

**DESIGN AND CONSTRUCT PROFESSIONAL  
INDEMNITY**

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**13 JULY 2006**

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The object of this talk is to:

- 1 Explain what is the cover provided;
- 2 Explain how it is different from other professional policies;
- 3 Suggest how these differences could practically affect the conduct of claims' handling and disputes.

Most importantly it is to explain how with such policies the cover is critical and awareness of its scope and limits could easily make the difference between a disaster and a problem.

However, it is first necessary to consider some preliminary questions to provide context.

This can be addressed by looking at three questions:

- Q1 Why do Contractors need Design and Construct Professional Indemnity?
- Q2 How do design liabilities arise?
- Q3 What is the relationship to other liabilities?

# 1. WHY DO CONTRACTORS NEED DESIGN AND CONSTRUCT PROFESSIONAL INDEMNITY?

1.1. The trite answer to this question is that Contractors need Professional Indemnity because Employers insist on them as a condition of Design and Construct contracts. It is now also the default position written into the JCT Design and Build Contract ("DB") 2005, Section 6.11-6.12.

1.2. As well as being a trite answer it is also a little profound and significant. It should be noted that the need does not arise out of any statutory or professional/trade association requirements. It is market driven, in particular by the relative prevalence of D&C contracts in particular construction sectors. The greatest factor has been historical. Although D&C contracts have been used for decades they had a comparatively minor share of the construction market by value as recently as the early 1990s. Now RICS describes it as the fastest growing procurement system and certainly now exceeds half the UK industry by value. This is an example of the classic 'S' curve model of the adoption of innovations or new products.

1.3. The Contractors we are considering do not actually have design and consulting departments who are active in preparing original architectural and engineering designs. In most cases, we will be considering a bought in design prepared by the Contractor's own consultants and sub-contractors or a design inherited via novation. If so then the real responsibility for any design failures should fall on these "designers" and their own insurance. However, no properly advised client of the Contractor is going to rely on such a chain of liability and a reason for D&C is to eliminate that chain for the client's purposes. Regardless of real responsibility the contractor is to carry primary contractual responsibility and as such cannot just rely on a third parties' insurance.

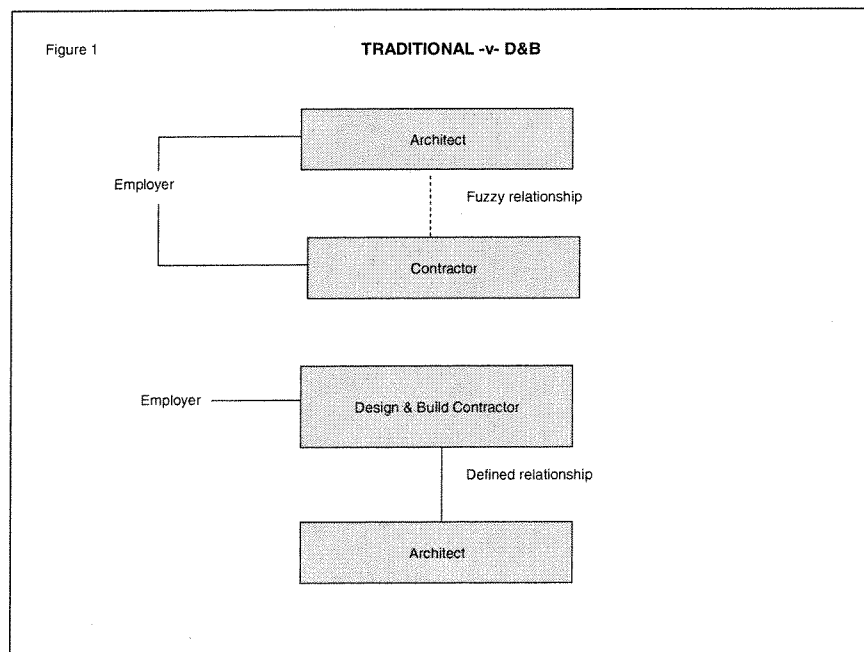
1.4. A further point of emphasis is that Contractors businesses and the responsibilities they assume have been undergoing rapid evolution and extension at least among the most progressive and competitive sectors of

the industry. "Design and Construct" doesn't completely capture these developments for the contract might now include non-traditional elements of supply, training, operation and maintenance and other activities. In fact D&C must now be seen as part of a spectrum of business support services which involves a far wider range of activity than is traditionally associated with getting a building put up. Examples of this abound in contracts under the PFI and also contracts currently let by Highways Authorities.

- 1.5. The D&C Professional Indemnity Policy is not to be seen in isolation. The risks it relates to are not covered by other traditional insurance policies carried by contractors notably the Contractors All Risk and/or Employers and Public Liability policies which primarily cover damage to property or persons during the Works. Other risk management techniques employed by contractors including the use of bonds, sub-contractors' warranties, limitation of liability and margin may all prove ineffective against the kind of losses and claims which could arise from professional or design risks. There is therefore little alternative, but compliance with the client's requirement for professional indemnity cover. One alternative which may be available or required where the character of the project puts it outside the scope of existing or obtainable professional indemnity cover is single-project insurance. An example might be a contract involving asbestos or nuclear risks.

## 2. HOW DO CONTRACTORS' DESIGN LIABILITIES ARISE?

2.1. First it is necessary to recall that there is a history going back to the 1960s of employers seeking "turnkey" contracts with the advantage of a one-stop shop for all design and build matters from conception to the finished articles. This type of contract has been called Design and Construct, or Design and Build and also encompasses management contracting in which the Contractor doesn't himself design or build anything very much. Typically, the contractual obligations of a D&C contractor are contrasted with those of "traditional" building contracts where the employer is an intermediary between the contractor and the design professionals. Traditional building contracts, however, are not lacking in contractors/sub-contractors own design elements particularly for specialist piling, foundations and steelwork. Therefore contractors design liabilities are not novel and this aspect of their work still constitutes an important proportion of the risk they run.



- 2.2. Standard Design and Construct contracts exist. Large utilities and other regular Employers often use their own one. The best known include the JCT Standard Form of Building Contract with Contactor's Design 1998 Edition (various amendments were added to 2003).
- 2.3. This has now been superseded by the 2005 edition of the JCT DB Contract. The JCT also publishes a Design and Build Sub-Contract (2005) "DBSub/C"
- 2.4. In the JCT DB 2005, the **Contractors' Obligations** are set out in Section 2.
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- 2.5. The key parts of Section 2 are attached with, for comparison, the 1998 wording which will still be used for many current projects.
- 2.6. Section 2.1.1 – *"The Contractor shall carry out and complete the Works in a proper and workmanlike manner and in compliance with the Contract Documents, the Health and Safety Plan and the Statutory Requirements and for that purpose **shall complete the design** for the Works including the selection of any specifications for the kinds and standards of the materials, goods and workmanship to be used in the construction of the Works so far as not described or stated in the Employer's Requirements or Contractor's Proposals, and shall give all notices required by the Statutory Requirements."*

And there is a design warranty as follows:

- 2.7. Section 2.17.1 – *"Insofar as its design of the Works is comprised in the Contractor's Proposals and in what the Contractor is to complete in accordance with the Employer's Requirements and these Conditions (including any further design required to be carried out by the Contractor as a result of a Change), the Contractor shall in respect of any inadequacy in such design have the like liability to the Employer, whether under statute or otherwise, as would an architect or, as the case may be, other appropriate professional designer holding himself out as competent to take on work for such design who, acting independently under a separate contract with the Employer, has supplied such design for or in*

*connection with works to be carried out and completed by a building contractor who is not the supplier of the design."*

- 2.8. Sections 2.10 - 215 are significant because they deal with discrepancies within and between the Employer's Requirements, the Contractor's Proposals and Statutory Requirements in far greater clarity than any previous version of this contract. Section 2.11 is likely to be helpful.

*"Subject to clause 2.15, the Contractor shall not be responsible for the contents of the Employer's Requirements or for verifying the adequacy of any design contained within them."*

- 2.9. Nevertheless, should discrepancies in the Employer's Requirements be discovered during the Contract then the contractor has positive obligation to address them (sections 2.14-2.15).

#### **Standard of Care/Fitness for Purpose**

- 2.10. Section 2.17.1 is the point of departure where professional design liabilities must be distinguished from the Contractor's other liabilities. In this section the liability is equated to that of an architect or other professional designers. This is a reference to the standard of care applicable to professional advisers and the standard achieved by ordinary competent professionals skilled in the relevant field of work, in this case building design. The Bolam test – **Bolam v Frien Hospital Committee (1957)1ALL ER118**.

- 2.11. This is very important because without this limitation, the Contractor is by law equated with a supplier of goods and services and held to offer an implied term that the design is fit for its purpose (as per the Sale of Goods and Services Act 1982, section 4(5)).

- 2.12. **Viking Grain Storage Ltd v TH White Installations Ltd [1985] 3 CONLR 52,33BLR 103** is authority to the point that absent an express standard of care then a fitness for purpose type obligation is implied. The Judge, Davies J, was positively enthusiastic for the proposition:

*"...The virtue of an implied term of fitness for purpose is that it prescribes a relatively simple and certain standard of liability based on the reasonable fitness of the finished product irrespective of considerations of fault and of whether its unfitness derives from the quality of work or material or design"*

- 2.13. Comparing this with section 2.17.1 throws light on the tension between the requirements of tort law versus contract law which is characteristic of the whole problem of insurable risk in this field. Viewing the matter from a wider perspective than that of the standard JCT DB contract it might be noted that professional services are, with notable exceptions e.g. NHS medicine, normally supplied within an express contractual framework with a standard of care usually but not always expressed (if it is expressed) akin to the **Bolam** test. The theme of concurrent duties in tort and contract is not at all unique to the building professions but the issue has been most exposed there because the contracts were much more explicit as to the Employers Requirements than elsewhere. The same issues arise when other customers or clients also start to define their requirements more fully.

#### **Scope of Duty**

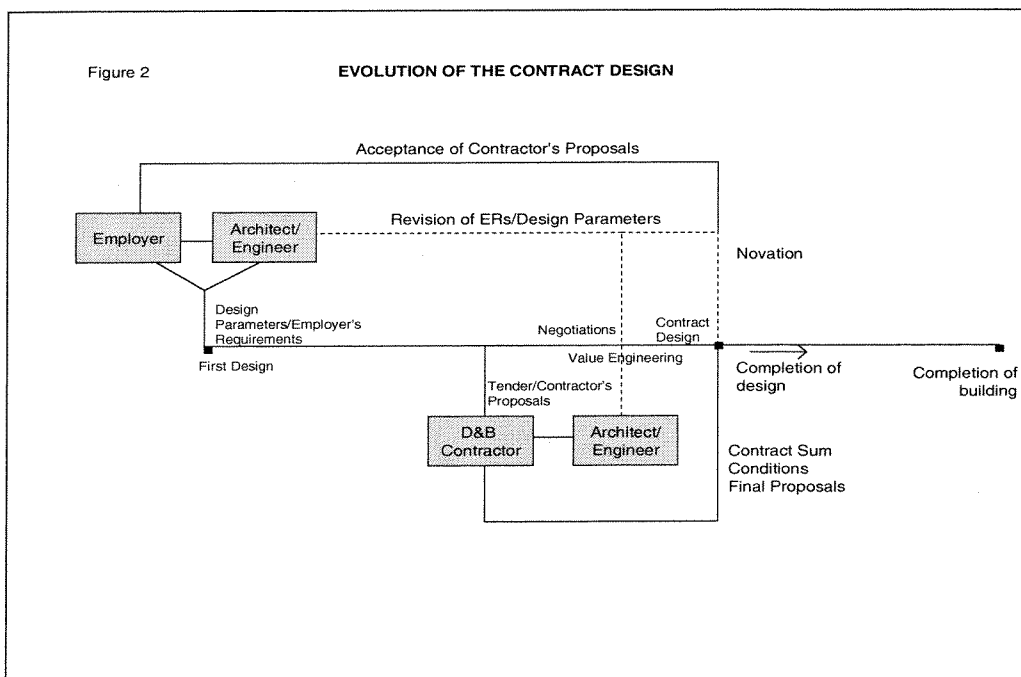
- 2.14. Section 2.17.1 of the JCT DB wording establishes the standard of care appropriate to design obligations, but we have only considered just one clause of the standard wording. The typical major building contract document contains far far more than the standard contract conditions and apart from amendments there may be reams and reams of Employer's Requirements, Design Parameters, Contractor's Proposals, Programmes, Contract Sum Analysis, express warranties, vague statements of intent and much much more. All of these could have a bearing on the scope of the design obligations and the extent of the professional duties generally. The JCT DB 2005 Section 2.11 wording was a direct response to the decision of HHJ Seymour QC in ***Cooperative Insurance Society v Henry Boot Scotland Limited (2003) CLJ 19 109*** in which it was held that "*completion of the design*" included checking an employer's pre-existing



design to be satisfied that it would produce a completed design capable of being constructed.

2.15. The adequacy of the pre-contract design is undoubtedly one of the most frequent issues to arise in disputes and it should certainly not be thought that the thinking which gave rise to *Henry Boot* can be laid to rest by Section 2.11 not least because it may be too simple for what employers actually want or the factual reality of developing an existing design.

2.16. Understanding why the scope of the Contractor's design obligations needs careful review and management can be assisted by appreciation of the typical process by which the complete contract documentation is assembled and what in that context is meant by completion of the design. For this, I refer to **Figure 2**.



2.17. The message of Figure 2 is that for the Contractor limiting responsibility to its interpretation of the "completion of the design" can easily be undermined because the Contractor is often deeply implicated with what went on before the Contract through their response to the Employer's Requirements. Even if the contract contains a term equivalent to Section

2.11, it may be narrowly construed or in conflict with a representation or warranty. The design liability of a D&C Contractor will be in question if it does a poor job of reviewing the Employer's Requirements and preparing the Contractor's Proposals. Given the time and commercial pressures of a competitive tender then it sometimes seems impressive that a good job is done in this respect. However, if a contractor is to be good at anything it should understand what its contract requires and a thorough assessment of design obligations and risk should be integral to the whole tender process of any competent D&C Contractor.

2.18. Nevertheless, it should be recognised that even good procedures and awareness of the assumed risks will not find out all problems. The D&C Contractor is often adopting the designs of others, either the Employer's consultants or his own consultants, and in addition there are the risks of design development or the need to change design during the contract to accommodate variations or site instructions which cannot be foreseen at the time of entering the contract. The whole scenario is one where the Contractor's liability can also arise unwittingly whether or not risk assessment procedures worked.

2.19. This is also a situation where the contractor commits to specified "deliverables" amid a process which has critical contractual pressures, including the need to put forward the best bid and within which the opportunity to exercise a complete technical or professional assessment may be limited. Again, it might be noted that however common this is in the construction industry, it is not unique to it.

### **3. WHAT IS THE RELATIONSHIP OF THE DESIGN LIABILITY TO THE CONTRACTOR'S OTHER LIABILITIES?**

#### **3.1. The fitness for purpose obligation/performance requirements/guarantees.**

While the general fitness for purpose obligation might be limited in relation to "design" by clause 2.17.1 that does not mean there will be no fitness for purpose obligations in the Contract. There are likely to be within the specifications or design parameters any number of particular requirements that can be construed as absolute obligations in the Contract. Failure to achieve such requirements will put the Contractor in breach, but they might not put the actual "designer" in breach owing to the distinction in the standard of care.

3.2. This is an area where management of the design professional appointments is critical. The Consultant's appointment will not change the professional standard of care, but it can address the scope of the duty to have proper regard for the obligations of the Contractor. Consultants have to be aware of and be instructed on the basis of the requirements of the Main Contract.

3.3. The same issue applies to sub-contractors. The JCT DB Sub/C (2005) requires compliance with the Main Contract (section 2.5), but sub-contractors' design is also subject to the ordinary professional standard (section 2.13)

3.4. Achieving a guaranteed level of performance may therefore be excluded from sub-contractors' and consultants' scope of duty, but if they give advice or represent that their designs will achieve a particular result then the difference is not so great. Even so the distinctions that are made between contractual performance and professional duties are definitely an important issue in the insurance of this type of risk.

3.5. This was most clearly found and exposed in Exclusion 11 of the DCW1 wording which excludes:

*"the giving by the Assured of any express warranty or guarantee which increases the Assured's liability but this exclusion shall not apply to liability which would have attached to the Assured in the absence of such express warranty or guarantee".*

3.6. This type of take-give is typical of Design and Construct Professional Indemnity. This illustrates the tension between the offer to cover certain liabilities, but not others. It should also be noticed that other contractual liabilities get similar treatment in contemporary policies including penalties, liquidated damages and indemnities.

3.7. **Obligation to carry out the works in a workmanlike manner to an appropriate standard.** Design and workmanship liability are often competing explanations of why something has gone wrong. In the traditional construction dispute this is the contested ground between the Contractor and consultant albeit the Employer might be representing the Contractor's position. In a D&C contract the terms of this contest are both within the Contractor's remit, but it remains a possible source of dispute with the Contractor's Professional Indemnity Underwriters.

3.8. A key aspect of how this difference manifests itself in the cover is in the need to define **Professional Activities and Duties** or sometimes **Professional Business** for which cover is granted by the Professional Indemnity Policy. It was also apparent in the qualification that holds in DCW1.

*"For the avoidance of doubt, Professional Activities and Duties do not include supervision by the Assured of its own or its sub-contractors work where such supervision is undertaken in its capacity as Building or Engineering Contractor.*

3.9. The reason why old style building disputes were fiercely contested was because it is very difficult to separate workmanship from design and professional supervision. There is no neat point of distinction between professional and non-professional work and on a case by case basis it might be a matter of opinion, custom or the facts on the day. Nevertheless, Underwriters will not be able to duck this issue and their

definition of the distinction will aim at limiting cover to professional activities and duties, but there is a great scope for debate as to how they should be identified and differences among Underwriters as to whose work they are ready to cover. However, whatever any individual's concept of the difference is there is no escaping the possibility of argument.

3.10. **Duty to Warn.** Legally this is a comparatively complex area because in relation to a D&C contractor the subject matter of a duty to warn would be quite various and is not necessarily limited to warnings arising from contractual duties and not necessarily arising from professional duties. The most frequently cited authority *Plant v Adams [1998] EWHC QB 335*, a Court of Appeal decision, disdained from going much further than confirming that it was "*an aspect of the general duty to take reasonable care and skill*". In other words it is just part of what is required professionally to get a job done properly taking into account knowledge which might be required at any stage of the project.

3.11. It has been noted that the breach in respect of a duty to warn will often be the omission of the warning. The giving of a warning is not a negligent act and therefore liability for the consequences only arises from some other breach of duty. In the D&C context the exercise of a warning will put the contract in conflict with itself often leading to extra cost, delay and the incurring of liquidated damages. Only a sub-set of the possible circumstances trigger a claim for breach of professional duties.

3.12. There is a definite tendency now for D&C PI wordings to address cover for duty to warn. Typically this is to provide cover for certain species of duty to warn (eg contractual) in order to exclude by implication others (eg non-contractual).

3.13. **Obligation to complete the contract on time and at cost.** Liability for liquidated damages and consequential losses can arise owing to contractual delay. A D&C contract internalises potential conflicts between completing the contract without delay and at the least cost and the need to get the design right. In the traditional contract situation the

Contractor seeks to recover any losses caused by a negligent designer from the Employer either by agreed variation or extension of time or if not agreed by a loss and expense claim. The D&C contract changes this situation entirely. It also alters the nature of the mitigation required in that the Contractor's obligations to complete the contract now includes provision of the revised design solution which may lead to a question of whether there is betterment.

- 3.14. Underwriters' approach to liquidated damages and the consequences of delay is generally the same to apply to other aspects of contractual performance which in this case is akin to a warranty to deliver on time with fixed penalties in the event of failure. However, the problem of assessing the real reasons for delay and whether or not they are arising from breach of professional duties or instead commercial difficulties, programming errors or mismanagement of resources is a difficulty of the same type and magnitude as distinguishing workmanship issues from design issues.
- 3.15. The same problems relate to the differentiation of pricing risks from design and other professional risks. The D&C contractor may be competitive and win contracts solely on the basis of the lowest tender, but if there is a subsequent cost overrun because the original design was insufficient or the programme was misjudged it may be suggested that the original cause was professional errors which again must be hard to separate from the commercial misjudgement. They can be the two sides of the same coin.
- 3.16. The above list of obligations is not exhaustive. The D&C Contract still involves the Contractor in all the traditional liabilities and the design obligation is an overlapping addition. The management of the traditional liabilities involve the Contractor in multiplicity of formal and informal techniques of risk management, including the use of performance bonds, warranties, insurance (Contractors All Risk), sub-contracting, limitations on liability including LADs, retention of risk, margin for both costs and time. Successful D&C allows the design obligation to sit comfortably with the rest.

3.17. One of the messages of this paper is to highlight the fact that for certain D&C Contracts, the Professional Indemnity Policy will not have the scope to cover the main contractual risks. Sometimes this may be apparent at the time of contract formation, but unfortunately not always. Where the "driver" of a Contract is a guarantee or performance requirement then the question may have to be addressed whether it is possible to effectively make the designer responsible for that achievement. Alternatively, if the chief challenge on a project is constructability and it is discovered that the design adopted cannot be practically implemented to an adequate construction standard then again it will not be always possible to hold the designer responsible. Finally, if the financial and time requirements of a project are paramount then again the contractor may be driven to solutions or expedients in completing the Contract for which the designer cannot be responsible. In any of those situations the Design and Construct Professional Indemnity Policy is more likely to disappoint the Insured than if those factors were not present. However, given that those kinds of factors are likely to be present in a fair proportion of projects then careful attention to the requirements of the policy is required by both Underwriters and Insured. On the one hand Underwriters must not allow the interpretation of the policy to expand to cover all the Insured's commercial imperatives. On the other hand the Insured has the power at the time of contract formation and through its appointment of professionals to "maximise" the scope of its activities which fairly fall to be protected by the policy. Fortunately, the interests at stake are mutual because an Insured that pays attention to such issues at the right time is effectively engaged in risk management and that is likely to be to the Underwriters' benefit 9 times out of 10.

#### 4. THE COVER.

- 4.1. A study of the policy wording is the only place to start understanding the scope of and limitations of any cover. However, reference might also need to be made to the insurance proposal because the statements made in that document can affect cover as well. A good example relates to the declarations which are made of turnover connected to defined disciplines and types of work. If it is found that work has been undertaken in different disciplines not disclosed then the policy could be voided.
- 4.2. An interpretation of the cover should reflect what the Underwriter is trying to achieve. The most obvious point is that the Underwriter does not intend to pick up the ordinary construction and commercial risks of a project. Further the policy should not duplicate cover available on other policies. Nevertheless, to be of any value the policy has to reflect the reality of design and construct contracting and take account of the fact of bought in design and the fact that the Contractor is or was in a Contract with strict obligations.
- 4.3. In the London Market the DCW1 wording might be regarded as the ancestor of other wordings currently available in the market. DCW1 is notable for its brevity and simplicity and its DNA can be found in all other D&C Professional Indemnity policies. Subsequent wordings show signs of drafting to address perceived ambiguities or insufficiencies of the wording. Underwriters also have exercised a degree of give and take to adjust the scope of the cover to improve their offer or their underwriting results. However, the wording has also to cope with the evolution of the design and construct industry which as stated in the introduction has tended to widen the scope of the activities undertaken and Underwriters have had to decide how to accommodate this trend if they are willing to do so. Most of all the difficulty of distinguishing professional risks from commercial risks is what drives the development of most attempts at redrafting. It can be questioned whether a completely satisfactory approach is attainable. If not then that is serious because this is so much more a prominent product now than it was in former times.



## **Negligence of the Insured and its Consultants or Sub-Contractors**

- 4.4. The "COVERAGE" is restricted to **negligence** in relation to Professional Activities and Duties.

*"... the Underwriters hereby agree to indemnify the Assured for any sum or sums which the Assured may become legally liable to pay arising from any claim or claims first made against them during the Period of Insurance stated in the Schedule as a direct result of negligence on the part of the Assured in the conduct and execution of the Professional Activities and Duties as herein defined".*

In addition to this cover for the Insured's breach an additional extension is available for the Insured's sub-contractors or sub-consultants:-

*"2. The Underwriters will, subject to the terms, exclusions, conditions and endorsements of this Policy, indemnify the Assured in respect of liability arising out of any act of negligence by specialist designers, consultants or sub-contractors of the Assured and engaged in the performance of the Professional Activities and Duties defined herein provided that the rights of recourse against such specialist designers, consultants or sub-contractors are not waived or otherwise impaired".*

- 4.5. This is usually considered more than an optional extension and instead closer to an integral element of a Design and Construct Professional Indemnity Policy. In newer wordings it is often but not always drafted into the same main insuring clause covering the Insured's professional activities. This is critical because it extends the class of persons whose activities are covered by the Policy and reflects the issue of bought-in design.
- 4.6. It is one of the unique features of D&C Professional Indemnity policies that the above situation leads Underwriters to insure the professional duties of construction industry consultants from whom they have never received a proposal form. In fact they do not know the identities let alone the character and record, of the parties whose activities they are in practice covering. This explains some aspects of the cover available as we shall see later in this paper.

4.7. The definition of **Professional Activities and Duties** is also critical as it determines the type of activity that is insured. DCW1 initially covered:

- Design or specification
- Supervision of Construction (but not of own labour)
- Feasibility Study
- Technical Information Calculation
- Surveying

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There is no cover for "similar" activities not listed although this rather restricted list was supplemented with additional activities by way of endorsement and newer wordings also have more extensive lists of covered activities. The covered activities are and should also be driven by declarations in the proposal form and along with turnover is an important factor in rating these risks.

4.8. However, all these activities are excluded within the DCW1 definition if they are not undertaken "by or under the direct control of a properly qualified Architect, Engineer or Surveyor." A fundamental feature of the policy is that it only covers certain activities under the direction or control of certain types of persons. This definition in itself has not proved sufficient. Elaboration of the definition of "properly qualified" has generally been required usually by reference to experience in the relevant technical discipline (5 years usually) as an alternative to professional qualification. Furthermore, as the list of insured activities is extended the reference to the three specific professions is less appropriate.

4.9. There is a different approach to the definition of professional duties which is to relate it to the activities of technically qualified people and not directly define the type of work at all. This reflects the fact that in the most diverse of contracting organisations it is difficult to put a limit on the types of professional work which might be undertaken. This approach originates in the policies designed to appeal to the largest contractors where it is hard to discover what they do not do.

- 4.10. It should also be apparent that the extended definitions of **Professional Activities and Duties** or in other policies **Professional Business** shows that the idea that the policy is for "design" liabilities is rather misleading being much more extensive than that. Nevertheless, it ought to be asked whenever coverage comes to be considered whether the claim arose from properly qualified people doing one of the defined activities – or not.
- 4.11. There is a final part of the definition of the insured activities which is expressed as a limit on the scope of Professional Activities and Duties which does not include the supervision of the Insured's own labour or its sub-contractors as noted at paragraph 3.8 above. This provision is at the heart of the point of controversy of workmanship and design and its invitation to disagreement. Whether you blame the words or the underlying concepts for the problem will determine if you might think major improvements could come from revising the terms of the cover.
- 4.12. In this respect, I have had my attention drawn (thanks to Mike Earp and Peter Ibbotson of Willis) to the Carey Syndicate 919 Design and Build Professional Indemnity Policy (circa 1985) which had no express exclusion for own labour supervision although it was not expressly included either. There was an evident intention to cover Project Managers and *"...other consultants or inspectors as would otherwise have been appointed by the Employer on the advise of or under the direction and control of the Architect or Consulting Engineer..."* . There is in this what might be known as the "Clerk of Works Question" and an attempt to rationalise the D&C PI cover by comparison to the indemnities available to the parties to traditional contracts.
- 4.13. **Costs Prior to Hand-Over.**

This is the second main component of the cover which in DCW1 was also expressed as an additional extension to the policy:-

*"The Underwriters will, subject to the terms, exclusions, conditions and endorsements of this Policy indemnify the Assured against the costs and expenses necessarily incurred in respect of any action taken to mitigate a loss or potential loss that otherwise would be the subject of claim under*

*this Policy. The onus of proving a claim under this Extension shall be upon the Assured who will be obliged to give prior written notice to Underwriters during the Period of Insurance of the intention to take action that will incur such loss"*

It is perhaps worth considering this with a more recent wording to show how much and how little this provision has evolved.

*"indemnify the **Insured** subject to notification in accordance with the Claims and Notification Provisions, which are conditions precedent to the provision of indemnity, for costs and expenses reasonably incurred with the prior written consent of [XXX] which will not be unreasonably withheld in respect of rectifying prior to any practical completion ,take-over certificate or defects period any part of the works constructed by the Insured to the extent that the Insured is able to demonstrate on a balance of probabilities that the need for such rectification is due to the **Insured's** negligence in the conduct of their **Professional Business** and is necessary to mitigate a **Claim** or likely **Claim** that would otherwise have been insured under Clause 1 .1."*

- 4.14. This is a most interesting and highly charged aspect of the cover. Mitigation is, of course, not a strange concept in Professional Indemnity, but for all other types of Professional Indemnity it is usually the Insured who is raising the cry of mitigation against Claimant. In the case of a D&C Contractor it is he himself who is in a position to do the mitigating. The wording above betrays the anxiety of the Underwriter by placing the onus on the Insured to prove on the balance of probabilities the **necessity** of the mitigating action. The danger for the Underwriter is that the mitigation against professional negligence might be mixed up with all sorts of other mitigation connected to the progress of the Contract that ought not to be indemnified.
- 4.15. The Insured needs to demonstrate there would be a claim under the policy although there is no need to wait for a loss to occur, just to demonstrate a potential loss within the scope of cover. Failure to obtain

prior written consent will certainly result in no assurance of cover for mitigating steps taken before this is remedied and possibly an argument about any course of action taken to which the Contractor has become committed.

4.16. When such a claim is presented an important question is how will the Contractor demonstrate an actual or potential loss justifying the proposed action and to distinguish the costs of mitigation from costs which could otherwise be incurred under the Contract. The difficulty of this will vary according to the situation, but in complicated situations it is not going to be easy at all. In controversial situations the Underwriter may need independent professional assistance to verify the contractor's proposals.

### **Exclusions**

4.17. Exclusions define the cover as much as the insuring clauses. The DCW1 standard exclusions are not excessively numerous (11) but in reality they must for a long time, if not always, have been supplemented by exclusions through endorsements.

4.18. As noted above the D&C PI exclusions will evince an intention to prevent the policy picking up the performance requirements and workmanship obligations which might be imposed by a D&C contract. These include:

- contractual liability – fitness for purpose, warranties, guarantees and liquidated damages;
- incorrect specification, estimates and programmes;

both of these exclusions are qualified in that they will be covered if they arise from a breach of professional duty properly defined.

- Unsupervised work
- Workmanship/supervision

4.19. More general commercial risks adopted by the D&C contractor are addressed by the following exclusions some of which may be negotiable to a degree:

- Assignment of collateral warranties;
- Maintenance of insurance and financial provisions or advice;
- Consortia and joint ventures;
- Binding adjudications;
- Insolvency of Insured;

4.20. There are exclusions relating to other insurance:

- Employer's liability;
- Occupier's liability;
- Other insurance.

4.21. Finally, there is a class of unacceptable risks:

- Pollution (save for sudden, unexpected and accidental);
- USA/Canada;
- War/terrorism;
- Toxic mould;
- Products;
- Asbestos;
- Nuclear.

### **Conditions**

4.22. In DCW1 the primary condition of note relates to claims notification. In this respect the wording was a perfectly typical clause of its type which could be found in identical form in any other PI policy. The only particular twist was the additional requirement to give prior written notice and demonstrate the necessity of actions to be indemnified via the mitigation extension.

- 4.23. As with the DCW1 wording, it is normal for notification conditions to be conditions precedent in D & C PI policies. The requirement is to notify claims and circumstances as soon as practicable (adjudication notices within 48 hours). In other professional indemnity policies it is common for the Insured to be protected by Special Institution Clauses which may in effect excuse the Insured from failure to properly notify a claim. This does not typically occur with D&C PI policies.
- 4.24. The terms of the policy should ensure that if the Insured wishes to benefit from the cover purchased it has to have strong systems in place to ensure the Underwriters are advised of what might be a fast moving, developing situation very quickly.
- 4.25. The other chief DCW1 conditions concern the constraints and duties placed on the Insured pending Underwriters taking control of the claim circumstances and prior to the giving of written consent to certain actions including:
- Incurring defence costs and expenses
  - Admissions and settlement
  - Information and assistance
  - Incurring costs prior to handover to mitigate a claim
- 4.26. Other policies have made all these conditions precedent to indemnity and in some the Insured is also positively obliged to take reasonable and practical steps to avoid or diminish any liabilities to Underwriters and avoid the assumption of obligations.
- 4.27. It is suggested that all of the above are more critical in a design and construct context than in many other professional indemnity situations because the relevant difficulties of the Underwriters establishing real control of the circumstances are greater and the Insured needs clear requirements against which to balance his other commercial interests if a proper choice of priority is to be made.

4.28. As it is difficult in many instances to disentangle the contractual liabilities that are not covered from the liabilities for professional activities and duties some conditions have been developed to allow for an agreement of the allocation of amounts in respect of covered and uncovered matters. Such a procedure might prove a practical alternative to prolonged reservations of rights and an element in the settlement of claims especially where causation might not be established prior to trial as is often the case.



## 5. THE DIFFERENCE FROM OTHER PROFESSIONAL INDEMNITY POLICIES

- 5.1. There is no single profession covered by this type of policy it is multi-disciplinary. The cover is also for some other person's/firm's negligence as well as the Insured.
- 5.2. Cover for civil liabilities is inappropriate and would be impossible. The Contractor is sued for breach of contract but can only be indemnified for negligence. This reflects the central distinction of designer's obligations verses Contractor's obligations.
- 5.3. The Contractor can rarely sit outside a dispute. In a construction project the financial outcome of the contract might easily be the measure of loss owing to the negligence. The Contractor is 'piggy in the middle' and wherever responsibility for the loss lies it is rarely an option for the Contractor to walk away which is the opposite of mitigation. It is often a valid strategy for a professional consultant to "wait and see" whether a claim circumstance might resolve itself. A Contractor does not have this luxury.
- 5.4. Above all whereas another professional's Professional Indemnity is to a considerable extent a mirror to his duties, a Contractor's frame of reference is his contract which is not a mirror to the Professional Indemnity cover.

## 6. HANDLING - D&C PROFESSIONAL INDEMNITY CLAIMS

6.1. Establishing cover under a Professional Indemnity Policy after completion of the contract is something akin to a normal Professional Indemnity investigation. Doing so during the contract is much harder and the pressures different parties may be under could be acute. For example, the Contractor may be under threat of termination of a contract, adjudication, or the calling in of a bond. Against this a threat to reserve rights or even decline indemnity may be the least of the Contractor's worries but the Underwriter needs to consider his position even so.

### **Mitigation**

6.2. The cover provides that the Contractor has to show that the mitigation action is **necessary** to avoid a loss to the policy. This is not the same as a loss to the Contract or to the client or to repair goodwill or anything else. Of course it might be hugely difficult to spot the difference between the different motivations of mitigating actions. Control of and direction of mitigating actions is an important topic as the Underwriters do not take control of the Contract in the same way as they control the defence of the claim.

6.3. The terms of the policy may be clear enough but it is very likely, the Employer will also wish to approve mitigating actions if not dictate what they are should it be aware of the situation. Sub-Contractors/sub-consultants who may be the actual negligent parties may also seek a say in how their faults are to be rectified. It is easy to see that if they all agree on what has to be done it would be difficult to propose some alternative in Underwriters' interest and separate specialist advice might be needed. If the parties disagree as to what has to be done then it will be necessary to prove that what is in fact done is reasonable in terms of costs, taking into account how difficult this might be to assess in advance.

6.4. Two difficult questions might arise:

- i). The Contractor might confess he does not actually know how to remedy the defect or whether the proposed action will work.
- ii). If the Underwriter approves or even chooses the appropriate remedial scheme, does he thereby become a project manager or quasi-employer?

### **Subrogation**

6.5. In theory the D&C PI Underwriter having indemnified on the basis of the principle components of the cover will be thinking if a claim has to be paid, then as the Insured Contractor has hopefully contractually off loaded all design responsibilities, then a complete recovery can be achieved through a subrogated action against the responsible sub-consultant or sub-Contractor.

6.6. However, there may be a few obstacles to this scenario:

- Sub-Contract/Appointment may not be back to back
- Disputes as to which Sub-Contractor/Sub-Consultant could be responsible
- Inadequate Insurance
- Insolvency
- Dispute as to whether the Contractor had a Defence against the Employer
- Dispute as to whether the loss is caused by the Contract or by negligence
- Different forms of dispute resolution applying to the main and sub-contracts.
- Litigation Costs/Time Costs
- Decay of the evidence

6.7. Underwriters too can take some prior action to off-set these risks of incomplete recovery. Hence:

- Requiring Sub-Contractors/Consultants to have written appointments.
- Requiring Sub-Contractors/Consultants to ensure that Sub-Contractors have adequate Professional Indemnity Insurance, ie at least same as the Contractor. This is in the present policy addressed through Condition 4.16 where the Insured is required to exercise best endeavours in this respect.

## 7. **CONCLUSION**

7.1. The D&C PI market is not yet at a point of maximum extension and is riding the considerable growth that has been experienced in D&C procurement in the last 15 years. This has widely extended the customer base of the market and expanded the interest and appetite for understanding of this product among contractors, brokers, underwriters, claims handlers and solicitors who have been caught up in this development.

7.2. The basic concepts of the D&C cover are not new, but there are long standing issues associated with the definition of the cover which excites debate and controversy to a degree rarely equalled in other PI sectors. This makes this a fertile field for innovation and differentiation between products. It is also a field where relationships are critical and the key to avoiding the worst pitfalls. The risks are very considerable, the rewards also.