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A TOUGH (PI INSURANCE) MARKET: WHY IT MATTERS, AND WHAT PARTIES CAN DO ABOUT IT

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SUMMARY

In the UK, the professional indemnity insurance (PII) market is hardening. It is becoming increasingly common to find that contractors and consultants do not hold (or are struggling to obtain) PII at the level and on the terms that were negotiated and agreed with their employers.

At the same time:

- There has been a proliferation of cladding claims against contractors following the Grenfell Tower tragedy in June 2017; and
- Other economic headwinds have caused insolvency to become more prevalent in the construction industry.

The combination of these factors has led to a perfect storm for employers: where developments are found to contain substantial defects (whether relating to cladding or anything else), the road to recovery of the employer's losses is more challenging and outcomes are more uncertain. If the contractor or the consultant becomes insolvent, the employer might not have available to it the full amount of PII that was agreed, or (in respect of more recent contracts) the agreed amount might, due to market forces, be manifestly inadequate.

State of the PII market

In 2018, Lloyds of London carried out the "Decile 10" review, in which it identified that non-US PII was the second-worst performing class of business. 62% of syndicates reported aggregate losses in non-US PII in the six years from 2012 to 2018.

In the 18 months to May 2020, reports suggest that capacity in the UK PII market approximately halved and that some insurers have withdrawn from the market altogether.

This has impacted the availability of PII in the construction industry. Premiums and excesses have increased, limits of indemnity have been reduced, brokers have struggled to place certain risks, and there is less scope for negotiating the terms of insurance. There is a trend towards more exclusions and sub-limits, and limits of indemnity being offered on an aggregate rather than “each and every claim” basis (all of which may vastly reduce the amount of PII that is available).

Cladding claims

Since the Grenfell Tower tragedy, there has been a proliferation of cladding claims. There is a debate as to whether this was a cause of PII market hardening or a catalyst in an already declining market. Either way, it certainly has not made market conditions any easier. Neither have economic uncertainties surrounding Brexit or Covid-19.

Some insurers are now issuing PII policies that are subject to exclusions or sub-limits in relation to cladding / fire-safety claims.

The fact that PII coverage is being restricted at a time when contractors need it the most is concerning. In some cases, it may call contractor solvency into question, as cladding claims are often high value, and larger contractors in particular may face them in respect of a number of their projects at any given time. That is not to mention the other economic headwinds that are currently impacting the construction industry.

Navigating these waters

Despite the tough PII market and challenges facing the construction industry more generally, there are steps parties can take to protect themselves:

- Employers may wish to make enhanced enquiries into the financial standing of tenderers prior to a contract being awarded.
- During contractual negotiations, employers may wish to make their own enquiries as to what PII levels and terms are appropriate for the project and what is available in the market.
- Employers should ensure that each consultant and each contractor provides a broker’s certificate verifying that the required level of PII has in fact been taken out.
- Ensuring that the contractor procures all of the required consultant and subcontractor collateral warranties is more important than ever. Recourse against others involved in the design and construction of a project may be essential in the event of contractor insolvency.
- Employers may wish to negotiate for parent company guarantees with an appropriately distant expiry.

- It may be worthwhile exploring with an insurance broker whether extended latent defects insurance (LDI) cover can be taken out.
- If a consultant or contractor becomes aware that the PII limits or terms might change, it may be worth approaching its employer(s), potentially with assistance from an insurance broker, to explain why its PII limits or terms have changed and discuss the PII that is available in the market.
- Employers would do well to detect change in PII limits and/or terms early. Employers should request an updated broker's certificate upon each policy renewal date (which should be noted on the initial broker's certificate). Most standard form building contracts (including JCT, NEC and FIDIC) require the contractor to provide such information.
- In the event the employer has a substantial defects claim against an under-insured contractor, there may be risk in treating the contractor as a single point of responsibility. The employer may be able to spread its risk by joining others who may be responsible (consultants and subcontractors) to the claim.

Third Parties (Rights against Insurers) Acts 1930 and 2010

These statutes provide a mechanism by which claimants can claim direct against a defendant's insurer, where the defendant has become insolvent. This may provide employers with an additional route to recovery where a contractor or consultant has become insolvent but holds adequate (or at least some) PII.

Which Act applies depends on when the defendant became insolvent and incurred liability to the claimant. If both took place prior to 1 August 2016, the 1930 Act applies; otherwise, the 2010 Act applies.

The 2010 Act is generally less burdensome for claimants. For example, actions under the 1930 Act required claimants to restore insolvent companies to the register prior to commencing an action under the Act, whereas under the 2010 Act that step is not required.

The 2010 Act provides claimants with a right to compel a wide range of parties (defendants, insolvency practitioners, former officers of the company, insurance brokers, insurers etc) to provide information about the insurance the insolvent defendant holds, such as policy terms.

Employers may wish to check the terms of the relevant PII policy to ascertain whether an action under the 1930 or 2010 Act is viable. A 2017 commercial court case illustrates that policy terms can have a very real impact on whether, and how much, can be recovered from the insurer in such an action. In Crowden and another v QBE Insurance (Europe) Ltd, the claimant brought an action against an insurer under the 1930 Act where the defendant had provided negligent financial advice and had then become insolvent. The policy terms provided that cover was excluded where the

insured was insolvent. The Court upheld the exclusion and summarily dismissed the action, with the result that the claimant recovered nothing.

Limitations of PII

It is important to remember that, even if adequate (or at least some) PII is in place, it covers negligent services (usually design) only. It does not cover contractor insolvency, or defects that appear as a result of poor workmanship. In other words, it is not a solution for all things that may go wrong on a project.

Final thoughts

While the hardening of the PII market poses very real and substantial challenges for the UK construction industry, there are steps parties can take to protect themselves. A higher level of prudence and forethought is undoubtedly required.

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