You could also include in your contract what is known as an 'evaporation clause' limiting your liability to the amount available under your insurance policy.

Policies have always included restrictions on certain things, such as work undertaken abroad or as part of a joint venture. (It would be wise therefore to check cover for any partnering arrangement). However, new restrictions are being introduced, eg on adjudication, where certain conditions have to be met before there is cover. Sometimes cover is excluded, but then provided if certain conditions are met (meaning that the burden of proving that there is cover rests with the insured, who has to demonstrate that the conditions are met). Do therefore ensure that you and your colleagues are familiar with the terms of your insurance before it is too late and you find that you are uninsured. Fines and penalties under health and safety legislation are excluded from PII policies, but the costs of defending a prosecution may be covered (you should check your policy wording).

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 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 and it is likely to be expensive.

Is there an alternative?

PII gives a measure of protection to you the professional, but it is not an efficient or effective way of protecting client's risks. Payment under the policy is dependent upon you being at fault, and costs will be incurred by both you and your client in establishing whether you are liable or not. There must be a better way of insuring the risks associated with designing and building construction projects. One answer is first party material damage policies, such as latent defects insurance (which covers the client or building owner against loss arising from defects). There are other similar policies. **It is recommended that you suggest to your clients that they investigate what is available to them to insure their risks more directly**.

This *Liability Briefing* is for general guidance only and insurance or legal advice should be sought to cover your particular circumstances.