‘Battle of the Contracts’
Round Two
The insurance implications of JCT & NEC forms
Introduction

Earlier this year Arthur J. Gallagher, Construction hosted a joint interactive workshop with Hawkswell Kilvington the construction and engineering specialist solicitors. At its core this event had a strong theme: the benefits both owners and contractors can accrue from prioritising contract certainty.

Hawkswell Kilvington partner, Jonathan Hawkswell, set out his thoughts on a wide range of contract-related matters, including the insurance issues associated with the latest versions of the rival JCT and NEC contract forms. His legal insight into the complexities of contract formation overall can be found in the sister paper to this one “Employers, Contractors and the ‘Battle of the Contracts’” dated September 2013.

As the second technical briefing paper to flow from that workshop, this instalment draws on Jonathan’s presentation and further examines the issues and considerations that surround the arrangement of insurance under these two competing construction contract forms.
Background

The Joint Contracts Tribunal (JCT) became a limited company in 1998 and is made up of seven bodies which between them represent all of the key sectors of the construction industry. Since 1931, it has produced standard forms of construction contract, together with guidance notes and a range of other standardised documentation. Today, JCT is the most common standard form used in the UK accounting for around 70% of projects. The most recent version of the JCT suite, which was the third revision of the 2005 versions, came into effect on 1st October 2011.

By contrast, the New Engineering Contract (NEC) is a relative newcomer that traces its roots back to 1993. The NEC is a suite of standard form construction contracts created by the Institution of Civil Engineers in response to the Latham Report which examined procurement and contractual arrangements in the UK construction industry. The 1993 suite was updated with a revised version in 1995 and 2005 (NEC3). Most recently, in April 2013, came the first major changes since 2005 and a new short-form Professional Services Contract for the procurement of professional and consultancy services on smaller projects was also introduced. NEC3 was the standard contract form of choice for the projects related to the 2012 London Olympics.

In the case of both the JCT and NEC forms, many of the recent changes were driven by legislative change, in particular the Housing Grants, Construction and Regeneration Act 1996 under the umbrella of the Construction Act 2009, which came into effect in England and Wales on 1 October 2011, and Scotland on 1 November 2011.

Where the JCT was concerned the key changes were:

- The revision of the definition of insolvency in the contract termination section
- The updating of the terrorism cover provisions
- Payment provisions in contracts, elements of which were substantially re-written to reflect the amendments to the Construction Act
- The inclusion in the updated contracts of a statutory reference to the Bribery Act 2010
- Revisions to the retention provision in the sub contracts
- The deletion in the sections on Professional Indemnity (PI) insurance of the sections on asbestos and fungal mould.
In light of the impact of changing legislation, the decision was taken to update NEC3 instead of producing an ‘NEC4’ by publishing a series of loose leaf amendments culminating in a new ‘box set’ in April 2013.

Like the JCT, the NEC amendments particularly reflect the changes in relation to the provisions on payment and adjudication, plus provisions and clauses that enable clients to make payments into a single bank account to which all contractors have access - although this tends to only apply to public sector projects. References are also included to the Construction Industry Council (CIC) Building Information Modelling (BIM) Protocol. Published in March 2013, BIM uses a computer-generated model to centrally collect and manage information on the design, construction and operation of a project, with design changes made during the project automatically applied to the model.

Back in October 2011, commentators took the view that the JCT amendments were more comprehensive and focused than those contained in the NEC, covering as they did all aspects of the Construction Act changes. By contrast, some labelled the NEC changes ‘opaque’ as they glossed over certain aspects. For example, when interpreting the NEC payment provisions, direct reference to the provisions of the Construction Act is required.
JCT and NEC and their different approaches to ‘risk’

The majority of construction contracts have provisions that require cover to be purchased for physical damage and/or the loss of the works.

The JCT ‘Design and Build’ form specifies the types of insurance types required:

- Option A (New Buildings) requires the contractor to take out and maintain ‘all risks’ insurance of the works;
- Option B (New Buildings) requires the employer to take out and maintain ‘all risks’ insurance of the works; and,
- Option C (Existing Structures) requires the employer to take out and maintain (a) insurance in respect of the existing structures and their contents and (b) ‘all risks’ insurance of the works.

Where injury to persons is concerned, the contractor is deemed liable unless the injury is due to the employer’s negligence; with respect to damage to property, the contractor is liable for damage due to his negligence, otherwise the employer is liable; and, in the area of design liability, the contractor has the same liability to the employer as would an architect or professional designer - that’s to say, they are required to act with reasonable skill and care.

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Under the NEC3 ‘Engineering and Construction Contract’ the contractor provides the works in accordance with the works information and is deemed liable for all risks that are not carried by the employer. An employer’s risks are defined as:

- Unavoidable damage;
- Negligence of the employer;
- Fault in the employer’s design;
- Plant and equipment until received and accepted by the contractor;
- War risks;
- Strike and riots, not confined to the contractor’s employees;
- Loss, wear or damage to parts of the works taken over except where this is due to a defect which existed at takeover; and event occurring before take over for which the contractor is liable and the activities of the contractor on site after take over;

- Loss, wear or damage to works/materials retained on site by the employer in the event of termination other than due to the activities of the contractor; and
- Risks stated in the contract data, which are additional and voluntarily assumed by the employer.

However, there are some other important variations. JCT insurance is arranged on the basis of joint names (contractor and employer) to cover ‘all risks’ – the works, materials, reasonable costs of removal and disposal of debris and shoring and propping up the works – with cover and limits defined in the conditions and contract particulars. NEC contracts, on the other hand, are drafted differently to include the concept of employer and contractor risks and clause 84.1 of the NEC3 ECC allows the parties to set out in the contract data who takes out each type of insurance. This means it could be either the contractor or the employer who insures – or a mixture of both.
Contractors All Risk (CAR) and Public Liability are required to be in joint names but the contractor is only required to take out ‘all risks’ protection to the extent of its risks in the work, plant and materials. Thus, even though the policy is in joint names anything that is at the employer’s risk will not be covered.

Under clause 83.1, NEC3 does provide a ‘mutual indemnity’ - but this is not explicitly linked to insurance which is only there to provide the parties with some comfort that the means to meet losses will be available. The outcome of an event occurring is, therefore, likely to be the employer arguing that, as the event does not fall within his list of risks, liability must, by default, lie with the contractor and any shortfall in the insurance placed to meet an employer’s loss will be the contractor’s responsibility. However, there is some comfort offered under clause 83.2 which states that the parties’ responsibilities under the contract must be taken into account when apportioning liability under the indemnity.
Limits of liability

Clauses to limit a contractor’s liability are becoming more common, especially in the case of major projects, but are not yet a standard feature of many contract forms. Under JCT the limit of the contractor’s liability is ‘unlimited’ – except under clause 2.17.3 of the JCT D&B Contract. Under this clause, the contractor is able to benefit from a limit on liability for loss of use, loss of profit or other consequential loss in respect of the contractor’s failure to design the works with reasonable skill and care. However, this clause is often deleted. Similarly, under NEC it is ‘unlimited’ but, by applying clause X18, there is the option to cap the liability by applying different levels of financial limit in respect of indirect and consequential loss, employer’s property, design liability and the contractor’s total liability. While this may seem to favour the contractor, express exclusions from specific caps can make this clause less useful than first appearances might suggest. Areas for consideration here include the application of hold harmless/waiver/indemnity options especially for high risk contracts such as rail, petrochemical and power plants.

Existing structures and their contents

As noted above, under JCT three options apply and of these Option C (Existing Structures) requires the employer to take out and maintain (a) insurance in respect of the existing structures and their contents and (b) all risks insurance of the works. In the circumstances consideration should be given to clause 6.5.1 indemnity. An anomaly for JCT forms of contract in that it needs to be maintained until the expiry of the defects period, clause 6.5.1 is concerned with damage to property which is not the fault of the contractor, but is subject to certain exclusions.

Under NEC there is the option to rely either on standard provisions or to deal with it as additional insurance requirements to be defined in the contract data.

It is worth noting that the NEC insurance table in clause 84 does not specifically mention cover for existing structures – although it does refer to insurance for damage to property other than the works, which potentially includes any existing structures. The best course of action would be to clarify the position regarding the existing structure either with a bespoke amendment or by including an extra insurance requirement in the contract data.

In either situation consideration should be given to:
- The value of the existing structure versus the works being carried out; and,
- given that portions of the ‘site’ may well be occupied, to objections from landlords and tenants.
Design liabilities and fitness for purpose

Under JCT the test is the application of reasonable skill and due diligence, while under NEC it is fitness for purpose unless another of the ‘X’ clauses - in this case X15 - is agreed. Insurers will normally look to exclude the acceptance or guarantee of fitness for purpose wherever it appears as an express term and, in these circumstances, the available options are to seek to delete the exclusion or to negotiate an acceptable wording. Insurers will look at how the contract defines the intended purpose/use of the works and likely exclusions here are:

• State of the art defence
• Seepage pollution or contamination
• Unforeseen ground conditions
• Process engineering other than relating to the structural integrity of the works.

In the case of unforeseen ground conditions there is normally only minimal cover available. However, where seepage/gradual pollution and contamination are concerned consideration can be given to options such as Environmental Impairment and Contractors Pollution Liability.

Under NEC, suspension - for example as a result of archaeological finds - is treated as a compensation event but the contractor can recover costs and expenses via the NEC compensation event process. Similarly the JCT form makes clear that the contractor can claim reasonable costs and expenses incurred. So in then needs to be changed to lower case in this respect there is little difference between the two contract forms.

Consideration should be given to effecting Performance Warranty insurance. Limited cover is available subject to the work involving proven technology and the risk being part of a portfolio of wider business.

Where the contractor is taking over pre-existing works, it is of critical importance that there is a thorough due diligence of both the design and building works and an investigation of the status of all warranties and rights of recourse.
Additional considerations

Where the key questions and issues revolve around design, workmanship, specification and/or materials, the application of Design Exclusion (DE and LEG) clauses may be considered with Professional Indemnity insurance providing the ‘backstop’ longer term solution. Options such as Latent Defects cover should also be explored.

Likewise, where extension of time provisions are concerned, employers need to consider Consequential Loss/Delay In Start Up cover and supply chain insurance that will protect them against loss of profit, increased costs of working and pre-loss mitigation as well as liquidated damages due to supplier failure and disruption. Liquidated damages for Delay and Performance insurance are normally written on an all risks basis with a 10% retention.
Summary

Whichever form of contract is chosen - JCT or NEC - the reality is that every construction project is unique and so the wordings of the contract will, almost certainly, need to be negotiated, modified and tailored to the particular circumstances and risks assessed and presented. For example, the presence of third party agreements may produce additional contract and insurance implications as would the use of an Owner Controlled Insurance Programme (OCIP).

Ultimately, all of the contract provisions and promises to pay, or to compensate, when problems occur are worthless unless the parties to the contract have the resources available to meet the costs involved. Consequently, ensuring that the construction of the insurance programme underpinning the contract and contracting process is correct is vital.
Authors and Contacts

Jonathan specialises in advising the building and civil engineering industry sectors primarily in relation to contentious matters. He has advised on a number of major construction and engineering disputes in adjudication, arbitration and litigation. He has been involved in a number of substantial claims through adjudication for extensions of time and final account disputes. Previously recognised as “Construction Lawyer of the Year”. Described in Chambers & Partners as “a quick astute lawyer … diligent and hard working … extremely commercial … always has client’s best interests at heart.” Jonathan was previously National Head of Construction at Pinsent Curtis Biddle (now Pinsent Masons).

Bernadette has 20 years of experience, the last 14 in the London Insurance market, she started her career in Australia before moving to London in 1999. She has provided insurance advice and solutions on projects all around the world, from power stations to mines, light rail, roads and stadia. She has worked for both She is responsible for the development of AJG’s fast growing construction business, providing solutions to clients from all around the world and her team provide a global best practice when it comes to advice on insurance, and indemnity and insurance provisions in a contract and access to insurance and reinsurance markets in London and Europe. Bernadette joined AJG in January 2013 from JLT and prior to working at JLT she worked at Sedgwick (now Marsh) and Aon.
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