

CONSTRUCTION : BULLETIN

10 Insurance Pitfalls To Avoid

Construction contracts allocate risk and liability between the parties involved in a construction project. A party accepting a risk may choose (or may be contractually required) to cover its liability with insurance. As well as protecting the party that takes on the risk, insurance also protects the party to whom the liability is owed by reducing the possibility that the party bearing the risk will have insufficient funds to meet any liability that may arise.

Although it offers valuable protection, insurance is a complex area and strict compliance with the terms of the insurance policy is essential. This bulletin explains 10 of the most common insurance pitfalls to avoid.

1. Failing to obtain appropriate cover

Any contract you are proposing to enter into should be sent to your insurance broker so that they can check your existing insurance complies with the requirements of that contract.

If there is any shortfall in your current insurance cover which cannot be remedied (e.g. because it is not possible to obtain the higher level of insurance required by your potential client), the shortfall should be drawn to the attention of your potential client at tender stage so that you can agree a solution which both parties are satisfied with.

If your insurance does not correspond with the insurance requirements in the contract, you may be faced with two problems; a breach of contract claim from your client and a policy of insurance which is inadequate for the risks associated with the project in question.

2. Lack of awareness of policy exclusions

All insurance policies contain exclusions in respect of matters which are not covered by the policy. However, it tends to be the case that the cheaper a policy is, the more exclusions it will contain. This should be borne in mind when shopping around at renewal stage.

Insurance policies should be checked carefully to ensure that there are no exclusions which would have a significant impact on how your business operates, such as an exclusion for claims arising from a particular type of work which your business regularly carries out.

3. Accepting uninsurable obligations

By far and away the most common example of this problem is design and build contractors and design consultants signing up to “fitness for purpose” obligations.

Professional indemnity insurance policies only respond to negligence claims, which are rooted in an alleged failure to provide services with reasonable skill and care. A fitness for purpose obligation goes beyond the obligation to exercise reasonable skill and care and consequently falls outside the scope of a professional indemnity insurance policy. Such a claim would be uninsured and payable from the business’ own resources.

If possible, it is good practice to ask your insurer or insurance broker to review contracts which involve the provision of design services, as they should be able to advise on whether the obligations imposed by the contract would fall outside the scope of available insurance cover.



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4. Failing to notify

Notification of potential claims is one of the most fundamental requirements of any insurance policy. Many insurers will impose a tight time limit for notification of a potential claim and will treat compliance with this time limit as a condition precedent to the availability of insurance. Failure to notify a potential claim on time could result in the insurer refusing to provide an indemnity in respect of that claim or, more seriously, could result in the policy being revoked entirely.

Even if notification within a specific time limit is not a condition precedent, it is still crucial to give notice of any potential claim as soon as possible because a delay in notification could result in your liability increasing or deprive the insurer of the opportunity to instruct you to take action to prevent the situation from escalating. If the insurer takes the view that the delay in reporting the claim has prejudiced their position, they may refuse the claim.

If in doubt about whether a particular set of circumstances may give rise to a notifiable claim, it is better to err on the side of caution and approach your broker or insurer for guidance.

It is also important to check who the policy requires notice to be given to. Is it sufficient to notify the broker, or must the insurer be notified directly?

5. Failing to keep the insurer informed

Satisfying the initial hurdle of notification of the potential claim does not guarantee your insurer will provide you with assistance. It is a condition of many policies that the insurer must be kept informed of all matters relevant to the claim as it progresses. Failing to pass on correspondence or provide updates on the progress of a complaint could result in the insurer taking the decision to decline the claim, particularly if the insurer takes the view that the failure to keep them informed has prejudiced their position.

6. Admitting liability

You should not admit liability for a claim or potential claim without the consent of your insurer. Failure to obtain consent could result in your

insurer refusing to provide an indemnity in respect of the claim. If you are asked to attend a meeting to discuss a problem which may lead to you making an insurance claim, ensure the meeting is held on a “without prejudice” basis and that any offer you make to try to resolve the problem (e.g. to carry out remedial works) is made without any admission of liability.

7. Failing to keep adequate records

Keeping evidence of work carried out or services provided which are relevant to the insurance policy is a key element of risk management. For example, a professional consultant should ensure that all advice he gives in the context of a project is recorded, even if his client ignores it, so that evidence is available to defend a potential professional negligence claim.

All emails, correspondence and documents relating to each project should be stored in a manner which makes them easy to access. It is important to back up documentation, because if an IT failure results in a loss of documents, this can make it very difficult to defend a claim. Documents should be retained for at least the applicable legal limitation period under the relevant contract.

8. Failing to maintain professional indemnity insurance

Professional indemnity insurance operates on a “claims made” basis, which means the policy must be in place at the time the claim is made, rather than at the time the event occurred. This is why the vast majority of construction contracts require professional indemnity insurance to be maintained for the full 6 or 12 year limitation period during which a claim could potentially be made.

If professional indemnity insurance is allowed to lapse and a claim is brought against you, the cost of both defending the claim and paying any damages due to the claimant will have to be met from your own resources. This can have serious financial implications, especially for small businesses with limited financial resources.

9. Not mitigating loss

Many insurance policies contain a condition that a payment will not be made unless the insured makes a reasonable effort to minimise any loss, damage or liability. If a circumstance arises which is likely to result in an insurance claim, you should take measures to try to reduce the level of loss which is likely to be suffered (and thereby the value of the claim). For example, this may involve carrying out remedial works to minimise the loss arising from a claim for negligent design. However, remember the importance of points 5 and 6 above, and ensure that the insurer’s consent is always obtained before any mitigating action is taken.

10. Lack of understanding of the insurance positions of others

On many construction projects, it is also important to be aware of the terms of insurance policies taken out by other parties. For example, a sub-contractor may be insured on a main contractor’s all risks policy. A party benefiting from another party’s insurance should comply with the terms of that insurance as if it was their own insurance policy. It is important to be aware of this and to request copies of any policy of insurance which has been taken out by another party for your benefit.

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