ISSUE NO.2

BuildingBlocks

RISK INSIGHTS FOR THE CONSTRUCTION INDUSTRY

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Ascertaining the identity of parties to a contract and the scope of duty for a consulting engineer

PRODUCT FOCUS

Using environmental liability insurance to get the project done

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The benefits of inherent defect insurance (IDI) cover - a claims case study

BROKER Q&A: LIMITING LIABILITY UNDER CONTRACT

Building Blocks asks Graham Medland, Partner in Gallagher's UK Construction team, about changing contractual risks, and how insurance can be best used to manage these risks.

Gallagher

Insurance | Risk Management | Consulting

ABOUT GALLAGHER

Founded by Arthur Gallagher in Chicago in 1927, Gallagher (NYSE: AJG) has grown to become one of the largest insurance brokerage, risk management, and human capital consultant companies in the world. With significant reach internationally, the group employs over 30,000 people and its global network provides services in more than 150 countries.

Gallagher's London divisions offer specialist insurance and risk management services. We provide bespoke policy wordings, programme design and risk placement solutions, and consulting support across a range of specialisms. We manage complex, large, global risks on a direct and wholesale basis and serve as primary access point to Lloyd's of London, London company markets, and international insurance markets.

WE HELP BUSINESSES GO BEYOND THEIR GOALS. IT'S THE GALLAGHER WAY.

CONTENTS

EXECUTIVE SUMMARY

Welcome to the second edition of Building Blocks – Gallagher's specialist risk publication for the UK Construction sector.

In this edition, we acknowledge the impact of several high profile losses in 2018 and how these have contributed to the changing construction insurance market. Although a 'hardening' market poses a challenge, it also presents an opportunity for specialist knowledge, approaching risks differently and finding innovative solutions on both standard and non-standard insurance products. This is a rapidly changing market, which means we must bring our experience and knowledge in a proactive way to support our clients.

We've collaborated with specialists across Gallagher, as well as external contributors, to write about some of the risks that the industry faces and how these are relevant for organisations across the construction sector, from contractors and developers, through to financiers, lawyers and local authorities.

Since the last issue of Building Blocks, we have continued to expand globally and in the UK where we have delivered market leading organic growth. Our Construction division is attracting new talent, diversifying and expanding as it establishes an industry focused 'one stop shop' to support clients and differentiate with prospects.

We hope you enjoy the issue, and don't hesitate to get in touch.

MARTIN HILLER
Chairman, Gallagher Construction

ABOUT GALLAGHER CONSTRUCTION

Our Construction division arranges insurance for UK and international contractors and designs bespoke owner-controlled programmes across a wide spectrum of projects. Our clients range from contractors and engineers, to sponsors, financiers and local authorities. With our help, project stakeholders can identify, mitigate and transfer risk more strategically.

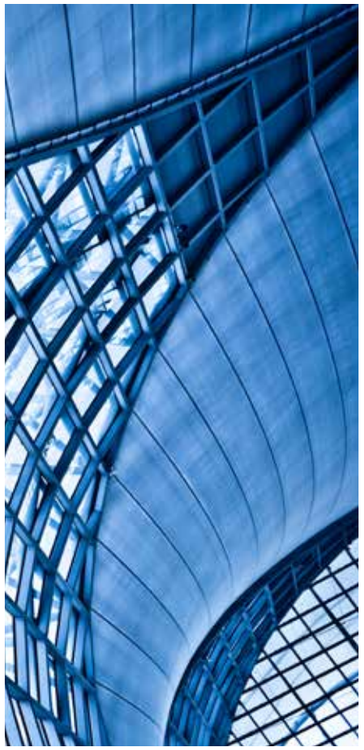
We offer products and services to enable our clients to manage complex risks of all sizes, including:

- Construction / Erection All-Risks
- Delay in Start-Up
- Pre-handover & Operational Risks
- Business Interruption
- General & Third-party Liability
- Marine Cargo
- Latent Defects
- Environmental / Pollution Liability
- Terrorism & Political risk
- Mergers & Acquisitions
- Legal Indemnity

01. UK CONSTRUCTION MARKET UPDATE

UK Projects Insurance Update

How things can change in the space of a few months. Despite the backdrop of a poor 2017 for insurers, until September / October 2018 the Construction All Risks (CAR) and Third Party Liability (TPL) projects insurance market continued to be arguably overloaded with capacity - rates continued to be extremely competitive, and largely unaffected. Further reserving on a number of high profile losses throughout the course of 2018, however, this has finally started to have an impact.



We saw several high-profile fires - the Mandarin Oriental Hotel, the Glasgow School of Art and the Belfast Primark – all carrying eight or nine-figure reserves[1].

In addition to these high profile major losses, insurers have suffered from industry-wide issues related to attritional water damage losses. Although the majority (but not all) result in smaller individual claims, they have consistently eroded insurer profitability and arguably had a greater overall impact on underwriting results than the more high-profile fire losses.

As a result, since Q4 2018, we have now seen seven insurers cease writing Construction All Risks insurance in the London market. The impact of this has been a hardening of the UK projects insurance market, with rates increasing principally in relation to project CAR and EAR business. There is then additional scrutiny on projects involving large existing structure refurbishments. Insurers are also demanding greater underwriting information up front around water management plans and applying increased excesses in respect of water damage.

Whilst this all paints a fairly negative picture, the good news is that there is still significant capacity in the London Construction market for the right risks, if managed and brokered correctly.

The markets dropping out only accounted for about USD500m of Projected Maximum Loss (PML) capacity, meaning there is still ample appetite and capacity of about USD2.5bn from the remaining insurers and there is additional capacity entering the market from carriers such as Berkshire Hathaway and Liberty who have seen this market shift as an opportunity to begin writing these classes of insurance. Whilst we have seen an increase in rates, they are still significantly below where they were five or six years ago and still offer cost effective protection for project owners and developers.

In other developments

Construction Professional Indemnity (PI) Market

From a buyers perspective we have seen further deterioration of market conditions since our last update. A Lloyd's report published in August 2018[2] identified non-US PI as one of the worst performing classes of insurance with 62% of syndicates having made an aggregate loss over the last six years. Lloyd's has responded by placing strict controls and intense scrutiny on the insurers who continue to write this class.

This has resulted in a number of insurers withdrawing from the construction PI market altogether, and others applying greater selectivity when evaluating clients risks and layers on which they are willing to participate. In combination with total annual premium caps on business underwritten by each Lloyd's insurer, the pressure on clients when renewing their programmes has increased significantly.

The market has an expectation that clients recognise their professional risks and the importance of implementing a robust risk management programme which addresses their activity profile, supply chain and contractual controls. In order to provide these assurances and help put themselves in the best possible position relative to their peer group, it is vital that Clients partner with a proactive insurance broker who specialises in this class.

Latent Defects Insurance (LDI) Market

The LDI market continues to grow fuelled by recognition of the enhanced protection an LDI policy affords the purchasers of assets post completion. Indeed, as well as directly smoothing the sale process LDI is also increasingly recognised as a requirement in many Agreements for Lease, particularly where anchor tenants on long-term leases have increased negotiating power, thereby ensuring it is considered a 'core policy' by developers.

Coverage and premium rating continue to improve based on attractive loss ratios, with market capacity increasing to in excess of GBP1bn for correctly presented risks. Several major London insurers are also considering a further push into this sector and if that happens there is potential for a 'softening' of market conditions in the future.

TO FIND OUT MORE ›

MARTIN HILLER
Chairman, Gallagher Construction
+44 (0)20 7560 3109 | Martin_Hiller@ajg.com

[1] www.telegraph.co.uk/men/thinking-man/fire-fighters-saving-britains-heritage-ashes/
[2] https://www.lloyds .com/news-and-risk-insight/press-releases/2019/03/lloyds-reports-aggregated-market-results-for-2018

02. USING ENVIRONMENTAL LIABILITY INSURANCE TO GET THE PROJECT DONE

The risk of landowners and developers having to pay for the clean-up of their land and meet third party claims for pollution emanating from their sites - even where they were not the original polluters - has increased as a result of recent environmental legislation introduced in the UK and across Europe. There is also an increased focus on new site development as a primary means of achieving remediation of historic contamination. In this article, Gallagher's Environmental specialists look at how there are insurance options available for those at risk of third party claims of pollution.

The changing risks

Increasingly these risks are being passed on to contractors, through contractual allocation of environmental liabilities in project agreements. It is common practice for the risks associated with unexpected ground conditions, including contamination, and the risks of pollution from off-site sources to be taken on by the main contractor. In some instances, contractors have also been required to take on known contamination risks.

Whilst the frequency of environmental claims and regulatory actions remains relatively low, when they do arise, the costs and losses can be significant, especially when consequential losses, legal costs and management time costs are taken into account.

Environmental investigations are typically required under planning conditions prior to property development – especially on brownfield land. However, whilst the investigations and risk assessments conducted by consultants provide important information, they are rarely conclusive (often due to tight timescales, access limitations, etc) and usually indicate some residual environmental risk associated with known and unknown historic contamination at the site.

Even if the project agreement contains provisions allowing the contractor to recover increased costs arising from discovery of unexpected contamination, the responsibility for any legal liabilities arising from the unintended release of such contamination will almost certainly rest entirely with the contractor. Typically the contractor will also be required to indemnify the employer against any costs/losses it suffers (including consequential losses) as a result of such releases, under the extensive environmental provisions contained in the project agreement.

This typical approach provides little in the way of effective long-term protection against potential environmental claims and regulatory actions for either the contractor or the employer. The contractor faces significant potential for uninsured losses, as their normal public liability cover is likely to provide only very limited cover for pollution. The employer still retains a significant long-term contingent liability, in the event that the transfer of environmental liability to the contractor fails, owing to, for example, insolvency. Also, disagreements between the employer and the contractor over the allocation of environmental liabilities in project agreements can result in contract negotiations stalling, or ultimately failing.

The role of insurance in deal closure

Environmental insurance is increasingly being used to support property development projects, by providing robust long-term financial protection against pollution and contamination risks for employers, contractors, lenders and other interested parties. The environmental insurance is either specified (usually by the employer or lenders) from the outset as a required insurance to be placed by the contractor or employer, or it is used as a means of resolving disagreements between the parties on allocation of environmental liabilities, by providing effective protection for the relevant parties.

In doing so, the environmental risks are transferred to an insurance company that is strictly controlled by a Regulatory Authority and has a strong credit rating. Opportunities in environmental insurance are at an all-time high with new insurers increasing competition on costs, providing wider cover and offering greater capacity. A further comfort is the fact that the insurance industry is one the most regulated industries for the transfer of liability; few other companies have specific requirements to keep long-term financial reserves in place for potential environmental liabilities. This means that transferring these risks to the insurance market can be a robust and reliable solution.

Range of benefits

Crucially, environmental insurance policies can provide cover which includes protection against change in law.

Polices can cover third-party and regulatory claims and can include consequential loss, property damage, bodily injury and remediation costs, technical and legal defence costs. Cover can be provided for both the employer and the contractor and also extended to include sub-contractors, lenders and other interested parties with relative ease.

During construction, risks arise from possible creation of new pollution conditions. The exposure can be particularly heightened on brownfield site developments, where construction activities can create a 'pollutant linkage' causing existing contamination to be released and result in on-site and off-site injury and damage. Specific cover for legal liabilities arising from such releases, whether due to a sudden identifiable event or an unidentified gradual cause, can be obtained under a Contractors Pollution Liability policy.

In addition, several commercial benefits can be gained with an environmental insurance policy. These may include:

- Avoiding the need to price uninsured environmental risk into contract values
- Long-term policies that can be transferred with site ownership with assignable policies
- High credit rating and protection can secure lenders and, in some instances, reduce the level of the lender's risk rating and therefore loan interest rates
- A long-term and sustainable approach - the insurance remains intact even if a member of the project becomes insolvent
- Insurance policies are based on financial loss occurring and streamline the process should a claim occur; instead of chasing multiple parties.

Growing awareness of the true financial impact of environmental liabilities, in terms of costs, losses and blighted property values and, the ability to obtain cost-effective long-term protection against such liabilities has resulted in a significant increase in the number of companies routinely using environmental insurance to facilitate property transactions where environmental risks are present.

With capacity increasing in the insurance market for these specialist risks, now is a good time to test the market, and see how this product can be strategically utilised for the benefit of your clients and their transactions.

Case study

During a large building refurbishment project, power for the site office and storage compound was provided by a power unit comprising a generator and integral bunded fuel tank.

Following several months of use a leak was discovered in the tank and base of the bund. The leaked fuel had seeped into the soil and groundwater and eventually migrated into the river, where it was spotted and the leak was eventually discovered. Actions were quickly taken to clean up the river and prevent further migration of the leaked fuel into the river. An extensive clean-up operation, taking several months, was then required to remove the fuel contamination from the impacted soil and groundwater. The contractor was liable for the significant resulting costs.

TO FIND OUT MORE ›

GRAEME MERRY
Environmental Director, Gallagher
+44 (0)1305 839425 | Graeme_Merry@ajg.com

MATHEW HUSSEY
Environmental Director, Gallagher
+44 (0) 13 9287 6771 | Mathew_Hussey@ajg.com

03. BUILDING INFORMATION MODELLING (BIM) AND CYBER RISK - SHOULD THE CONSTRUCTION INDUSTRY BE CONCERNED?

In this article, Paul Lowe, a specialist Construction solicitor at Weightmans LLP, flags one of the key issues facing the UK Construction sector, and whether firms ought to be giving due consideration to the use of cyber insurance.

Most sectors are exposed to cyber risk and the construction industry is, unfortunately, no different. According to recent research, only 41% of even the most disruptive cyber security breaches are reported[3]. This means that most cyber attacks in the construction sector may not become public knowledge, resulting in an untrue reflection of the scale and nature of cyber crime being presented. However, a leading survey indicates that the construction industry does not prioritise cyber security highly enough and the sector ought to educate itself in this vital area as the speed and extent of digitalisation accelerates.

A government cyber security survey shows that 59% of construction businesses believe online services are not a core part of their business offer. The same study reveals that the construction sector is an industry where senior managers are more likely to see cyber security as a low priority (35%, versus 24% overall.*) This is despite the fact that the construction sector is increasingly susceptible to data security issues due to its reliance on digitised information from the design stage through to the construction of major projects.

BIM

One of the major trends in the construction world in recent years, particularly in the area of design, has been the introduction of building information modelling (BIM) – a way of digitally coordinating design data. Whilst there is no commonly agreed definition, in its broadest sense BIM describes the process of generating and managing digital information concerning a built asset. In other words BIM is a tool used principally in the design and construction stages of a project to allow digitised information and drawings to be incorporated into one model, typically in a 3D format.

[3] www.gov.uk/government/statistics/cyber-security-breaches-survey-2018

For example, complex construction projects will, as a matter of course, incorporate numerous services, such as electrical, water and gas which will be required to be co-ordinated with the structural design elements of the building. BIM enables digitised information and drawings to be brought together into one 3D computer generated. As a result, BIM is increasingly important to the construction industry because of the versatility it allows in the design process.

Central to the use of BIM is the operation of a common data environment, which is used by the design team to collect, manage and issue documentation, the project's graphical model and non-graphical data. One of the principal motivations behind operating a common data environment is to enable greater collaboration between project members.

Some of the most popular software drawing tools for BIM are:

- Autodesk Revit (Architecture/ Structure/MEP)
- Graphisoft ArchiCAD
- Autodesk AutoCAD
- Autodesk AutoCAD LT
- Nemetscheck Vectorworks
- Other
- Bentley Microstation
- Trimble Sketchup (formerly Google Sketchup)
- Bentley AECOsim Building Designer.

However, as BIM becomes more important, threats to the security of digital data become greater. In particular, BIM platforms are vulnerable to attack, manipulation, or other malicious activity by third party actors. The integrated nature of BIM also contributes to those threats. If designers and contractors are joining together a range of different designs and information from consultants who have different data, and this information is being pooled, the potential risk arises of malicious actors attacking one designer to affect the broader project. The risk not only lies with external parties but from internal actors too, who may wish to sabotage or otherwise detrimentally influence the course of a project. As information and designs from different individuals involved with a project are collected together, the consequence is that if one point of entry is compromised then a whole project can be accessed. This can have severe cost and timescale implications for a project. For instance, if all the CAD drawings relating to a project are stolen or deleted, the costs of replacing them and business interruption costs would be huge.

There is a risk then of a domino effect, with very costly delays to projects. In the construction world projects are built to tight timescales often based on the need for investors to realise their investments in an achievable timescale. This return can be disrupted as a result of interference in the design and construction process, representing a significant financial risk to everyone in the procurement chain.

The construction industry also heavily relies on other forms of digital information and other cloud applications to organise projects, right from the design stage through to the construction stage. Most of this information is commercially sensitive and is therefore valuable to those involved with the projects. The increased activity of cyber criminals therefore poses a real risk to construction businesses.

Ramping up cyber security

Construction companies also need to consider further tightening the security of their information systems. For instance, it is important to tailor access and sharing rights to relevant parties so that opportunities to influence design are not presented to organisations who do not have responsibility or competency for an element of design or who have not approved a project's BIM policy. There are also regulations, such as GDPR, and international standards relating to the handling of data which should be complied with, to assist the protection of digital information.

Importantly, the insurance market offers a mature cyber risk product including cover for: First Response and Incident Management, Regulatory Investigations and Third Party Claims, Business/ Network Interruption and Cyber Ransom and Extortion. Insurers are, therefore, able to provide much needed expertise and advice to businesses on how to avoid cyber risk. Cyber insurance policies then offer comfort to business against the growing cyber risks of operating in a BIM environment.

Weightmans has recently launched CyXcel - A 360° approach to information security, data protection and privacy - with an emphasis on cyber resilience, incident planning and response.

› Weightmans LLP is a leading UK law firm with a nationally recognised construction practice providing a comprehensive service for both projects and dispute management across a broad range of sectors. Clients include developers, main contractors, utilities, transport authorities, education institutions, consultants and sub-contractors. The team advises on all aspects of construction risk management from procurement to completion.

TO FIND OUT MORE ›

PAUL LOWE
Associate, Weightmans LLP
+44 (0)20 7822 7134
Paul.Lowe@weightmans.com

04.ENHANCING THE PROMISE

Mike Roberts, Managing Director Construction & Engineering at Charles Taylor Adjusting, in this article discusses the importance of having reliable partners to manage the claims process, and the valuable role of the adjuster.

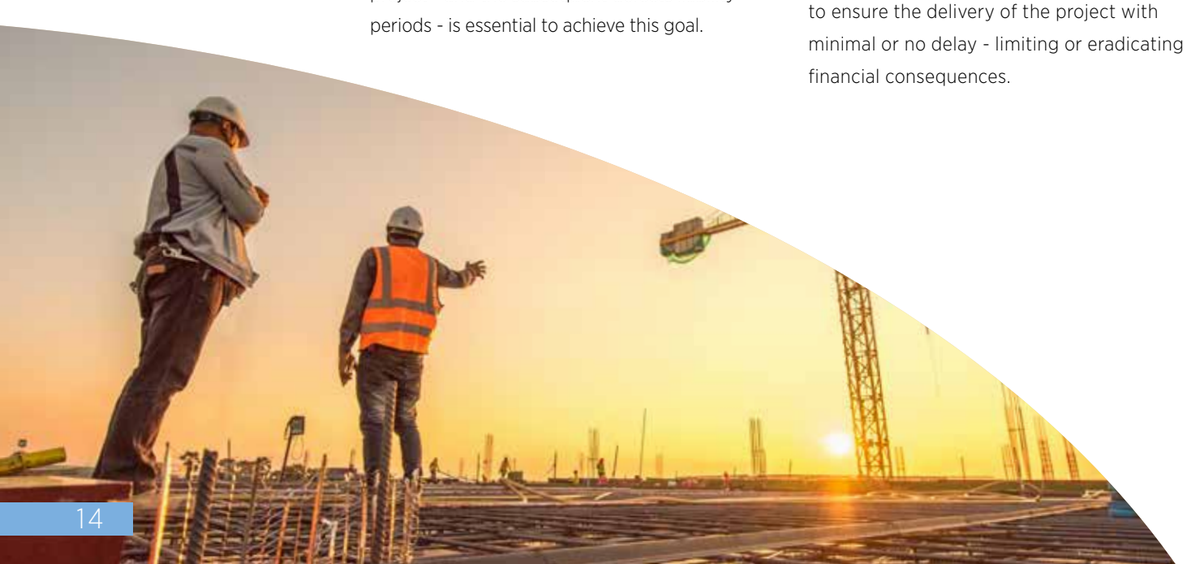
The prudent investor, having secured the necessary funding to facilitate a development, regardless of sector, must retain a commercial view, whilst simultaneously being mindful of brand protection. The management of financial risk both before and during the construction project - and the subsequent defects liability periods - is essential to achieve this goal.

That investor will surround himself with a team of professionals to ensure that the correct contractual relationships are established with both the upstream user, for example a lessee, plus those downstream, particularly any design and build contractor. Throughout, the contractual matrix will dominate, and all should be aware of risk transfer mechanisms.

Allied to risk allocation is the requirement for appropriate insurance. Commonly, Owner Controlled Insurance Policies (OCIP) specific to the project are used. A tripartite of covers would be expected involving Construction and/or Erection All Risks; Third Party Liability, plus Delay in Start Up (Business Interruption). Similar facilities can also be arranged via the Contractor (CCIP).

The benefits of a single project policy for all stakeholders are numerous; not necessarily limited to guaranteed cover throughout the project period and cost protection, but with all collaborating parties intended to benefit from the policy, cost effectiveness.

Operationally, under the umbrella of such policies, higher tier stakeholders can monitor and influence the outcome of insured events to ensure the delivery of the project with minimal or no delay - limiting or eradicating financial consequences.



Experienced and specialist brokers are necessary to develop appropriate policy wordings and to place the risk in the insurance market. The policy wording is the insurer's promise to the insured parties, often supplemented by well publicised Claims Codes of Practice.

With such arrangements in place, can the project team sit back and be assured of the right response to any given claim scenario?

Project insurers will mostly involve loss adjusters to investigate and settle claims on their behalf. Appreciating the need for specialist adjusters; with a depth of technical knowledge and sector experience, brokers have developed a practice of, with project insurer's approval, prenominating the adjuster to provide the claims response in the policy. Having secured the nomination, should the adjuster merely be reactive or is there an argument for a proactive role?

Strategic partners

Whilst the loss adjuster will be remunerated by project insurers based solely upon their involvement in 'live' claims, the client and/or insured parties should expect front loading from the nominated adjuster to enhance the service provided by the broker and the promise made by the insurer.

Understanding the risk and the relationships between project stakeholders is essential. To ensure the correct level of understanding is attained from the start, the adjuster should be brought into the project from the outset. This means that they can work with the broker as wordings are developed; bringing an acquired knowledge of claim examples and wording issues on similar projects to ensure risk appreciation and the correct market solutions (if available).

An early interaction with the project team is desirable to ensure that appropriate claim notification and escalation procedures are put in place.

A proactive review of procurement throughout the contractual matrix can be undertaken to ensure that the policy will operate to provide protection for all as intended.

The contract remains king and the suite of forms utilised need to reflect the full nature of the insurance cover intended to be cascaded down the contractual chain. If, for example, a standard suite of Joint Contract Tribunal (JCT) contracts are utilised, the employer only contracts to provide limited cover to the main contractor. In such a case the contractor would not benefit from the protection of the project policy for cover beyond practical completion; the enhanced cover derived from the exceptions to common Defects Exclusion clauses or, any indemnity under the Third Party Liability section. Equally, a sub-contractor under a standard JCT form would face similar restrictive access to the project policy and may find himself retaining full responsibility for the cost of making good damage to the sub-contract works caused by anything other than the Specified Perils as defined.

The contract is not the sole arbiter however, and if prior to any loss it can be demonstrated that lower tier parties had given authority for higher tier parties to insure on their behalf, access as intended can still be achieved. If for some reason contract terms cannot be amended the use of side letters; publication of claims procedure manuals or even minutes from pre-start meetings can assist.

Allied to this is the need to explain to the contracting team how damage rectification costs and delay are treated if an insured event occurs. Is the event a change or variation, and with whom does the cost of resultant delay rest?

Loss examples can be used to clarify how the policy functions and highlight which insurances may still be required by the contracting team.

Clarity retains cost control for the employer; avoiding any duplication of insurance charges in preliminary costs or if there is any shortfall in the project policy, an opportunity for the contracting team to make appropriate arrangements separately-either through annual arrangements or individual Difference in Conditions/Excess covers. Commonly there will still be a requirement for contractors to arrange separate covers for their own Constructional Plant and Equipment plus policies for the Employers' Liability and Professional Indemnity risks.

The notification procedure should always be such that the earliest advice of an event even only likely to give rise to a claim is encouraged. Initial triage allows the adjuster to provide general advice and, for example, subsequent to an on-site injury to act as a repository for essential documents until a formal claim is made, which could be several years later. The practice also allows the adjuster to ensure a serious event is proactively investigated (for example a fall from height) protecting the insured parties' and insurers' collective interests.

The requirement, if any, of stakeholders for management information should be agreed, with data to be transmitted to designated parties at agreed intervals covering both notifications and live claims.

Trusting relationships bear fruit

It is not hard to imagine the indecision that can result from limited knowledge and a proper understanding of the risk. The relationships and levels of understanding developed before any loss thus bear fruit when they are needed most; enabling the smooth process of any claim.

At the end of the first post loss meeting, stakeholders should have a clear understanding of the claim process and any issues arising. A strategy to mitigate the financial exposures of both stakeholders and Insurers should have been developed, with agreed timescales and roadmap for addressing all pertinent aspects of the claim with a view to setting milestones to reach the earliest resolution.

A proactive, transparent and collegiate approach to loss management; plus, contractual and policy interpretation is key, as often loss mitigation and innovative approaches to complex losses require consents from all stakeholders. Adaptability, where issues which may cause reputational harm are identified, can also be necessary.

Insurance cannot however remove risk in its entirety, or all the financial consequences of an event during the project. Communication between the parties is essential. Cover shortfalls or areas of doubt should therefore be identified immediately, to manage the expectations of stakeholders across the contractual matrix. Stakeholders will need to make provision for both insurance recoveries and retained exposures in short order, hence the need for no surprises.

Early decisions can also assist to release other insurance markets, for example Professional Indemnity covers.

War stories are an adjuster's stock-in-trade and often clearly demonstrate the advantages of partnering. For now, however, discretion must remain the better part of valour!

Partnering with experienced loss adjusters under contractor's annual insurance arrangements to minimise risk is just as important. They should be able to add value through reviews of existing procurement, with a realignment of subcontract risk allocation and insurance policy dependent upon whether the client is risk adverse or otherwise. Stress testing of subcontract terms and policy covers should be offered as well as an ongoing commitment to training through lectures or other educational material.

Where necessary, innovation to provide continuity of service for within deductible claims solutions should be provided in both regulated and non-regulatory environments.

With a strategic partner properly in place, perhaps now all can sit back and be assured of the right response to any given claims scenario!

TO FIND OUT MORE ›

MIKE ROBERTS ACII FCILA
Managing Director, Charles Taylor Adjusting
+44 (0)20 7025 2031 | Mike.Roberts@ctplc.com

05.KEY CONSIDERATIONS FOR TENANT WORKS TO EXISTING STRUCTURES

In this article, Sam Hiller and Libby Snow, Associates at Gallagher Construction, examine the intricacies of projects when tenants are employing contractors to carry out works, and how insurance policies ought to be suitably adjusted.

In the construction insurance market, we may sometimes come across a client who is a tenant within an operational existing structure who is employing a contractor to carry out a non-structural fit out.

Commonly the Joint Contracts Tribunal (JCT) form of contract is utilised and Insurance Option C is assumed to apply, but this insurance option comes with two key requirements:

- C.1 – the Employer must maintain a policy in joint names of the contractor, covering the Existing Structures for any loss or damage due to any Specified Perils.
- C.2 – the Employer must maintain a policy in joint names of the Contractor for All Risks insurance covering the contract works.

Where the Employer is the tenant, they are not the landlord, and therefore they cannot achieve the requirements of C.1, at which point their legal advisor will need to amend the contract to avoid a breach of contract conditions. JCT 2016 contracts allow replacement provisions where C.1 cannot be achieved and the JCT's view is that preparation of such replacement provisions must be assigned to insurance professionals.

At this stage, it is key that the tenant's contractor agrees a position with the landlord regarding how they are to be treated during the works in respect of the risk of damage being caused to the existing structure.

There are three main options in this situation:

1. The ideal solutionwould be that the landlord agrees to name both the tenant and their contractor as composite insureds on the existing structures property policy, which would mean that they cannot subrogate against them in the event of a loss. Failing this, a written confirmation of a full waiver of subrogation would suffice.
2. It is often difficult to obtain the above solution, given that naming the tenant on a policy could affect the landlord's claims experience – so a secondary option would be to agree a cap on liability for the tenant during the works. The property insurers can agree to provide the tenant and their contractor with a waiver of subrogation above a specified limit, which is commonly a nominal value e.g. GBP5m or GBP10m. From the tenant's contractors point of view in this case, the lower the better.
3. Should this not be something the landlord and their insurers are willing to agree to, the worst case scenario is that the tenant's contractor is not given any beneficial cover on the property insurance and are held fully liable in respect of damage to the existing structure arising out of the works. The solution in this case would be for the tenant to procure project specific Third Party Liability insurance to protect themselves.

Typically the tenant is automatically named on the existing structures policy due to the fact that they contribute to the premium. As a minimum, the tenant should expect a full waiver of subrogation from the landlord's property insurers. It is important that the tenants legal advisors are consulted on this point. Ultimately, this is a negotiation between the landlord and tenants contractor, assisted by their insurance and legal advisors as appropriate. However it is appreciated that as the tenant is employing the works, they may have to facilitate the negotiation. Furthermore, the size of the contract works in comparison to the reinstatement value of the existing structures needs to be taken into consideration.

Should options 2 or 3 above be the case, it is imperative to keep the appropriate legal advisor appraised and ensure that the contractor is carrying sufficient Third Party Liability insurance up to at least the reinstatement value of the existing structure, or at least to the relevant liability cap, per option 2 above. This is because it is likely that the existing structure is to be deemed third party property to the contractor, and possibly to the tenant too and this must be clearly disclosed and evidenced to the Third Party Liability insurers. This will ensure you have enough cover should there, however unlikely, be a total loss arising out of the works.

When carrying out tenant fit out works to an existing building, there are three key construction insurances to consider:

- Firstly, Construction All Risks (CAR), that provides indemnity for damage to the contract works, permanent or temporary.
- Loss of Revenue/Delay in Start Up cover is available to insure financial losses you would suffer following insured damage to the contract works (note that this insured damage must be covered under the Construction All Risks insurance to trigger any cover under the Loss of Revenue insurance). For the tenant, the financial loss could be the cost of sourcing alternative accommodation in event the works are damaged and therefore delayed.
- Finally, Third Party Liability insurance protects tenants against their legal liability for damage or injury to third parties or third party property, but the extent to which this is required will be defined by the outcome of any negotiations with the landlord in respect of cover provided under their property programme.

Although the legal advisor will ultimately sign off the final contract wording, it is essential not to underestimate the importance of consulting your insurance broker to understand if there is any relevant text that should be included in the contract to make the final proposal for insurances clear. The insurances must accurately reflect the contract requirements, to prevent the tenant being exposed to a breach of contract and, consequently, any losses associated with the breach.

TO FIND OUT MORE ›

SAM HILLER
Associate, Gallagher
+44 (0)20 7234 4284 | Sam_Hiller@ajg.com

LIBBY SNOW
Associate, Gallagher
+44 (0)20 7234 4291 | Libby_Snow@ajg.com

06.VIEW FROM THE LAWYER

Williams Tarr Construction Ltd v Anthony Roylance Limited, Anthony Roylance (2018)[4]: Ascertaining the identity of parties to a contract and the scope of duty for a consulting engineer.

Construction professionals frequently set up companies through which they carry out their professional activities. This case involved an engineer's liability for defects in the design of a retaining wall. In answering that question, the court had to decide whether the professional appointment was concluded by an engineer in his individual capacity or whether it was concluded through his trading company. The court was also required to consider the nature and scope of the design duties owed to the Claimant.

[4] https://www.lexology.com/library/detail.aspx?g=005344ce-f32c-44f7-b2cf-2d552e094f0d

The facts

The Claimant was a construction company that had been engaged to carry out construction works on a housing development by the employer. The works included the construction of a retaining wall. The Claimant engaged CSS as its sub-contractor in order to construct the retaining wall. The Second Defendant, Mr Roylance, was a civil engineer. The First Defendant was a company owned by the Second Defendant and through which he regularly carried out his professional services.

The First or Second Defendant had initially been appointed by either CSS or by the Claimant's employer (the point did not fall to be decided) to carry out certain engineering work on the site. Originally the retaining wall was to be constructed by CSS using blockwork, but this was changed to a gabion wall design upon the advice of the First/Second Defendant to CSS. The Claimant believed that the First/Second Defendant, being the only consulting engineer on site, had been instructed to design the retaining wall.

By October 2010, a number of problems were being experienced in the construction of the retaining wall, including increased levels of water, which required the wall to be redesigned. It was agreed between the parties that in November 2010, and in response to these defects, the Claimant had engaged either the First or Second Defendant to carry out certain engineering services connected with the retaining wall.

The Claimant alleged that either the First or Second Defendant had been engaged to review the design of the retaining wall, to provide a solution to the problems experienced and, in particular, to provide a design that was fit for its intended purpose. The defendants, however, contended that the First Defendant had merely been instructed to design a system of water drainage to be installed behind the wall and that they had not undertaken any obligations in relation to the design of the wall itself (which remained with CSS), let alone warrant that the design of the wall would be fit for its intended purpose.

By March 2011, it was apparent that the design of the retaining wall constructed by CSS was defective, necessitating remedial works costing in excess of GBP300,000. It was not alleged that the First/Second Defendants' design of the drainage system installed behind the retaining wall was in any way defective.

The issues that arose for consideration included:

1. Whether the Claimant had contracted with the First or Second Defendant; and
2. Whether one of the defendants had undertaken a duty to design the wall and had warranted that it would be fit for its intended purpose?

Decision

Notwithstanding the fact that the Claimant paid for the services carried out by the Second Defendant after November 2010 to the First Defendant company, and notwithstanding the fact that the Second Defendant regarded himself as operating through the First Defendant company, the Court held the contract had been concluded between the Claimant and the Second Defendant. Prior to the formation of the contract, no mention of the First Defendant being the contracting party had been made in the pre-contractual correspondence. None of the Second Defendant's letterheads made reference to the name of the First Defendant company. The Second Defendant signed letters in an individual capacity. All email correspondence with the Second Defendant had been to a personal email address.

The certificate of P.I. insurance supplied to the Claimant in August 2010 did not name the First Defendant expressly. In those circumstances, and viewed objectively, it appeared from all of the pre-contractual correspondence and the contractual documentation itself, that the Second Defendant was contracting in his personal capacity.

The court held that as the Second Defendant's appointment was contained in writing, the court had to ascertain the scope and nature of the services by determining both the natural and ordinary meaning of the words used together with their context. That involved considering the dealings leading up to the date the contract was entered into. The parties had sought to rely upon evidence relating to what the Second Claimant had considered to be the scope of his duties in relation to design under its contract with CSS/the employer as a means of establishing whether the Second Defendant had assumed a similar duty as part of his appointment by the Claimant in November 2010, and that the appointment of November 2010 had to be interpreted in a context where at least one of the defendants was responsible for the design of the wall. Whilst questioning the relevance and importance of that evidence, the judge commented that the fact that one of the defendants may have assumed an obligation for design to CSS/the employer did not mean that the Second Defendant had assumed such a duty to the Claimant, and the absence of a duty of design to CSS/the employer did not prevent Second Defendant from assuming such a duty to the Claimant.

Having considered the evidence, it was held that the Second Defendant had only agreed to design the water drainage system to be installed behind the retaining wall. He had not undertaken a duty to design the wall itself.

Whilst the Second Defendant was obliged to exercise all reasonable skill and care to be expected of a competent civil engineer and providing its services, he had not been engaged either expressly or impliedly in connection with the retaining wall and he had not warrantied that the retaining wall be fit for its intended purpose. In those circumstances, and as no complaint was made about the drainage works designed by the Second Defendant, the claim failed. The judge did indicate, obiter, that if he had held that the Second Defendant had assumed a duty to design the retaining wall, he would have decided that the Second Defendant had warranted that the wall would be fit for its intended purpose as, on the facts of the case, the Second Defendant was being engaged to rectify problems, not merely to exercise skill and care in producing his design.

Lessons

This decision serves as a useful demonstration of the need for parties, particularly owners of small design and build and professional services companies who decide to set up companies for their personal protection, to take care to ensure that, during the course of contractual negotiations, they clearly identify the party through which they intend to contract. Failure to do so may adversely affect policy response and expose professionals to potentially very significant personal liabilities.

Similarly, and in order to avoid disputes over the scope and nature of contractual obligations, contracting parties should take the time to properly define in writing (i) the precise scope of any services to be performed, (ii) the standard to which those services are to be provided and (ii) ensuring that they have in place insurance to cover the obligations assumed. The judge's obiter comments that a designer might be held to owe a duty to ensure that its design is fit for its intended purpose where it is being asked to rectify problems should be a matter of concern for designers, who unless they properly record that no such warranty is being given, may find themselves without insurance cover.

TO FIND OUT MORE ›

CHRIS DORAN
Partner, Weightmans LLP

+44 (0)20 7842 0831 | Chris.Doran@weightmans.com

› Weightmans LLP is a leading UK law firm with a nationally recognised construction practice providing a comprehensive service for both projects and dispute management across a broad range of sectors. Clients include developers, main contractors, utilities, transport authorities, education institutions, consultants and sub-contractors. The team advises on all aspects of construction risk management from procurement to completion.

07. INSURANCE FOR MERGERS & ACQUISITIONS (M&A) TRANSACTIONS

Warranty & Indemnity (W&I) insurance can be a vital ingredient in any M&A transaction, particularly in the real estate sector. Sellers have now become accustomed to the product as it negates the need for escrow and allows for their clean exit. For a buyer, the W&I policy can give them protection (in the form of a reputable insurance policy) in case of a breach of warranty by the seller.

It is paramount for lawyers to be kept abreast of W&I enhancements and new levels of cover that have recently become available. Sticking points, such as known tax issues, might have previously derailed deals; but now these matters can often be wrapped into a W&I policy for no extra cost. Law firms act as crucial intermediaries between client and broker, due to their proximity to Sale and Purchase Agreements (SPA) negotiations.

It is important that the legal team know who to contact in the event of a seller being asked to provide a large escrow or indemnity by the buyer – to not suggest an insurance route might be deemed negligent, as a W&I policy could result in a much smaller cost to a client than paying out themselves for a breach of warranty.

TO FIND OUT MORE›

CHARLES RUSSELL
Head of Transactional Risks, Gallagher
+44 (0)20 7204 6237 | Charles_Russell@ajg.com

Real Estate project lifecycle & utilisation of W&I

Feasibility Analysis, Financing and Acquisition

- Buy-side transactional risks
- Lender conditions
- Legal indemnity and challenges to title

Disposal or Demolition

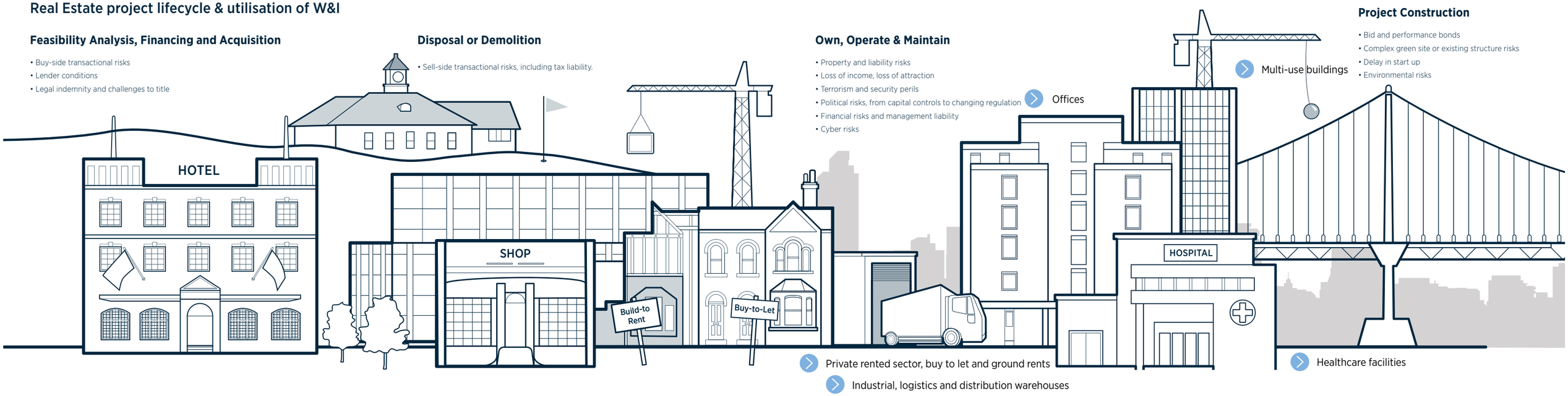
- Sell-side transactional risks, including tax liability.

Own, Operate & Maintain

- Property and liability risks
- Loss of income, loss of attraction
- Terrorism and security perils
- Political risks, from capital controls to changing regulation
- Financial risks and management liability
- Cyber risks

Project Construction

- Bid and performance bonds
- Complex green site or existing structure risks
- Delay in start up
- Environmental risks



W&I: Step by Step

Asset marketed

Initial review of asset

Share deal: Gallagher will provide advice and guidance on the most appropriate diligence approach needed to obtain W&I insurance so that the seller can limit their liability to as low as £1. Gallagher will review any potential title issues and provide indications for cover.

Sale Agreement drafted

Share deal: Gallagher will review the early draft set of warranties, discuss with the insurance market and provide a full report/ recommendation as to which insurer to proceed with based on coverage/ price and ability to be commercial/ hit tight timelines

Final bid / offer submitted

Attaching the W&I policy to the final bid will make the offer much more attractive to the seller and may form the competitive component that is required to edge into exclusivity

Exclusivity and Due diligence Process

Share deal: Gallagher will review the draft DD reports with the selected insurer and provide a more comprehensive coverage position, which may include affirmative cover for known risks that have arisen during the diligence process. Gallagher is also able to undertake specific insurance DD if that is required.

Any title issues flagged within the DD will be reviewed and options to protect your asset will be provided, giving comfort to you and lenders.

Sale Agreement negotiations

Share deal: Gallagher will work with the insurer and the lawyers to make sure that as many warranties as possible are covered as drafted. Any type of property transaction: Fundamental warranties can be covered under a standalone title policy to the full value of the transaction.

Property Insurance negotiated

Gallagher will provide a review of the following property insurances that the target currently has in place:

- Property damage
- Loss of rent
- Liability
- Terrorism
- Engineering
- Any other relevant covers.

Completion

08. THE VALUE OF AN INSURANCE BROKER?

The value of an insurance broker can often be overlooked by law firms and corporates alike when it comes to title insurance matters.

When procuring specialist insurance such as Professional Indemnity (PI), Cyber, Employers' Liability and other core commercial insurance products, a broker is generally used as they can provide specialist advice, ensure competitive quotations from a range of markets, guide your firm through volatile market conditions, and manage claims.

In this article, Anna Beadsmoore, Gallagher's Head of Legal Indemnity, examines the reasons why your lawyers should be using brokers to procure title insurance and the potential risks of going direct to insurers.

Lawyers often take control when procuring title insurance and often law firms approach insurers directly, all too often only one carrier is used - typically based on prior relationships. However, this can cause problems as all insurers have fundamentally different approaches and capabilities in respect of risk appetites, capacity limits, sector expertise, security rating and, finally, jurisdictional capabilities.

Gallagher recently was asked to assist in a case where a law firm urgently needed assistance when their insurer (that they had transacted with on a direct basis), let them down. A law firm had procured a title policy for their client for a site upon purchase of the land; there were some easement issues and a number of missing transfers within the title.

The site was to be developed and lawyers approached one insurer who was able to incept a policy at a reasonable premium, allowing for future development. However, one year later, at the point that the development was due to start, the lenders requested major changes to the insurance policy. Unfortunately, the insurer was not able to agree to the changes due to reinsurance requirements and a low risk appetite for some of the additional covers. This caused significant delays to the project and increased costs, not only in legal fees but in premium costs.

A broker would have known that the future redevelopment could cause problems with the insurer as this particular insurer has a notoriously low risk appetite for contingent covers within title policies. There are many benefits to lawyers to approach a broker when procuring title insurance, namely:

Regulation

The Insurance Conduct of Business Sourcebook (ICOBS) requires that a statement of the demands and needs[5] must be communicated to the customer prior to the conclusion of a contract of insurance. It also states that a firm must take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgement.

Generally this means that a broker must approach the appropriate insurers for the risk and ensure that if they are giving advice that a recommendation is made upon the product that is to be incepted. By marketing the risk to more than one insurer, this can give greater certainty that the client would be getting market leading coverage, and paying competitive premiums.

The Insurance Distribution Directive[6] (IDD) requires an Insurance Product Information Document[7] (IPID) to be included with the insurance policy. It is imperative to ensure that insurers are including these within all policies.

Time saving

The legal landscape is increasingly competitive and law firms will quote fees based on the total project, rather than hourly. When lawyers are charging hourly, this can increase costs significantly and by using a broker, money is saved as brokers are remunerated by insurers. Spending hours liaising with multiple insurers would on paper appear not to be practical or a good use of time, as such, a broker can take care of the leg-work of seeing multiple insurers, as well as managing policy issuance and invoice raising.

Financial security

The financial stability of insurers is constantly changing and most insurance brokers have a dedicated team to ensure that the security ratings of insurers meet with their minimum requirements. They also have a responsibility to notify customers if insurer security changes. If an insurer's rating fall below a certain requirement, advice can be given to clients and options provided. This is particularly important as most title insurance policy periods are in perpetuity.

In the unfortunate event that negligence is deemed to have occurred when placing an insurance policy on a direct basis with an insurer, the law firm must call upon their PI insurance in order to pay the insured's claim. If a broker is used, this risk can be transferred.

In short, a broker will help protect you as the client by ensuring the following regulatory requirements are completed:

- Producing demands and needs statements for the insured
- Liaising with insurers and managing timelines
- Ensuring competition
- Only using insurers that meet our strict market security criteria.

In addition there are significant benefits to the insured – your client:

1. **Coverage & Premium:**
   Insurance brokers have leverage with insurers. They place millions of pounds of premium annually and are able to utilise their relationships to negotiate cover and premiums. They are also more knowledgeable on the types of cover and specific wordings available as they will push for certain amendments to be accepted. At Gallagher, we have marked up policies for certain situations, allowing for a suitable coverage position against insurers standard wordings, ensuring less time spent back and forth with amends.

   Approaching more than one insurer enables a comparison against premium. These policy premiums can range from GBP50 to GPB5m and even for a simple covenant risk, the premiums offered can differ by thousands of pounds. A broker's leverage also comes into play here.

2. **Claims:**
   In the event of a claim, brokers have in house claims teams to manage the claim, not only from a legal process, but ensuring that their corporate leverage is used. There have been instances where Gallagher have secured a claim payment, even though technically the policy had been voided by the insured.

Gallagher's Legal Indemnity team are experienced with working to tight timescales, delivering complex transactions and developments. Our clients include law firms, property owners and developers. The team understand the complex nature and the significant impact on the future value of a property associated with these risks. Our experience enables us to provide advice and comment on the availability of products, coverage and premium rates to assist your firm quickly and thoroughly to avoid unnecessary delay.

TO FIND OUT MORE ›

ANNA BEADSMOORE
Head of Legal Indemnity, Gallagher
+44 (0)20 7234 4618 | Anna_Beadsmoore@ajg.com

5. www.handbook.fca.org.uk/handbook/ICOBS/5/2.html
6. www.fca.org.uk/firms/insurance-distribution-directive
7. www.handbook.fca.org.uk/handbook/glossary/G3483i.html

09. THE BENEFITS OF INHERENT DEFECT INSURANCE (IDI) COVER – A CLAIMS CASE STUDY

In this edition of Building Blocks, Jonathan Sargent, Head of Property & Engineering Claims, and Cedric Wong, Senior Engineering Underwriter, Swiss Re Corporate Solutions, look at some of the challenges presented by inherent defect claims and how as a first-party solution, IDI cover is a strategic way to provide reliable and timely protection to developers against the long-term risk of defective construction work.

The problem

To highlight the benefits of IDI cover it is useful to consider a hypothetical claim scenario.

Imagine a large mixed-use commercial development with three below-ground levels. The ground and upper floors comprise a hotel, residential and retail units. The basement levels contain function rooms and catering facilities for the benefit of the hotel.

The basement is constructed from reinforced concrete secant piles, which, whilst structurally sound, are not watertight. Consequently ground water is able to reach the external face of the external concrete perimeter walls and, over time, penetrate into the lower basement(s) through construction joints. It is unclear whether this is due to a failing in design, materials or workmanship, or a combination of all three.

Damage to internal fixtures and fittings is first identified three years after Practical Completion.

Sound complicated? Perhaps. But as water damage is one of the most common causes of claims on IDI policies, this type of situation is unfortunately all too common.

The benefits of a comprehensive, first-party solution

In our hypothetical claim situation, the benefits of IDI immediately become clear. The IDI policy provides a single point of recovery for all parties having a beneficial legal interest in the property. There is no need to spend time trying to establish fault, either contractually or in tort, in respect of the parties involved in the original build.

Whilst it will still be necessary to investigate thoroughly to establish what went wrong – in order to ensure any remedial scheme fully rectifies the defect and any subsequent damage – ascertaining whether the policy should respond, and providing piece of mind to the Insured by confirming coverage, should be straightforward.

Compare this to the scenario without an IDI policy in place. The parties impacted by the water ingress (typically the developer or subsequent purchaser) would be left with little option but to incur the cost of rectifying the defective work and consequential damage themselves: particularly as any operational property policy they may have purchased would typically exclude damage caused by defects in construction.

Could the developer then get their money back? Not easily. Pursuing a legal action to recoup any outlay would be complicated for a variety of reasons.

Firstly, it may be evidentially difficult to establish culpability on the part of one or more of the original contracting team, particularly where construction records cannot be located or where the documentation that does exist is ambiguous or disputed. Secondly, establishing a cause of action in respect of purely economic losses may not be straightforward in the absence of a direct contractual relationship or collateral warranty. Thirdly, even if a contractual relationship can be established, there may be financial limitations of liability in deeds of appointment or the building contracts which ultimately restrict the extent of any recovery.

Lastly, even if these three hurdles can be overcome, you would need to be satisfied the potential target of the recovery is both (i) still trading as a going concern, and (ii) in a position to satisfy any judgment made against them, or protected by insurance for their legal liabilities. That's before you consider the costs of pursuing a claim, which can be considerable - and the adverse impact this type of legal action may have on the commercial relationships between the parties involved,

However, it is important to recognise that IDI is not the panacea to every claim problem. The material damage proviso as a trigger to cover means it is still necessary for a developer to consider whether appropriate contractual protections are in place to protect against the risk of discovering defective work that doesn't lead to physical damage. Equally, the IDI policy is unlikely to provide recompense for consequential or economic losses which the insured may incur beyond the direct cost of repair (albeit a comprehensive policy can provide cover for business interruption, loss of rent or damage to M&E elements). There will be a policy excess to deduct.

However in terms of providing cover from day one, in a form which is capable of being used immediately or assigned to future tenants or purchasers if the asset is sold (and as a result, enhancing the sale value), and in a manner which allows for any rights of recovery to be waived against the original project participants, an IDI policy can be a very valuable asset.

Buying an IDI policy

What should you look for in an IDI insurer?

- Technical knowledge – the ability to understand the commercial construction market, discuss and develop bespoke transfer solutions tailored to your needs. Aligned with this technical expertise is the ability to work closely with the appointed Technical Inspection Services (TIS) provider. The TIS ensures that design is in accordance with codes of practice, details and procedures reflect the design intent, and that relevant quality control is employed throughout the project period
- Longevity - The cover incepts at the end of the construction period, which may well be a number of years after the policy is sought, thereafter the cover can last over a decade. Having the highest level of confidence that your provider will be there to pay your claims after such a long duration is essential.
- Claims handling expertise – having a claims team that understand the IDI product facilitates timely resolution to covered claims that will enable you to continue your business with the minimum amount of disruption.

› We're the commercial insurance arm of the Swiss Re Group. This means we can draw from more than 150 years of experience, significant capacity and financial strength. We also have an appetite for risk. With over 50 traditional and innovative insurance products and a global network of more than 50 offices in over 20 countries, we will work with you to find a solution that fits your needs and exposure.

Our extensive knowledge and expertise – across industries and geographies – allows us to understand, anticipate and help protect against the risks you face. We aim to build lasting relationships in the hopes that we can help you with your risk management needs, both today and in the years to come.

It's our goal to make your business, and the world, more resilient.

TO FIND OUT MORE ›

CEDRIC WONG
Senior Engineering Underwriter, Swiss Re
+44 (0)20 7933 3275 | Cedric_Wong@swissre.com

10. FINES AND PENALTIES: MANAGING THE RISK OF INCREASED LITIGATION FOLLOWING AN ONSITE CONSTRUCTION ACCIDENT

In this article, Neil Hodgson from Gallagher Risk Management Solutions examines the changing sentencing guidelines for Health & Safety offences[8], and how these will inevitably put more onerous requirements on sectors with hazardous workplaces, such as the Construction sector.

In February 2016, the Sentencing Guidelines Council issued new guidance for Health and Safety offences. This new guidance directed the courts on sentences and the size of penalties for breaches of health and safety, corporate manslaughter and food hygiene offences. Before its introduction, there was a lack of consistency, or indeed predictability, about what a defendant could expect.

[8] www.sentencingcouncil.org.uk/wp-content/uploads/Health-and-Safety-Corporate-Manslaughter-Food-Safety-and-Hygiene-definitive-guideline-Web.pdf

With effect from the 1st November 2018, a change to these guidelines came into force, which applies regardless of when the offence was committed and relates to the inclusion of Gross Negligent Manslaughter, which had previously been excluded.

The Sentencing Guidelines are simply broken down into nine categories, each to be considered by the sentencing Court in turn.

- The court must first consider the level of culpability. This ranges from 'very high' which involves a deliberate breach or flagrant disregard for the law, to a 'low' level of culpability where significant efforts were made to address the risk, even if those attempts were inadequate and there was no warning of the risk, the failings were minor and it was an isolated incident.
- The next stage to be considered is the seriousness of harm 'risked' and the likelihood of that harm occurring. Health and Safety is based on 'risk' and the overarching responsibility of each duty holder is to ensure, as far as is reasonably practicable, the health, safety and welfare of employees and non-employees.

  Under the new guidance, there is no requirement for actual harm to have been caused by a breach of care – no accident or injury has to occur – rather the focus is on the potential for the risk of harm arising from the alleged breach of duty.

  When the guidelines consider the level of harm, they are concerned with the seriousness of harm 'risked' and if actual harm has been caused.
- Thirdly, after considering the seriousness of harm risked - almost always 'death' or serious physical impairment - the court will then consider the likelihood of that harm occurring, which assists in identifying the most appropriate harm category. The category can be adjusted if the alleged breach resulted in actual harm, for example, someone was actually injured and/or a wide group of the public or employees were put at risk.

Once the court has established the level of culpability and harm caused, they will consider the means or turnover of the defendant to identify an appropriate punishment.

Since its introduction, we have seen the total of fines double, the size of individual fines double with the number of fines in excess of £1m showing a sharp increase.[1]

What we have also seen is that the Health & Safety Executive (HSE) have found it easier to prosecute firms and to issue significant fines.

Willmott Partnership Homes Ltd was fined in September 2018 after exposing members of the public to carbon monoxide fumes. An investigation by the HSE found that they built the flats in question several years before the incident and in 2014 some remedial work was carried out on an external wall. During the demolition and reconstruction of the wall, many live flues from flats' gas boilers were removed, damaged and/or blocked, exposing the residents to a risk from carbon monoxide poisoning.

Willmott Partnership Homes Ltd as the principal contractor had not ensured that an adequate system of work was in place to manage the risks from working around the live flues and although they pleaded guilty, were fined GBP1.25m and ordered to pay costs of GBP23,972.33.

The new guidance meant that the prosecutions go beyond the household names with significant turnover to those of all shapes and sizes and perhaps more interestingly, not just the primary contractor, but the client / developer.

An example of this was in July 2018, Sherwood Homes, a construction company that specialises in new-build residential developments across Northwest England, was fined GBP76,000 for multiple breaches of the Construction (Design and Management) (CDM) Regulations, following a HSE investigation that revealed widespread safety failings at two sites.

Sherwood Homes had appointed several principal contractors to build new homes at the sites, one in Preston, Lancashire and the other at Tarporley, Cheshire. In the course of what it describes as "proactive" inspections of both sites, the HSE found that workers were exposed to risks including falling from height, electrocution, inhalation of silica dust and being struck by construction plant. An interesting development, however, is that much of the press focuses on Sherwood, not the principal contractors.

Workplace fatal injuries statistics released by the HSE in 2018 details that the construction industry reported 38 deaths, with the second largest figure being 29 in agriculture.

Should the construction industry be concerned with the inclusion of Gross Negligent Manslaughter?

Typically, H&S cases for Corporate Manslaughter have focussed on the organisation; however, there is a growing trend by the Police to focus on the individuals within the organisation.

Gross Negligence Manslaughter occurs when the offender is in breach of a duty of care towards the victim of a fatal incident and amounts to a criminal act or omission.

As an offence, it can only be committed by individuals in their own capacity. The new guidelines increase the risk of lengthy custodial sentences for the offenders (employers or managers). Criteria contained within the 'high culpability' category detailed earlier include decisions being made that put profit before safety or, that the offender was aware of the risk of death due to negligent conduct.

It is therefore easy to see how an individual could be accused of allowing the risk of death to be present - if their risk assessment, for example, identified a risk of death and that remedial measures were not cost prohibitive but were still ignored, and that a foreseeable incident then resulted in a fatality.

The guidelines detail not only a range of custodial sentences, but give a starting point for consideration depending on how culpable the offender is deemed to be. Factors such as previous convictions, ignoring previous warnings or the number of people at risk can contribute to an increased sentence.

Culpability	Custodial Sentence Starting Point	Sentencing Range
Very High	12 Years	10-18 Years
High	8 Years	6-12 Years
Medium	4 Years	3-7 Years
Low	2 years	1-4 Years

Although you would hope that many cases will fall in the 'medium' culpability bracket with the advances in safety we have generally seen over the years in the construction industry, this should still be of major concern, especially as the maximum sentence can be life imprisonment.

Gallagher Risk Management Solutions offer a range of services which can help prepare your organisation and mitigate risks such as these.

TO FIND OUT MORE ›

NEIL HODGSON
Managing Director, Risk Management Practice, Gallagher
+44 (0)19 2443 3123 | Neil_Hodgson@ajg.com

11. SUPPORTING THE SMALL TO MEDIUM ENTERPRISE (SME) CONSTRUCTION MARKET THROUGH PRODUCT DEVELOPMENT

The insurance market for Construction Liability & CAR continues to be competitive despite some markets reducing their appetite and capacity being withdrawn in some areas. With over twenty years of experience, Pen's Construction underwriters are specialists in contending with insurance market cycles and developing new product innovations in anticipation of more challenging market conditions. Below we outline risks in the sector and how the latest design of policy wordings for the SME Construction market ought to respond. All of the below benefits are included as standard in Pen's Construction wordings.

Health & Safety Executive (HSE) fee for intervention

Since 1st October 2012, the HSE has been able to recover costs for carrying out some of its activities from those parties found to be in material breach of health and safety law. This cost recovery approach is known as Fee for Intervention (FFI) Pen's policy will meet the costs where an inspection results in a letter, enforcement notice or investigation by the HSE. The average cost of a FFI invoice in 2018 was GBP750.

Part product

Most Contractors Public/Products Liability policies will as standard exclude damage caused to a product by its own defect. Pen interprets the product as being any and all work undertaken by or on behalf of the insured under a contract - a 'product' meaning anything constructed, altered, repaired etc. by the insured and no longer in their possession or control.

Pen's policy only excludes that part of the product which is defective. This allows cover to be brought back in on the overall product and limits the exclusion to the defective part of the product only. Giving the example of a new build property as the product which is destroyed by fire the excluded defective component part may be as small and inexpensive as a fuse, the rest of the product now being covered.

Environmental impairment liability

A standard pollution policy will pick up circumstances where the incident giving rise to a claim is sudden and takes place in its entirety at a specific moment in time. Environmental Impairment Liability allows cover to be brought back in where the incident giving rise to a claim is gradual. Giving the scenario where a fuel tank on site has been gradually leaking into the drains, Pen's policy will respond in the event of bodily injury or damage arising from such cause.

Defects extensions

Most Contract Works policies will as standard exclude damage to property which is in a defective condition but will provide cover to other parts of the property which are damaged as a consequence of. This is referred to as DE3, and is common amongst most policies. Uplifts may be available to DE4 and DE5 to give wider cover. As an example scenario, consider a marble column fails because its inner steel supporting rod is defective in design. The roof collapses, causing extensive damage to an expensive tile floor. Under DE3, the floor and roof would be covered but not the column. DE4 would cover the floor, the roof and the column but not the rod. DE5 covers everything except the cost of an improved type of supporting rod. Our wording provides DE3 cover with the option to uplift to DE4 post loss should this be economically viable to the insured. DE5 cover can be considered upon request.

Professional negligence

Professional Negligence cover will offer protection against financial loss to an employer arising from the design activities of the insured. For example, a plumber designing and installing all the waterworks for a new home may find the system fails.

If there is no damage and no injury, but the system simply does not work due to an error in the design or specification, Professional Negligence insurance may cover the financial losses incurred by the employer. They may, for example, need to find alternative accommodation and place furniture into storage while the work is being rectified.

Speculative build

When a build under contract reaches practical completion, cover under a standard contract works policy ceases with the transfer of risk moving from the insured to their employer. If there is no employer and no contract -and the insured has purchased land to build in the hope of an onward sale - this is classed as speculative. Where practical completion is reached without a buyer, the insured retains ownership of the risk pending sale. Pen's policy will provide cover up to 365 days for residential speculative build and 90 days for commercial speculative build pending sale, lease or rental of the property, subject to the contract works policy remaining in force.

› Pen's construction team has been established for over 20 years. We specialise in UK liability and contractors All Risks, offering cover on an annual or single project basis.

TO FIND OUT MORE ›

SIMON FOWERAKER
Managing Director, Pen Underwriting
+44 (0)1992 449 467 | Simon_Foweraker@penunderwriting.com

TONY EWING
Associate, Pen Underwriting
+44 (0)1992 449 427 | Tony_Ewing@penunderwriting.com

12.BROKER Q&A: LIMITING LIABILITY UNDER CONTRACT

Building Blocks asks Graham Medland, Partner in Gallagher's UK Construction team, about changing contractual risks, and how insurance can be used to manage these risks.

Q. Why are contractors limiting their liability under contract?

A. From a principal contractor's perspective, the profile of a contract may not be acceptable where they are obliged to accept open-ended liability for certain risks. Prudent contractors make informed decisions on the relative risks and rewards of each contract, and if the risks outweigh the rewards they may decide against tendering the contract at all. However, by applying a limitation of liability, it may be possible for the contracting parties to achieve a more reasonable risk / reward equilibrium.

A good example is a contract involving a single floor fit-out of a multi storey commercial building. In the absence of a limitation of liability (or risk transfer – a point we discuss later), the contractor could be exposed to potentially significant risks associated with damage to the existing structure - not to mention consequential losses from the tenants. In these circumstances the limited rewards, i.e. the contract value, do not correlate to the substantial risks, and the contractor may be unwilling to tender for this contract without some form of liability cap.

A limitation of liability can be applied to defined risks in isolation, (for example the employers consequential / indirect losses, design defects, employers property), or as a cap on the contractor's overall liability arising from the contract. They often take the form of a monetary limitation; a defined figure or percentage of contract value, but can also be time related, e.g. indirect losses arising from first 14 days of non-availability.

I should point out however that it is not legally permissible to limit certain risks under contract, examples being personal injury caused by negligence and statutory fines / penalties.

Q. What impact does this have on the employer?

A. If an employer accepts a cap on the main contractors' liability, then in the event of a loss they would have no right to seek indemnification from their supply chain in excess of that limitation.

As such. the employer should carefully consider how they manage these risks, with two principal options available to them;

i. Retain – in other words, they can accept the risk of loss against their balance sheet, or maintain a fund from which the loss will be financed
ii. Transfer - they can transfer the risk through insurance or an alternative mechanism.

Q. How does this impact on the insurance policy?

A. As far as the contractor is concerned, application of a limitation of liability provides certainty over the maximum loss which they can sustain. This has the potential to influence their insurance procurement strategy, in other words, if they rigidly apply a GBP10m limitation of liability on their design liabilities under all contracts, they may consider that this is the maximum Professional Liability (PI) limit which they need to maintain.

A limit of liability should also shape the employer's insurance purchasing decision, and one of these considerations is whether the employer or contractor is responsible for procuring insurances. In circumstances where the employer accepts a greater level or broader range of risks than the contractor (as will be the case where a liability cap applies), and these risks are insurable, then it is logical for the employer to retain this responsibility. It may also influence the employer's decision making in terms of the types and limits of insurance policies required.

To consider this further, I return to the example of a low-value fit out in a significant existing structure. Let's suppose that the Contractor has successfully negotiated a GBP1m liability cap for damage to the employer's property. This means that the contractor is largely protected against the substantial risk of damage to the existing structure – great news for their Third Party Liability insurers. What does this mean for the employer though? As they carry the risk of loss, I would expect the Employer to take on responsibility for insuring the existing structure, i.e. the contract specifies an Owner Controlled Insurance Programme (OCIP). They will also need to take a decision on the most effective means of covering the structure; with the options being:

i. Extension of the owners Material Damage policy
ii. Project specific Third Party Liability insurance
iii. Inclusion of existing structures as insured property under a Construction All Risks policy.

Q. What insurance policies can employers put in place to mitigate their exposure?

A. There is actually a raft of different exposures which could fall to the employer as a result of the contractor limiting their liability under contract; some of these are insurable and some are not.

Where the employer looks to the insurance market to cover these liabilities, they may consider a number of different policies. In addition to those which we have already highlighted, employers may consider the following;

Latent Defects Insurance (LDI)
This policy provides indemnity for post-completion physical damage arising from inherent defects. It would provide valuable cover where the contractor has limited their liability for design defects, and this proves to be the cause of the damage.

Delay In Start Up Insurance (DSU)
DSU insurance indemnifies the employer for lost revenue in the event that the project is delayed by physical damage during construction. The employer may consider this insurance where the contractor limits their liability for consequential losses suffered by the employer.

Single Project Professional Indemnity insurance (SPPI)
In the event that the contractor limits their liability for design to a defined monetary limit, employers may consider procuring PI cover to protect themselves from losses arising from the professional activities of the whole supply chain including principal contractor, designers, engineers and architects.

Q. Will contractors continue to apply caps on liability in the future?

A. Contractors operate on notoriously tight margins, and one underperforming contract can eliminate the profits earned on multiple well-executed projects. Recent history has seen the industry sustain some high profile casualties which serve to demonstrate this point; Carillion being the most obvious example.

The days of securing turnover at all costs are well and truly over, and contractors are now exercising far greater caution when making bid/no bid decisions. Increased awareness and scrutiny of the contract terms and conditions is an inevitable by-product.

Alongside this, the construction insurance market has been hardening over recent months (most notably in relation to PI insurance). In a sellers' market, underwriters can afford to be selective in the risks which they write, and we see this leading to a renewed focus on contractors' corporate governance.

For these reasons, I believe that the application of appropriate liability caps will continue to form a key aspect of the contractors' contractual risk management strategy.

TO FIND OUT MORE ›

GRAHAM MEDLAND
Partner, Gallagher
+44 (0)20 7560 3156 | Graham_Medland@ajg.com

www.ajg.com/uk | gallagher-uk | @GallagherUK

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