

# CONSTRUCTION & ENGINEERING DEFECTS CLAIMS ON THE RISE?

Property damage as a result of defective design, workmanship and specification is among the most common forms of claim for large and complex construction and engineering projects. Unsurprisingly, defects are equally a major cause of dispute and construction litigation, due to the differing stakeholder interests. As Insurers continue to look for ways to minimise claim processing costs and reduce friction between themselves and the Insured, we look at whether more large and complex projects should be insured under a Single Project Insurance Policy covering CAR/EAR, Third Party Liability and Professional Indemnity and indemnifying all Contractors, Architects, Consulting Engineers and other professionals as joint Insureds.

Back in 2014, Zurich Insurance analysed their database of large losses, which covered more than 225 claims valued at over USD300 million across 16 major categories of types of loss. This showed that faulty design, workmanship and specification was the second largest loss type in terms of severity and frequency.

David Lammond, Head of Property & Engineering Claims at Generali endorses this view “some 10 years ago Generali analysed the split in claims between defects in design, workmanship and other perils and found this to be 51%/49%. I’d say that now we would more likely discover this to be 75%/25%, although this may partly be the result of changes in our geographic risk portfolio”.

**integrated** surveyed Insurers and Brokers to ask this very question and this revealed differing opinions. Gareth Evans, Senior Loss Adjuster, Integra Technical Services explains “anecdotally, based on my caseload over recent years, I would say that the incidence of this type of loss is very

high on certain risk types and we have recently seen a number of large losses, but when we looked at the responses to the survey only 20% thought that the loss frequency had increased. Interestingly, whilst some felt that just 10% of CAR/EAR claims resulted from defect in design, workmanship and specification, others suggested over 50%.”

### DEFECT IN DESIGN, WORKMANSHIP OR SPECIFICATION?

Most, if not all, CAR/EAR Insurance policies will include DE or LEG exclusion clauses which broadly distinguish between the costs of rectifying a defect (excluded), and damage caused as a consequence (normally covered, except under the most restrictive clauses). This quite often results in the Insured sustaining an uninsured loss and these can be substantial.

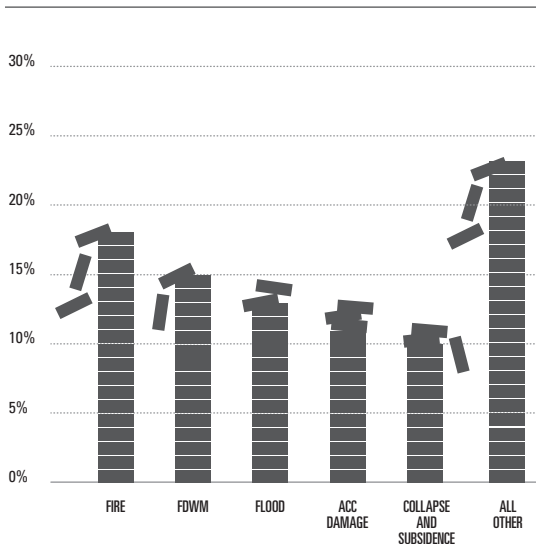
Where a loss is considered to be as a result of defective design or at least in part, an opportunity may exist for both the Insurer and the Insured to jointly pursue

a subrogated recovery of both insured and uninsured losses from the responsible third party e.g. Architectural and Consultant Engineers.

Under most standard CAR/EAR policies, cover for these parties is limited to their on-site activities only, of which design, provision of design information or professional advice is not generally considered. These parties would have Professional Indemnity insurance policies in place to cover the cost of remedying the defect and any consequential damage. Whilst many contractors now have their own in-house design teams it is not unusual for firms to sub-contract their work to a specialist Consulting Engineer which then brings them and their Professional Indemnity Insurers on any potential action.

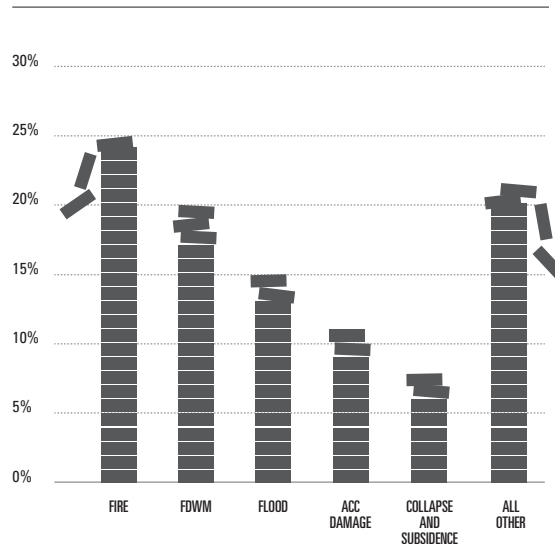
The trouble is that all too often there is disagreement as to the cause of the loss. As Gareth explains “On certain CAR/EAR risks involving elements of geotechnical design, whilst an overall

**SEVERITY** % of total incurred value



Source: Zurich

**FREQUENCY** % of total number of claims



scheme is designed, requiring a discrete set of pre-determined interventions, the application of these interventions will be based on observations during the course of construction. In some instances, this may be directed by a resident Engineer, or a specialist Contractor on-site. Sometimes the source of disagreement regarding causation is whether the loss that arises can be considered to be as a result of shortcomings in the design or workmanship, with the obvious implications in terms of cover afforded under the CAR/EAR Policy.”

According to Tony Bennee, Partner, Alesco Risk Management “the various parties involved may appoint their own experts and then you can end up with all these reports that say roughly the same thing, but coming to slightly different conclusions”.

According to Gemma Tait, Divisional Director, Willis Towers Watson “the expert pool being called upon is probably not as wide as it should be. Sometimes there is an investment in one individual opinion and the reality is that this single person has a different view to an entire project of experts. For me it’s important to have an early meeting with the different experts as that often reveals the reason for this difference in opinion and can result in a change of view about the cause of the loss.”

### **SUBROGATING THE LOSS**

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There can be many reasons why subrogation does not happen, for example an inability to find a definitive cause. David, also, suggests “it’s preferable not to subrogate, if possible, it is about getting other stakeholders to assume responsibility, should the contractual situation allow, before an indemnity is provided under the Policy.”

Where Insurers take a decision to subrogate the loss, this would generally mean that they consider it to be economically viable and their chance of success to be strong. However, in today’s soft market where Insurers are increasingly looking to minimise outlaid indemnity costs, according to Gemma “some Insurers may be looking at ways of pursuing subrogation actions which possibly in the past they may have written off much earlier.”

Gareth says “Over the past several years, more of an emphasis appears to have been put on establishing the possibility of pursuing a subrogated recovery by Insurers. That may be the result of Insurers analysing historical claims data or trends where it may have been concluded that they have missed recovery opportunities, a function of a slight over capacity within the market allowing focus to be applied in this area, or the way in which legal services are being provided. Either way the role of the Loss Adjuster is key in identifying the potential for a subrogated recovery, and working with the Insured at an early stage to collate the necessary documentary evidence in terms of causation and quantum to hopefully form the basis of a successful recovery action.”

### **IS THERE A DIFFERENT WAY?**

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Defective design, workmanship and specification claims can be among the most difficult to manage. Focusing on remediation works to ensure the loss does not also cause delays in completing the project and then trying to establish the root cause of the loss – design, workmanship or specification – and consider the potential for subrogation, which will essentially be against the Contractors’ project partners.

As Gemma explained “investigations relating to loss causation and the potential for subrogation are generally run in parallel to the remediation works. This can create friction and require sensitive handling as often this may involve partners to the Contractors who are key to completing the project on time.”

This begs the question of what the insurance market could do to reduce potential conflict and ultimately claims management costs. For many years, Single Project Professional Indemnity (PI) Insurance has been available, with cover placed alongside CAR/EAR and with the Insured including all Contractors and professional Consultants.

A trawl of the internet quickly reveals several articles espousing the benefits of such arrangements, but Graham Goddard, Executive Director at Willis Towers Watson feels that “this has to be carefully considered on a project by project basis as it can make insurance procurement difficult. Consultants and Contractors are likely to question their contribution as they already have annual PI insurance policies in place and this is also likely to limit choice of CAR/EAR Insurer. Many Insurers and Reinsurers are just unwilling or unable to offer the 10, 12 or 18 year liability period that’s required.”

Whilst we may be facing a rising level of claims emanating from defect in design, workmanship and specification, it seems that to reduce friction and cost we need to maintain a high level of dialogue with all the parties and work with the experts on site to reach collective agreement on causation as early as practically possible.