Insurance in the Construction Industry

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Insurance is a vital risk mitigation tool in construction projects. Whether insurance is taken out due to a statutory, regulatory or contractual requirement or as an additional measure of protection, parties cannot afford to go without it.

It is essential for every party involved in a construction project to be prepared, to understand the risks involved in the project and to manage the risks to ensure the success of the project and to mitigate any potential liability that may be incurred.

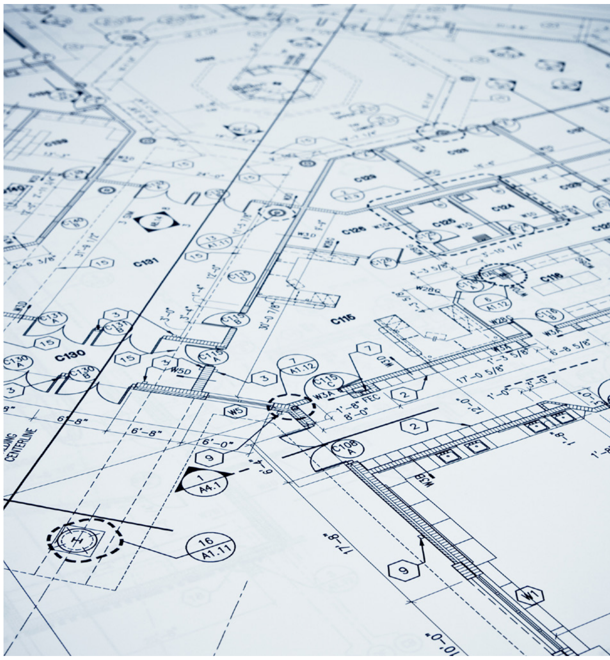
The purpose of this document is to:

- Provide an overview of risk and the types of risks that organisations face in construction projects.
- Look at the relationship between risk and insurance, how insurance can be used to mitigate risks.
- To give you a better understanding of the importance of insurance and what to look out for in construction projects.

Where to?

We will have a look at:

- How parties may be affected by construction risks and the far-reaching implications of risks materialising in construction projects
- A closer look at the common types of risk in construction projects
- How we can best utilise insurance products to address the risk
- Understanding types of common and special insurance that may be required in construction projects
- Considerations of why insurance in construction projects is so important, and some key takeaways.



In general, Construction Projects are broken into various phases, for example:

The conception phase (where the requirements and specifications for the project are determined)
The design phase
The pre-construction phase and the works contracts are concluded (this is normally the tender or bidding stage where a contractor or sub-contractor is chosen and the site examined)
The construction phase
The post-construction phase (involves commissioning that may be required and hand-over of the project)

There are various parties involved in the different phases of the construction project and the types of risk that need to be considered and catered for by a particular party depends on the parties' role in the project and the phase of the project involved in.

Construction can be an unpredictable industry with many elements that cannot be controlled, for example:

Weather | **Strikes** | **Injury to Employees** | **Operational Machinery Failures**

Another concern is that issues may only arise well after the construction phase and post-construction phase. It is imperative that a party has the necessary insurance policies or products in place to protect itself from risks associated with its obligations and the risk associated with other parties involved in the project failing to comply with their obligations.

Some of the ways parties may be affected by construction risks include:

- Adverse impacts on property value due to building deficiencies and structural defects which may require repair or refurbishment.
- Lengthy delays in the construction process may affect your contractual undertakings related to ownership of the property or the lease of the property, and may result in an increase in the cost of the project.
- Liability and determining who in the construction process or post construction process is liable should defects or deficiencies arise. This is often referred to as the incidence of the risk – who the risk falls upon.
- Conflicts arising before, during, or after the construction project may have time and monetary ramifications.

As members of the commercial and industrial property industry, an understanding of the risks in the construction project and ensuring that such risks are addressed with careful consideration is imperative and necessary to protect your interests and to avoid unplanned costs down the line.

Risk in Construction Projects

Protection against loss, damage and liability is required at every stage of a construction project, from conceptualisation and design to implementation, handover and operation. The inherent risks associated with each stage of a construction project are numerous and substantial.

Every construction project is unique and has its own risks, therefore it is imperative that a party assess its risk upfront as part of the risk management process to ensure that the risk is adequately catered for and that comprehensive insurance coverage is put in place.

Considering common risks at the various phases of a construction project

In the conceptualisation and design phase, a poorly defined scope which creates uncertainty as to what is required, inappropriate specifications for the type of project, poorly drafted contracts and unknown site conditions are risks which may arise.

In the construction phase, risks such as health and safety hazards, changes in labour supply, availability of building materials, increase in material costs, delays, poor or defective workmanship, the occurrence of natural disasters and other force majeure events and unexpected variations to the scope and design may arise.

In the construction phase, handover is particularly important as it often signifies the passing of risk. Depending on the contractual arrangement, the incidence of risk may transfer from one party to another, where one party is released from liability as another incurs liability. Handover may take place only at the end of the project or in section during the execution of the project. Handovers may be between sub-contractors, with main contractors, or from the Contractor to the client/Employer.

The types of risk that may be encountered in the handover phase is defective or incomplete work and incomplete and inadequate handover.

In the post-construction phase, parties must be cognisant of risks such as defects, deficiencies and delays following the handover process. Some defects only become apparent some time after the project has been handed over.

There are ways to manage risks in construction projects and this process of managing risks has been separated into three steps:

Firstly

Parties must engage in an inspection process to determine which risks may arise in the construction project prior to commencement. This is the **identification of risks.** (Inspect the project requirements, specification and scope, industry standards, the site conditions, and potential contracts that need be concluded with the various parties involved in the projec).

Secondly

These risks must be assessed and possible outcomes of the risks must be identified and quantified. Provisions must then be put in place and implemented to manage and mitigate the risk. This is where insurance becomes important. **Implementation of risk management solution.**

Thirdly

Once the construction project is under way, throughout the various construction phases, risk responses and changes in risk exposure must be monitored to ensure that the risk management solutions implemented are still effective. It is important to ensure that the insurance products put in place to manage the risk remain effective and valid for the entire period that they are required for and are updated and renewed if applicable. **Continuous assessment of risk.**

Therefore it is very important that the risk management solution must be re-assessed throughout the project to ensure that risks are managed carefully.

Addressing risk with insurance

In the second step of the risk management solution, once risks have been identified and quantified, in formulating the risk management solution, one of the ways to manage and mitigate risk is with insurance.

In order to determine the incidence of risk in a construction project, the works contract must be considered.

The works contract is entered into by parties with the intention of creating legally enforceable obligations, including:

- **The scope of work to be done**
- **Each party's obligations**
- **The period for completion**
- **The payment terms**
- **The standards and specifications agreed upon**

Insurance is a risk mitigation tool, and serves to protect parties from the inevitable risks related to construction.

Works Contract

A works contract is usually entered into between an Employer and Contractor, or a Contractor and Sub-contractor. The works contract may be a standard form works contract (with special or particular conditions / contract data) or a bespoke contract.

Bespoke Contract

A bespoke contract is customised for the particular parties and project and isn't based on a standard form contract.

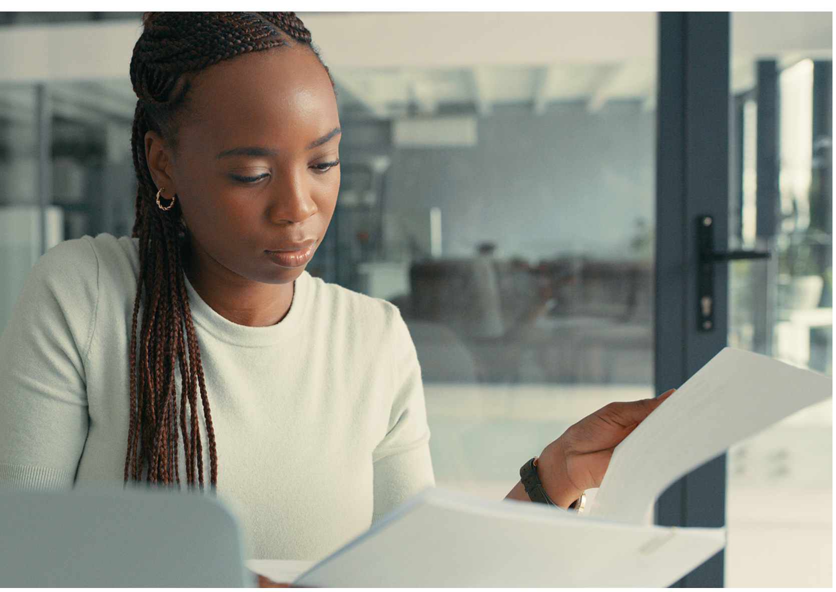
Standard Form Contracts

Standard form contracts are pre-prepared and have been drafted in line with an industry recognised set of terms, and which can be used for various types of construction projects and can be amended to provide for the specificities of the parties and project.

In South Africa, standard form works contracts commonly used include

The General Conditions of Contract for Construction Works (GCC)	Developed, published and maintained by the South African Institution of Civil Engineering and is suitable for building and construction works.
The NEC	The New Engineering Contract (NEC) is a formalised system / suit of contracts created by the UK Institution of Civil Engineers. It covers construction as well as associated professional services.
The FIDIC Conditions of Contract	The FIDIC Conditions of Contract refers to a suite of international standard form contracts for various types of construction projects and are commonly-used standard form contracts in Africa.
The JBCC (the Joint Building Contracts Committee) Contract	The Joint Building Contracts Committee, the JBCC came into existence in South Africa in 1997. The aim of the committee is to compile contract documentation with an equitable distribution of contractual risk pertaining to the building industry. The JBCC Contract and associated documents are confined to building works.

Therefore it is crucial that a proper and in depth consideration of the works contract is done prior to its conclusion to ensure that all the risks provided for in the contract are identified and provisions put in place to manage such risk. If using a standard form contract it is important to pick a suitable contract for your project which may have already identified and catered for the risks associated with the type of project.



Both bespoke and Standard form works contracts may be modified by parties to provide for the specific terms and conditions of the project, as well as to address the specific risks of that project.

Insurance in Works Contracts

We will now look at the works contract itself, and the types of obligations usually found in the contract which may result in a risk that needs to be insured against. The works contract typically includes the party responsible for taking out and maintaining the required insurance, as well as the minimum insurance coverage required. Certain clauses are indicative of the incidence of risk and provide for each party's obligations in respect of insurance. Depending on whether it is a bespoke contract, a standard form contract or a standard form contract with amendments, these clauses may or may not be included in the contracts and the formulation of the clauses may differ between contracts.

Clauses in the works contract related to risk or insurance include:

- Limitation of Liability, indicating the extent of the liability of each party
- Indemnities clauses, which provide protection to a specified party against damages and exempting the party from liability caused under certain circumstances
- Employer's or Contractor's Care of the Works, whereby a party is required to take full responsibility for the care of the works and goods from the commencement date until a specified event, such as when the taking-over certificate is issued
- Employer's Risks & and the consequences of the risk
- Contractor's Risks & and the consequences of the risk
- Requirements for Insurances, a general clause stating any specific insurance requirements that each party is obligated to obtain
- Types of Insurance required, stating which insurances are required for the project, or phase of the project.
- Effective Date and Duration of Insurance
- Insured Amounts
- Extent of Insurance Coverage
- Exclusions of Liability
- Renewal of Insurances, including whether and when insurance must be renewed, and which party will be responsible for such renewal.
- Liability for Deductibles, stating which party is liable for deductibles and to what extent.
- Claims Notifications, describing the way in which claims notifications must be made, as well as applicable time periods. These are generally not claims notifications to the insurer (which is governed by the terms of the insurance policy or contract with the insurer) but rather notifications to the Employer / Engineer / Project Manager or other parties to the contract.

Types of Insurance in Construction

The works contract and the clauses just highlighted provide an indication as to the various types of insurance policies which may be required of a party to obtain, and the requirements of such policies.

A common requirement is the approval of the insurance terms by the Employer and the provision of copies of the insurance policies to the Employer, which the Contractor is to obtain, to ensure that adequate insurance is in place and that the Contractor has complied with its contractual obligations. Insurance policies may be once off or annual, depending on the works contract requirements, the type of insurance required and the purpose for the insurance, among other variables.

Although there are many types of insurance coverages relevant to the construction industry, there are common types of insurance coverage that most works contracts will require. It is important to bear in mind that the works contract will not cater for every insurable risk and a proper assessment of the project as a whole must be done to ensure all risk is identified.

Insurance for Works, Plant, Materials and/or Equipment

Insurance against liability for any loss of or damage to the works, plant, equipment, materials and/or contractor's documents. This may include insurance for the removal of debris, the costs of demolition and cover of hired equipment. This category of insurance is very broad – more specific types of cover are available under this category, and cover depends on what is included in the policy. For example, Builder's Risk Insurance concerns insurance of the works and will cover the risks arising during construction such as damage from wind, fire, hail, vandalism and lightening.

Insurance for Works, Plant, Materials and/or Equipment may fall under Contractor's All Risk Insurance, which includes these risks related to the works as well as liability insurance.

Third Party Insurance / Insurance against Injury to or Death of Persons and Damage to Property

Insurance against liability for any loss, damage, death or bodily injury which may affect any third party or occur to any property arising out of the Contractor's performance of the works contract.

Employer's/Contractor's Liability Insurance

Insurance against liability for claims, damages, losses and expenses arising from sickness, disease, injury or death to the Contractor's employees in the course and scope of their employment.

Special Risks Insurance / Political Risk Insurance

Insurance against liability for loss or damage to the works, plant and equipment due to incidents such as strikes, riots, public disorder, politically-motivated malicious attacks and terrorism. In South Africa, special risks insurance is issued by the South African Special Risks Insurance Association (SASRIA), a public enterprise.

Professional Indemnity Insurance / Professional Liability Insurance

Insurance against liability for legal costs and expenses incurred due to allegations of professional misconduct and negligence. PI Insurance will often also cover damages payable following negligence. In construction projects, PI Insurance is usually required by professionals such as engineers, project managers, architects, land surveyors and quantity surveyors.

Conditional Construction / Performance Guarantee

Insurance obtained by the Contractor or Sub-contractor to the benefit of the Employer guaranteeing the Contractor or Sub-contractor's performance of its obligations under the works contract and indemnifying the Employer against damages as a result of non-performance.

On Demand Guarantees

Insurance obtained by the Contractor or Sub-Contractor to the benefit of the Employer providing the Employer with protection against non-compliance by the Contractor or Sub-contractor of its obligations. An on demand guarantee constitutes a primary independent obligation placed on a guarantor to make payment of a specified guaranteed amount. The obligations are independent from the underlying works contract and are usually triggered by a written demand made by the beneficiary.

Workman's Compensation Insurance

Workman's Compensation is a type of insurance, instituted by the *The Compensation for Occupational Injuries and Diseases Act, 130 of 1993 ("COIDA")*. It protects employers from civil claims and permits both casual and full-time employees to claim compensation directly from the Fund for work-related injuries and disability. Dependents of an employee may also claim compensation from the Fund in the case of a work-related death. An employer with one or more employees is required to register for Workmans Compensation.

Types of special insurance in construction contracts

The works contract may also require special insurance to protect against specific risks. Special insurance is usually required until the date of practical completion, although this would also be specified in the works contract.

Examples of special insurance include:

Environmental Insurance	Insurance against liability for third party bodily injury, damage to property, clean-up operations and legal expenses due to pollution conditions including legacy environmental issues, site contamination and/or exposure to hazardous materials arising prior to or during construction.
Removal of Support Insurance / Temporary Lateral Support Insurance	Insurance against liability for physical damage to adjacent property or for injury to third parties resulting from the removal of support from the site or the weakening of support due to construction activities.
Delay in Start Up Insurance / Advance Loss of Profit Insurance / Delayed Completion Coverage	Insurance against liability for delays due to physical damage caused by an insured peril. If the interference with the construction or testing affects the project milestones and causes delays in the project, indemnifiable costs are payable to the insured party.

The inclusions and exclusions of the various insurance policies described above will vary depending on the requirements of the project and the terms and conditions of the works contract.

Why is insurance in construction projects important?

A comprehensive insurance plan, including the insurances required by the works contract and any special insurance, is a good risk management solution. To ensure that it remains a good risk management solution, risks must be assessed throughout the construction project, and adjusted to ensure complete coverage.

Adequate insurance can safeguard the interests of the Employer, Contractor and Subcontractor, as well as property developers, owners and managers involved in the project as you will have seen, other interests are protected, including third party, contractor's employees and environmental interests. A comprehensive insurance plan will ensure that:

- There are no (or fewer) impacts on property value
- Effects of delays and increased costs of completion can be mitigated
- The liability of parties is clearly defined
- Issues of conflict around the incidence of risk and liability are mitigated

In some instances, insurance is a legislative requirement. As indicated when we spoke about Workman's Compensation insurance, construction contractors must register with the Compensation Fund in terms of the Compensation for Occupational Injuries and Diseases Act 130 of 1993, or with a licensed compensation insurer. Under the Construction Regulations 2014 (Construction Regulations), issued under the Occupational Health and Safety Act 85 of 1993 (OH&S Act), employers must ensure that principal contractors are registered and in good standing with the compensation fund or a licensed compensation insurer, before construction work starts.

Insurance may also be a contractual requirement, and as we have described, obligations for procuring insurance may be found in the Works Contract. There are other sources of contractual obligations, including:

- Standard contractual terms and conditions of main contract
- National construction procurement guidelines
- Employment contracts

Key Takeaways

Identify

Identify risks associated with the construction project as soon as practicable. Whether you're involved in the actual construction process or only later on, identifying potential risks, both past and future, is crucial to protect your interests.

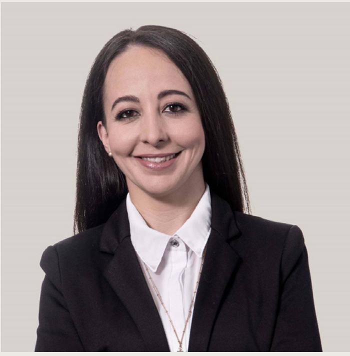
Build

Build a comprehensive insurance plan addressing the risks identified. If you are not involved in the project from the outset, you can examine the existing insurance plan for the project to ensure that your interests have been protected. Where there are gaps or deficiencies, take action to ensure risks are properly managed.

Assess

Assess your plan regularly to ensure that your interests are protected throughout the duration of the project. New risks may arise, certain risks may fall away, and your risk mitigation strategy should account for these changes. In addition certain insurance policies or products may require renewal during the course of the project therefore is important to ensure that a continuous assessment of the effectiveness of your insurance coverage and renewal requirements are done to ensure you retain the cover.

Contacts



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