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SEC GROUP briefing

Voice of the Specialist Engineering Contractor

*The members of the SEC Group are:*

Association of Plumbing and Heating Contractors

British Constructional Steelwork Association

Electrical Contractors' Association

Heating and Ventilating Contractors' Association

Lift and Escalator Industry Association

SELECT

# PROJECT INSURANCE IN THE CONSTRUCTION INDUSTRY

## 1. INTRODUCTION

The traditional approach to risks inherent in any construction project has been to pass such risks to others in the supply chain. These 'others' are then expected to insure that risk to the extent that they can, usually by way of a liability or indemnity insurance policy.

This process can be wholly inefficient, wasteful and costly. It also militates against integrating and building efficient project teams and supply chains. Moreover project teams must have integrated insurance policies in order to achieve the necessary coordination and collaboration within the team.

## 2. SINGLE PROJECT INSURANCE: A BETTER WAY?

Single project insurance is a policy that covers the construction delivery team (client, consultants, contractors and their supply chains) for financial loss incurred on the project. Such loss would include the cost of remedying defects or delays to completion of the project causing loss of revenue. Rights of subrogation are waived (i.e. the insurers will not stand in the shoes of an insured party in order to recover the loss from the party alleged to have caused it).

## 3. WHAT IS WRONG WITH THE CURRENT SYSTEM?

Most project risks are covered by three policies of insurance – professional indemnity insurance (covering negligence of consultants and contractors in providing services, usually design); contractors all risk (covering contractors for damage caused to existing works or other parts of the building): and product liability insurance (for manufacturers such as lift contractors).

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These policies are taken out by each member of the delivery team but, there is duplication of cover (due to the many tiers of sub-contracting) and gaps in the cover (due to the complex interfaces between liabilities under varying conditions of cover). The industry is probably wasting £1bn per year on premiums for all these policies. Furthermore the insurer will only meet its liabilities under current policies where liability is established usually as a result of litigation, arbitration or adjudication.

Leading insurance brokers, Griffiths & Armour, estimate that for every £1 paid out to the insured party, £5 is paid in legal fees. This is not surprising since it is often impossible to allocate responsibility exclusively to one or two members of the team; the legal processes involved in determining fault and responsibility are complex and time-consuming.

Existing policies cover the individual party (the insured party) – not the delivery team. This severely inhibits the public sector in achieving its aim of having projects carried out by integrated teams; individual policies promote protectionist instincts, which hinder cooperation and teamworking. For example, liability policies may hinder gain/pain share arrangements because any agreement to incur "pain" may not activate such policies.

The current emphasis is on pilloring the guilty party (in the hope that guilt can be clearly established) rather than on finding a solution. Also, if an individual organisation becomes insolvent, its insurance ceases to respond.

## 4. IS THERE SUPPORT FOR PROJECT INSURANCE?

- In principle the industry, its clients and the Government, are supportive because it will underpin teamworking arrangements. "Project insurance projects should be made available to underwrite the whole team to facilitate integrated working" (The 'Accelerating Change' Report launched by Sir John Egan on 12 September 2002).

- Support has come from the insurance industry from brokers such as Griffiths & Armour and Tysers, and from insurers such as Norwich Union.

- There has already been some experimentation. For example, a single project professional indemnity policy was adopted on the Heathrow Express project and on a Defence Estates project – the MoD North Andover site development. The effect in terms of successful and continuing collaboration in each case was exceptional. The British Airports Authority has gone on to adopt single project insurance on the new Heathrow Terminal 5 development.

- Project insurance for integrated teams is commonplace in Belgium and Luxemburg, where it operates in conjunction with "technical control", a monitoring of the team by an independent organisation voluntarily appointed by the client. This technical control embraces safety (through design to commissioning), opens the door to decennial insurance of the completed facility, and is the vehicle through which insurers see their risk as being managed down to acceptable limits.

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## 5. ARE THERE ANY OTHER POTENTIAL BENEFITS FROM HAVING FROM SINGLE PROJECT INSURANCE?

- It will overcome long-standing concerns of all those engaged in construction over the unfairness of the legal principle of "joint and several liability". This can mean that one party can be made solely liable for the negligence of himself and others where his fault is minimal.

- It will substantially reduce the industry's transaction costs by removing the current requirement for consultants and contractors to issue warranties to building owners, purchasers, tenants and funders.

- Because it is tied to the project, the insurance will remain intact despite any insolvency of one or more members of the team

- It should significantly enhance the quality of the finished product since the insurers will require an independent technical audit of the delivery teams' quality and risk management systems – as applies in Belgium where the risk profile and insurance cost remain at reasonable levels.

- Following on from the previous point firms selected to form integrated teams will be required to demonstrate technical competence possibly through membership of reputable schemes of qualification; otherwise the premium costs will have to reflect an enhanced risk.

- Since there will be an emphasis on ability to deliver the requisite quality and on risk management this is likely to lead to real improvements in health and safety. There is evidence that firms with a reputation for delivering good quality work also perform well in managing health and safety risks.*

** This could, in turn, have a significant impact on premiums for employers' liability insurance. This year the average rise in employers' liability premiums has been 23%. This is on top of increases of 35% and 50% respectively for the years 2003 and 2002. (Source: Engineering Employers Federation.)*

## 6. LET YOUR TRADE ASSOCIATION HAVE YOUR COMMENTS.

- ***Do you believe there are benefits to you in being covered by project insurance?***

- ***Have you had any experience of project insurance or similar arrangements?***

- ***Pilots are planned to address any potential problems and to see how they arise in practice and how they can be overcome. Would you like to be involved in piloting project insurance?***

*For further information on all aspects of SEC Group and its activities contact:*

**John Nelson**
Executive Secretary
**SPECIALIST ENGINEERING CONTRACTORS GROUP**
34 Palace Court
London
W2 4JG
Tel: **020 7313 4819**
Fax:020 7727 9268
E-mail:contact@secgroup.org.uk
Website: **www.secgroup.org.uk**